DOL's ESG Proposal Blasted in Public Comments

Some 1,100 critiques from asset managers, sustainable investment advocates and others focused on five key areas.

By Bernice Napach | August 07, 2020

It's not everyday that a proposal from the Trump Administration unites both asset managers with small investor advocates, who often take opposite sides on regulatory issues. But that's what's happened with a proposal from the Department of Labor that would effectively limit investments focused on environmental, social and governance ratings in 401(k) plans.

Overall, the proposal states that ERISA plan fiduciaries may not invest in ESG vehicles if the investment strategy subordinates returns or increases risk “for the purpose of non-financial objectives.” Also, such vehicles should only be used if they are “economically indistinguishable” from non-ESG investments and the plan fiduciary documents their use if selected for non-monetary reasons.

In addition, the proposal would ban the use of ESG-oriented fund options as a qualified default investment alternative in defined contribution plans.

Since the DOL announced the proposal at the very end of June, the department has reportedly collected about 1,500 comments, though it only posted 1,100 comments (https://www.dol.gov/agencies/ebisa/laws-and-regulations/rules-and-regulations/public-comments/1210-AB95) on its website — most of them negative, except for a handful from conservative political groups such as Americans for Prosperity and the Conservative Union.


Also, public and private private pension funds such as the California State Teachers Retirement System, as well as a number of individual investors and corporate governance advocates such as Nell Minnow and Robert Monks, oppose the measure.

Others including the Insured Retirement Institute, which represents annuity providers, went so far as to request that the DOL withdraw its proposal rather than amend it because of adequate existing regulations for plan fiduciaries and investment managers, making the proposal unnecessary.


The comments on the DOL proposal generally break down into these five categories:

1. Short Public Comment Period

Many commenters requested having longer comment periods beyond the 30 days, which was unusually short though not unprecedented for the current DOL. Its Best Interest fiduciary proposal designed to align with the recent SEC BI rule also had a 30-day comment period.

The U.S. Impact Investing Alliance called on the DOL “to suspend the rulemaking until well after the COVID-19 pandemic and economic crisis have passed.” Opponents argued that more time for comments was needed because of the complexity of the proposal and the magnitude of its effects, a response made even more challenging during the pandemic.
A group letter from the American Bankers Association, Insured Retirement Institute, Defined Contribution Institutional Investment Association, Investment Company Institute, SIFMA, Investment Adviser Association and the SPARK Institute stated that 30 days was not enough for a major overall haul to a DOL regulation that has been in place over 40 years.

Further, it could have the "unintended consequences" of increased costs and burdens on fiduciaries, including litigation risks, and significant limitations on plan participants' investment choices, the group noted.


2. Mischaracterization of ESG

The DOL proposal distinguishes between ESG factors that can have a monetary ("pecuniary") and non-monetary ("non-pecuniary") impact on investments, noting that ERISA plan fiduciaries "may not invest" in an ESG vehicle whose strategy "is to subordinate return or increase risk for the purpose of non-pecuniary objectives."

Many firms and individuals opposing the proposal argued that ESG investment vehicles do just the opposite: they reduce risk and rather than harm returns often boost performance, and therefore should be part of any prudent investment analysis.

"ESG risk ... is a pecuniary matter that is fundamental to evaluating the long-term performance of an investment," wrote the Morningstar analysts, noting that "ERISA fiduciaries should have an obligation" to consider it.

Lazard Asset Management cited data from several firms showing the importance of ESG analysis in relation to performance, such as a Goldman Sachs study revealing that companies with poor ESG management tended to underperform. Plus, S&P Global Market Intelligence analysts found funds investing in companies based on ESG factors were "relative safe havens" in market downturn within the Jan. 1-May 15, period this year.

BNY Mellon recommended that the DOL distinguish between "economically targeted investments" (ETI) that are selected in part because of their non-monetary benefits and "ESG integration" strategies, which are part of a disciplined investment process that considers all material economic factors.

3. Lack of Factual Support

The DOL proposal notes that "the growing emphasis on ESG investing may be prompting ERISA plan fiduciaries to make investment decisions" that don't benefit plan participants, cost more and are unrelated to investment performance.

"There is no factual support for the proposition that ESG is being misused currently," writes Margaret Raymond, vice president of T. Rowe Price. "Accordingly, the proposed rule's efforts to impose new requirements on fiduciaries' consideration of ESG is not necessary."

Value Edge Advisors noted that: "This rulemaking is literally baseless in that EBSA [Employee Benefits Security Administration, division of the DOL], fails to provide a single example of any ERISA fiduciary allocating any investment on the basis of 'non-pecuniary' criteria, much less any investigations or enforcement based on these concerns."

4. Negative Impact on Those Saving for Retirement

Citing research from Morgan Stanley Institute for Sustainable Investing, Putnam said the proposal could have the effect of turning off younger investors, who often have a strong interest in sustainable investing when saving for retirement.

Also, there's the reduced ability for investors "to have the choice to avoid investment risks they would prefer not to take," Vanguard wrote.

The proposals prohibition of ESG-oriented fund options as the default option for defined contribution plan participants, for those who don't choose their preferred investments "could damage retirement outcomes for certain participants and beneficiaries," according to T. Rowe Price.

5. A Burden for Fiduciaries

Fiduciaries, too, would be harmed by the DOL proposal, according to multiple comments.

The requirement that a fiduciary extensively document why the investments with ESG considerations were determined to be indistinguishable from other investments. Also, why such investments were in line with the purposes of the plan and financial interests of plan participants would discourage their use and increase compliance costs, according to Franklin Resources, according to some public remarks.

What Happens Next

The DOL will now review all the comments and respond to them "in some fashion when they issue final regulations," says Marcia Wagner, founder of the Wagner Law Group, which specializes in employee benefits and pension law.

She expects the agency will find it difficult to respond to all the negative comments but may "wordsmith some of the language" and "expand the definition of terms such as pecuniary factors."

Wagner also anticipates that a final regulation closely resembling the current proposal will "definitely be challenged in court as a violation of the Administrative Practice Act" and ultimately reversed by the next Labor Secretary if Trump loses the presidential election.
Comments from Minnow and Monk note that the proposal not only violates the minimum requirements of the Administrative Procedures Act, but also the Paperwork Reduction Act, cost-benefit standards of the federal government as well as Trump’s Executive Order on Energy Infrastructure/Rulemaking.

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