Defined Contribution Institutional Investment Association

Dedicated to Enhancing Retirement Security

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Re: Employee Benefits Security Administration, Department of Labor, "Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights," RIN 1210-AC03

This letter is submitted on behalf of the Defined Contribution Institutional Investment Association (DCIIA).[1] DCIIA would like to thank the Department of Labor (the Department) for its proposed rulemaking and for the opportunity to provide comment on the Department's Proposed Rule on "Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights" (the "Proposed Rule"). We appreciate the Department's outreach to receive stakeholder feedback, and we believe the Proposed Rule in large part reflects that feedback and seeks to balance a fiduciary's consideration of the ERISA duties of prudence and loyalty with appropriate consideration of environmental, social, and governance ("ESG") factors. We also commend the Department on its release of a Proposed Rule that adopts a principles-based approach for ERISA's prudence and loyalty standards.

DCIIA's members are uniquely positioned to provide comments on this topic and on retirement investing in general. Members of the DCIIA community include leading record-keepers, investment consultants and advisers, investment managers, education and advice providers, trustees and custodians, law firms, plan sponsors, and other industry participants. Although DCIIA's membership is diverse, its members are united in supporting initiatives that expand access to retirement savings. In fact, DCIIA has an ESG Subcommittee within DCIIA's Investment Policy & Design Committee, reflecting our members' strong interest in developing thought leadership and educational information on ESG investing in DC plans.[2] The ESG Subcommittee includes a broad cross-section of more than 100 individuals from DCIIA member organizations and its activities include hosting webinars and publishing peer-reviewed white papers on ESG investing.[3]

DCIIA members support the Department's considerable efforts and the Proposed Rule's framing to seek to remove barriers that may prevent the prudent integration of ESG factors into ERISA fiduciary decision-making. DCIIA's members believe that, overall, the Proposed Rule would support good actors who seek to use ESG appropriately by reducing the uncertainty and costs of compliance when considering material ESG (and other) factors.

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[1] In preparing this letter, DCIIA sought and received input from a number of individuals representing a wide variety of member organizations. However, this letter is submitted solely on behalf of DCIIA -- members may have differing views on any of the points made herein.

[2] ESG SUBCOMMITTEE, DCIIA, https://dciia.org/page/ESGSubcommittee.

[3] INCORPORATING ESG IN DC PLANS: A RESOURCE FOR PLAN SPONSORS, DCIIA (June 2021), https://cdn.ymaws.com/dciia.org/resource/collection/1A9748D1-6CCB-467F-9AAD-BA8EF9307632/IncorporatingESGinDCPlans_062821.pdf.

In addition, DCIIA's members are pleased to see that the Proposed Rule moves closer to a principles-based approach that does not uniquely target or single out (positively or negatively) ESG as compared to any other investment strategies, asset classes, or investment styles. DCIIA's members believe that a uniform set of objectives and standards should apply to fiduciary decision making and the application of the duties of prudence and loyalty. Therefore, we support the Proposed Rule's treatment of ESG factors the same as any other factor that may materially impact an investment's risk/return analysis. DCIIA's members agree that considering relevant, financially material ESG factors is part of sound fiduciary decision-making and believe that the Proposed Rule will encourage fiduciaries to weigh financially material information, which may include ESG factors, that is likely to impact investment outcomes. Consistent with this, DCIIA's members also support the Department's decision to omit the term "pecuniary" and instead use "materiality" as a more familiar term and concept.[4]

DCIIA would also like to provide comment on four specific points in the Proposed Rule: (1) the enumerated list of factors included in Proposed 29 C.F.R. § 2550.404a-1(b)(4); (2) the tiebreaker standard in Proposed 29 C.F.R. § 2550.404a-1(c)(3); (3) the proxy voting regulations in Proposed 29 C.F.R. § 2550.404a-1(d); and (4) the Department's economic impact analysis.

DCIIA supports the Proposed Rule's principles-based approach and asks the Department to reconsider the proposed inclusion of specific, enumerated examples of ESG factors.

