Commenters Hammer DOL on Proposed ESG Rule

More than 1,500 comments submitted regarding proposed regulation to limit ESG investing in 401ks, most with calls for changes, an extended comment period or withdrawal of the rule

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Commenters raised plenty of objections to the DOL's proposed rule on ESG investing.

Despite an abbreviated 30-day comment period that ended last Thursday, the Department of Labor got plenty of feedback on its controversial proposed rule intended to provide clarity on fiduciaries' responsibilities in ESG investing to “help safeguard the interests of participants and beneficiaries.”

The DOL received more than 1,500 comments, although only about half—728—of the comment letters were posted on its website as of Monday afternoon. The high volume of comments demonstrates just how concerned industry firms, trade groups, advocacy organizations, individuals and members of Congress are about the potential for unnecessary damage to investors, more lawsuits and unintended consequences without any demonstrated benefit.

An informal scan of the comments reveals the vast majority of the commenters are not happy with the proposed rule as written, and most ask for multiple changes, an extended
comment period, or to have the proposed rule withdrawn altogether.

The DOL’s Employee Benefits Security Administration (EBSA) developed the proposed rule, which seeks to make five core additions to the investment duties regulation.

The proposal is designed, in part, to make clear that ERISA plan fiduciaries may not invest in ESG vehicles when they understand an underlying investment strategy of the vehicle is to subordinate return or increase risk for the purpose of non-financial objectives.

“Private employer-sponsored retirement plans are not vehicles for furthering social goals or policy objectives that are not in the financial interest of the plan,” Secretary of Labor Eugene Scalia said in a statement announcing the proposed rule. “Rather, ERISA plans should be managed with unwavering focus on a single, very important social goal: providing for the retirement security of American workers.”

**Sampling of opposing comments**

While visiting the DOL’s comment web page allows anyone to read the full text of the published comment letters (many of which are frequently more than 10 pages long), here’s a quick sample of some excerpted comments submitted by interested parties who oppose the proposed rule:

- **T. Rowe Price:** In our view, the proposed rule is attempting to solve a problem that does not exist. Worse, the proposed rule discourages fiduciaries from taking into account ESG factors that should be considered, imposes unnecessary burdens on investment decisions including those involving ESG, and requires defined contribution plan fiduciaries to disregard considerations that are important to participants’ future financial security. Changes in the original 1979 rule that are not specific to ESG represent dramatic changes in the law and will result in increased litigation without any demonstrated benefit. We urge you to withdraw the proposed rule, and initiate requests for information before engaging in additional rulemaking on this topic.

- **ESG Global Advisors:** We respectfully suggest that the Proposal has misunderstood and/or mischaracterized the nature and purpose of ESG integration and as a result, fails to distinguish between ESG integration and ETIs. This is likely to lead to confusion for ERISA fiduciaries and additional costs to plan savers. If the Proposal is finalized in its current form, we are concerned that plan fiduciaries will struggle to fulfill their obligation to integrate all financially material ESG risk factors into their investment process (which most institutional investors recognize as being required by their fiduciary duty) while also trying to respond to the language in the Proposal that appears aimed at preventing them from taking account those same risks. Moreover, we believe the Proposal would be contrary to the interests of corporations, many of which have focused considerable resources on understanding how ESG factors can be used to better identify business risks and opportunities and deliver superior, long-term shareholder value. As such, we urge you to you to allow the existing guidance to remain in effect and not move forward with the Proposal.

- **Morningstar:** Simply stated, the Department’s proposed rule is out of step with the best practices asset managers and financial advisors use to integrate ESG considerations into their investment processes and selections. Were the Department to keep the rule as proposed, it would lead to worse outcomes for plan participants as plan sponsors shyed away from assessing ESG risks in selecting investments. Indeed, since most participants use qualified default investment options—and ESG considerations would be barred in these options—most participants would not get the benefits that ESG risk analysis can deliver... The Department has never opined that an approach to evaluating investment risks is better than any other approach. This proposed rule would do just that: erecting barriers to considering ESG factors that many financial professionals consider as a routine part of investment management and selection. Existing law is sufficient to ensure that fiduciaries select investments that are in their participants’ best interest. Should the Department continue to pursue this
regulation, it should, at a minimum, allow ESG funds in QDIAAs and allow more flexibility around the process for selecting ESG investments.

- **Voya Financial Inc.** We believe the Proposal is fundamentally flawed for two reasons. First, among the many qualitative factors an ERISA fiduciary may appropriately consider in making an investment decision, the Proposal singles out ESG factors and treats them with skepticism... We see no valid reason to isolate ESG factors and subject them to special tests above and beyond ERISA’s existing, robust fiduciary principles... Second, in the context of participant-directed individual account plans, the Proposal fails to account for the positive effect on investor behavior that the availability of ESG-focused investment options can have, and fails to identify how and when changes to employee participation and/or saving rates can be validly considered by an ERISA fiduciary when selecting available plan investments... We therefore urge the Department to withdraw the Proposal in its entirety and either leave prior guidance in place or develop a new proposal that recognizes and supports the important role that ESG factors can have in identifying appropriate investments and promoting participation in workplace retirement savings plans.