DCIIA asks the Department to reconsider the Proposed Rule's inclusion of specific, enumerated examples of ESG factors in subsection (b)(4). As already noted, DCIIA's members support the Proposed Rule's use of a principles-based approach to considering ESG factors. Specifically delineating certain ESG factors in the rule potentially sets them apart from other ESG factors that are not so delineated but which may be relevant to the analysis—for example, supply-chain management, product design and life-cycle management, and customer welfare. Stated differently, including a specific and enumerated set of ESG factors could have the unintended consequence of signaling that the enumerated factors are "more important" to consider than other ESG factors that are not included in the list. This could also unintentionally signal that other non-enumerated (non-ESG) factors, such as cybersecurity precautions, may be less relevant.[5] Additionally, it risks creating static definitions of which factors are considered "ESG," and which factors are material to an investment's risk/return analysis more generally, when these factors are expected to continue to evolve over time.

[4] For example, "materiality" is also used in the context of the federal securities laws that also directly regulate ESG investing. US federal securities law references materiality for a broad range of key concepts ranging from disclosure obligations (*see, e.g.*, Modernization of Regulation S-K Items 101, 103, and 105, SEC Rel. No. 33-10825 (Aug. 26, 2020)) to criminal liability for insider trading (*see, e.g.*, *Matrixx Initiatives, Inc. v. Siracusano*, 563 US 27 (2011)).

[5] U.S. Dep't of Labor, Employee Benefits Security Administration, Tips for Hiring A Service Provider with Strong Cybersecurity Practices, https://www.dol.gov/sites/dolgov/files/ebsa/key-topics/retirement-benefits/cybersecurity/tips-for-hiring-a-service-provider-with-strong-security-practices.pdf; U.S. Dep't of Labor, Employee Benefits Security Administration, Cybersecurity Program Best Practices, https://www.dol.gov/sites/dolgov/files/ebsa/key-topics/retirement-benefits/cybersecurity/best-practices.pdf.

To remove the potential for confusion, DCIIA suggests the Department revise the language of subsection (b)(4) to simply read: "A prudent fiduciary may consider any factor in the evaluation of an investment or investment course of action that is material to the risk-return analysis," removing the language "which might include, for example" and the list of specific examples. DCIIA believes the Department has made clear in both the Preamble and in b(2)(ii)(C) that ESG factors are capable of being material to the risk-return analysis, and therefore it may not be necessary to include specific examples in the Proposed Rule. The language in the Preamble should be sufficient to remove barriers and doubt that may have otherwise prevented ERISA fiduciaries from prudently integrating ESG factors into ERISA fiduciary decision-making (and the examples are not needed to provide this comfort). Therefore, providing limited examples of ESG may be both unnecessary and potentially harmful by undermining a principles-based approach.

But, if retained, DCIIA encourages the Department to provide appropriate clarity that the examples are not exhaustive, are not to be uniquely treated as endorsements or requirements or are not otherwise due special treatment.

DCIIA appreciates the Department's efforts to remove barriers to considering collateral benefits but believes this could be accomplished without the tiebreaker.

DCIIA appreciates the Department taking action to remove barriers to considering collateral benefits by removing some of the documentation requirements from the tiebreaker provision in Proposed 29 C.F.R. § 2550.404a-1(c)(3). Additionally, DCIIA supports the Department's deletion of the phrase "economically indistinguishable" from the prior regulation, as we believe that phrase was not practically founded.

DCIIA asks the Department to consider going further to eliminate the tiebreaker altogether. Again, DCIIA believes ERISA's fiduciary standards should be principles-based so that fiduciary decision-making is judged by universal principles of prudence and loyalty. A tiebreaker test may be interpreted as inconsistent with a universal principles-based standard because it introduces an additional test beyond the principles-based standard. Moreover, a tiebreaker test may inadvertently promote a fallacy that only one "best" investment or investment option exists (or that there could be two "equal" investments or investment options). The Department should exercise caution so that its rulemaking would not suggest there is only one "right" or "perfect" investment. In practice, there are any number of factors that can be appropriate depending upon the facts and circumstances. Factors that might be imprudent in one context may be appropriate in another context, and as such could render different, "unequal" investments or investment options as "prudent" and for the exclusive benefit of the plan's participants and beneficiaries. The proposed tiebreaker assumes the opposite: That there are two sides only—prudent and imprudent—and that investments must be viewed as static or "equal" over an investment time horizon. This view is at odds with a fiduciary decision-making process of selecting a prudent investment or investment option from any number of choices, each of which may be considered to satisfy ERISA's fiduciary standards.

In addition, despite the improvements, DCIIA's members still believe that the tiebreaker would create uncertainty. When coupled with the Department's proposed alternative disclosure requirements, DCIIA believes fiduciaries will be deterred from using the tiebreaker. Also, DCIIA's members believe the tiebreakers are not even needed because the Department has made clear in the Preamble that ESG factors are capable of being considered as material to the risk-return analysis, and therefore it may not be necessary to look to a tiebreaker test to incorporate ESG factors. In fact, there is a risk that the existence of a tiebreaker test could unintentionally signal that ESG factors cannot, on their own, be considered material to the risk-return analysis. The tiebreaker test is unnecessary and could undermine the view that ESG factors can, on their own, satisfy ERISA's prudence and loyalty standards (through the risk-return analysis).

As such, DCIIA supports removing the tiebreaker, and subsection (c)(3), in their entirety in favor of instead applying the principles-based duties of prudence and loyalty as detailed in Proposed 29 C.F.R. § 2550.404a-1(c)(1) and (c)(2). Although, DCIIA's members do not disagree with the view—and they would not object to the retention of clarifying text to the effect that a "fiduciary may not . . . accept expected reduced returns or greater risks to secure . . . additional [collateral] benefits."

DCIIA applauds the Department's changes to the proxy voting rules and requests an expansion to include separately managed accounts.

DCIIA specifically commends the Department for the changes to the regulations on proxy voting in the Proposed Rule that generally return the rulemaking to the Department's prior framing on proxy voting. One specific clarification that DCIIA's members would like to see added to the proxy voting section of the Proposed Rule is to expand subsection (d)(4)(ii) to apply not just to pooled accounts, but also to separately managed accounts that are managed by investment managers. This could be accomplished by amending the second-to-last sentence of subsection (d)(4)(ii) to read as follows: "Such an investment manager may, however, develop an investment policy statement consistent with Title I of ERISA and this section, and require participating plans to accept the investment manager's investment policy **<u>for pooled investment vehicles or separately managed accounts</u>**." (underlined and bolded text added.)

DCIIA would like to add context to the Department's economic-impact analysis.

DCIIA also would like to comment on the Department's economic-impact analysis. In the regulatory-impact analysis of the Proposed Rule, the Department estimates that 9% of plans are using ESG-inflected strategies. Yet, the number likely is much higher, at least among plans with more than 100 participants. This is because as many as 36% of large retirement plans already offer strategies that use ESG considerations to evaluate investments.[6] And the actual percentage of plans using ESG-inflected strategies may be even higher today than in 2019, as actively managed funds increasingly reference ESG analysis in their prospectus disclosures.[7] These plans would benefit from the legal clarifications proposed by the Department.

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[6] This percentage was computed applying Morningstar's broadest definition of ESG, which includes any fund that references using ESG information to value securities and matching this data to publicly available information on the 2019 Form 5500; at least 36% of plans with more than 100 participants offer at least one fund with an ESG component. Also, DCIIA's member expect this number could be even larger among large plans if you count ESG integration in its broadest sense, such as using an ESG factor as one factor, among many others, in evaluating investment options (including options that do not explicitly reference ESG in their objectives or underlying information).

[7] There are a few reasons why this number may understate the percentage. First, this analysis was performed by matching investments listed on Schedule H of the Form 5500 for the 2019 plan year to Morningstar's Sustainable Fund Attributes database. However, many investments cannot be matched in cases in which the filer does not provide sufficient information to identify a strategy or when it uses certain

Finally, the Department's impact analysis discusses studies pointing to the financial materiality of ESG information, as well as other studies that purport to show that ESG investing underperforms conventional strategies. It should be recognized that studies showing underperformance may reflect a negative screening methodology, while today's plan fiduciaries may instead use a more comprehensive lens that incorporates ESG factors and seeks to maximize risk-adjusted returns.[8]

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Thank you for considering DCIIA's comments. Please do not hesitate to reach out with questions or if DCIIA can offer more direct assistance.

Sincerely,

Lew Minsky
President and CEO
Defined Contribution Institutional Investment Association (DCIIA)

pooled vehicles. Therefore, we would expect this analysis to miss some investments that incorporate ESG analysis. Further, as the 2020 data is still being compiled by EBSA, we rely on 2019 filings. Any fund with a prospectus discussion of any use of ESG or other non-financial considerations is considered a fund that uses ESG analysis. As noted, this type of fund has been growing in number over the past few years, so the timing of the filings also means that the analysis may be understating the percentage.

[8] This is not to say that a plan sponsor could not prudently identify a negative screening strategy that it believes would perform as well.