- **American Retirement Association** The ARA does not believe that DOL guidance should discourage ERISA fiduciaries from considering environmental, social, governance (ESG) factors as they evaluate plan investment options; and the ARA believes otherwise-appropriate investments that include ESG factors should not be prohibited from qualifying as Qualified Default Investment Alternatives (QDIAAs) or as a component of a QDIA.

- **The Wagner Law Group** The proposed rule amending the DOL’s longstanding regulation on Investment Duties should not be implemented as published... The proposed amended regulation is inconsistent with existing law and guidance because it would require fiduciaries to only consider defined pecuniary factors in selecting investments, instead of using their judgment and discretion to evaluate investments under the totality of circumstances. The DOL cannot specify all potentially relevant considerations, and a narrow listing of permissible factors is inconsistent with the notion that prudence is not determined by a checklist and is a fact-specific determination. The regulation as proposed also includes provisions that are incompatible with each other, setting different fiduciary standards for selection of investment alternatives for self-directed individual account plans, even though the same ERISA fiduciary duties apply to all types of plans. The proposed standards for consideration of ESG Factors are similarly inconsistent, describing in proposed subsection (c)(3) factors for fiduciaries of self-directed individual account plans to consider in evaluating investment options, including options with ESG components, after declaring in subsection (c)(1) that fiduciaries can only consider ESG Factors under a heightened standard, with no support or explanation for the disparate treatment. We thus urge the DOL to retract and reconsider the proposed regulation. If the DOL still believes that rulemaking is necessary, the DOL should consider holding hearings and collecting relevant evidence to better inform the DOL as to the impact that this proposed rule could have on investment decision making.

- **BlackRock** We are concerned that the Proposal goes far beyond reiterating and clarifying the DOL’s long-standing and consistent position that plan fiduciaries must put first the economic interests of plan participants and beneficiaries. The Proposal creates an overly prescriptive and burdensome standard that would interfere with plan fiduciaries’ ability and willingness to consider financially material ESG factors, regardless of their potential effect on the return and risk of an investment. We encourage the DOL to address these consequences before moving forward with any final regulation. We urge the DOL to engage with the industry to understand how investment options incorporating ESG factors are used in ERISA plans. More industry dialogue would reveal that the Proposal would impose significant costs and burdens on ERISA plans that would ultimately be detrimental to plan participants and beneficiaries. To inform a robust regulatory impact analysis, we encourage the DOL to engage with plan sponsors, investment managers, and index providers to understand how ERISA plans can and do incorporate ESG factors to drive positive economic
outcomes for plan participants, and the extent to which the Proposal would create new costs and burdens for plans, including through the additional documentation requirements.

**Dems oppose, Republicans support**

Republicans and Democrats have gone back and forth on this issue for years, with the GOP trying to make it harder for fiduciaries to select ESG investments while Democrats want to make it easier.

A group of 13 Senators, all Democrats with the exception of Bernie Sanders (I-VT), wrote to express “deep concern” with the Proposed Rule, saying it “not only would impose a burdensome process for including ESG investments in ERISA-governed retirement plans, but it also arbitrarily prohibits the use of ESG funds as a Qualified Default Investment Alternative (“QDIA”) in a defined contribution plan, either as the QDIA itself or as a component of one.”

The letter also mentioned the proposal follows the DOL’s recent Information Letter allowing 401k and other defined contribution plan sponsors to begin incorporating private equity as a component of diversified asset allocation funds, such as target date funds, even when those investments may be riskier or have higher fees. “The fact the Department wants to make it easier for private equity firms to attract workers’ savings, while making it harder for workers to invest in ESG funds, raises serious questions regarding both the Department’s commitment to protecting workers and retirees as well as its willingness to support efforts to addressing systemic racism, racial injustices and other critical issues.”

In separate letters, a group of 41 Democratic members of the House of Representatives, and 20 Democratic members of the Education and Labor Committee, also voiced opposition.

On the other side, Republican Members of the House Committee on Education and Labor submitted a comment letter in support of the proposed rule, saying it is incumbent on DOL to ensure its policies and regulatory guidance are consistent with the fundamental tenets of ERISA and serve to protect the retirement savings of America’s workers and their families.

“We believe fiduciaries must be laser-focused on their obligations to retirement savers, and DOL’s heightened attention regarding application of non-financial considerations in their context is to be applauded,” the letter said.

What comes next with the proposed rule remains to be seen. The DOL could issue an extension of the comment period, as many commenters requested; issue a request for information; proceed with the rule, meaning it would be effective 60 days after date of publication of final rule in the Federal Register; or even withdraw it. Another option is publishing a revised rule based on feedback from the comment period, which would mean an additional comment period before it could become final.

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