



The Forum for Sustainable and Responsible Investment

ERISA – ESG Rulemaking Toolkit

JULY 2020

Bryan McGannon

DIRECTOR OF POLICY AND PROGRAMS | BMCGANNON@USSIF.ORG

Contents:

[Overview](#)

[Background](#)

[Key components of the proposed rule](#)

[Talking points](#)

[Sample letter](#)

[Selected research reports to consider referencing in your letter](#)

[Law firm memo links](#)

Recommended Action

- Submit a comment letter to the US Department of Labor
- Contact your member of Congress

Overview

On June 23rd, the US Department of Labor (DOL) released a proposed [rulemaking](#) (“Proposal”) to revise the fiduciary standard for ERISA-governed retirement plans. The Proposal attempts to isolate environmental, social and governance (ESG) criteria from other financially material information in investments covered under ERISA and implies that all ESG criteria are non-financial. The Proposal is out of step with professional investment managers who increasingly analyze ESG factors precisely because of risk, return and fiduciary considerations. In 2018, the US SIF Foundation’s *Trends* report found that sustainable investing assets had expanded to \$12.0 trillion in the United States, a 38 percent increase over 2016.

The Proposal will put a substantial burden on fiduciaries who consider ESG factors or offer ESG investment options in their retirement plans. The proposed changes require additional documentation to justify why ESG factors are financially material, and it effectively prohibits ESG considerations in default investment options for plans (Qualified Default Investment Alternatives, or QDIA).

Investors need to correct the record. The DOL has attempted to frame investing strategies that consider ESG factors as underperforming. To advance this specious claim, the DOL cites limited, cherry-picked data, ignoring the multitude of studies demonstrating that investment strategies that take ESG factors into account offer comparable or better financial performance when compared with conventional investments.

Below you will find our initial assessment of the proposed rule. If finalized, it would supersede [Interpretive Bulletin 2015-01](#), which clarified that fiduciaries could consider ESG criteria in investments. You may recall that US SIF spent several years working to obtain the changes made in 2015.

This proposed rule will have a 30-day public comment period, which closes on July 30th. US SIF has petitioned for a longer comment period. However, it is unlikely that an extension will be granted.

Background

US SIF, along with other organizations, successfully advocated for revisions to ERISA rules addressing ESG considerations in retirement plans. In October 2015, the US Department of Labor issued a new [bulletin](#) assuring that fiduciaries of private-sector retirement plans “need not treat commercially reasonable investments as inherently suspect or in need of special scrutiny merely because they take into consideration environmental, social or other such factors.” In addition, the 2015 bulletin explicitly stated, “Environmental, social, and governance issues may have a direct relationship to the economic value of the plan’s investment.”

The revised guidance reassured plan sponsors and fiduciaries who had questioned if they could offer sustainable investment options. It also allows ERISA fiduciaries—and ultimately their plan beneficiaries—to benefit from additional analytical tools to assess risks, opportunities and impact of their retirement plans.

In April 2018, the Department of Labor issued a lower level “[field assistance bulletin](#)” that generally reaffirmed its 2015 guidance and offered specific instructions on the qualified default investment alternative.

A rule is significantly different than a guidance bulletin issued by the Department. Rules give the Department a broader set of enforcement tools. In addition, reversing a rule requires a new notice and comment process, unlike a bulletin which can be rescinded by Department action alone.

Key Components of the Proposed Rule

Fundamental Misunderstanding of ESG: DOL makes clear in the Proposal that it believes nearly all ESG criteria are non-pecuniary, or not financially material to investments. Throughout the Proposal, DOL conveys a belief that ESG investing sacrifices return. DOL states that, “Plan fiduciaries are not permitted to sacrifice investment return or take on additional investment risk to promote non-pecuniary benefits or any other non-pecuniary goals.”

DOL notes its concern that some investment products are being marketed on the basis of “purported benefits and goals unrelated to financial performance.”

Singling Out ESG for Burdensome Justification: The flawed assumption that ESG criteria are not material requires fiduciaries to document the basis of their decision to include an ESG investment in a portfolio over an “economically indistinguishable” alternative. In addition, the Proposal sets a different documentation requirement for including ESG investments in Individual Account Plans, requiring a fiduciary to document and monitor the performance of the selection based on objective risk-return criteria (i.e., benchmarks, expense ratios, fund size, long-term returns, etc.)

These additional requirements may have the practical effect of dissuading fiduciaries, against their better judgment, from offering ESG investing options to plan participants.

Prohibition of ESG in QDIAs: The Proposal does not allow for ESG investments to be “added as, or a component of, a qualified default investment alternative.” This restriction is particularly troubling because QDIAs are a large segment of the 401k market.

Talking Points

- The Proposal is out of step with professional investment managers who increasingly analyze ESG factors precisely because of risk, return and fiduciary considerations. In the US SIF Foundation's 2018 survey of sustainable investment in the United States, 141 money managers with aggregated assets of more than \$4 trillion responded to a question on their motivations for incorporating ESG criteria into their investment process. Three-quarters of these managers cited the desire to improve returns and to minimize risk over time. Fifty-eight percent cited their fiduciary duty obligations as a motivation.
- The proposed rule reflects a fundamental misunderstanding of the use of ESG criteria and sustainable investing. While the Proposal states that there may be circumstances where ESG information is material, it fundamentally equates ESG criteria with non-pecuniary, or non-financially material, information. Also, it incorrectly characterizes ESG as a monolithic criterion or strategy when, in fact, ESG is not a one-size-fits-all investment approach.
- The Proposal cites no credible sources to support its claims that ESG criteria are not material to investment decisions. Citing two newspaper columns, the Department expresses concern that the rise of ESG investing may be prompting fiduciaries “to make investment decisions for purposes distinct from providing benefits to participants and beneficiaries,” and to make decisions “on the basis of purported benefits and goals unrelated to financial performance.” In fact, many [studies](#) demonstrate that ESG considerations do not compromise performance.
- The Proposal would put a substantial additional burden on fiduciaries who wish to offer ESG investment options by requiring additional investment analysis and documentation requirements. The rules require special documentation for any decision to choose an ESG-oriented alternative from among economically equivalent options. There is no reasonable basis for singling out the incorporation of ESG criteria for special and heightened scrutiny.
- The Proposal will restrict the choices in retirement platforms. Consequently, plan beneficiaries may lose some of the benefits of diversification. This rule could lead to plan participants losing access to ESG options—many of which have outperformed their indices over time and especially during the market shock related to COVID-19 (see Research Reports section below).
- The DOL seeks to limit plan participants ability to access ESG retirement options by prohibiting funds using ESG criteria to be ‘added as, or a component of, a qualified default investment alternative.’ The Department’s stated rationale for prohibiting an “ESG-themed fund” from being selected as the default investment option is that it is not appropriate to select “investment funds whose objectives include non-pecuniary goals.”

The Rulemaking Process

1. The proposed rule has a 30-day comment period. The comment period ends on July 30th. Many organizations, including US SIF, have written the Department of Labor (DOL), requesting that they extend the comment period to 90 days.
2. Anyone can submit a comment. Submitted comments are **public** and posted on the DOL website under the rulemaking comment file.
3. On July 30th, when the 30-day comment period ends, the DOL is obligated to review and consider each submission.
4. The DOL considers the comments and writes the final rule. There is no deadline for completing this step.
5. When it has completed writing the rule, the DOL will publish the final rule. This specific rule states that it becomes effective 60 days after the final rule is published.
6. Legal challenges can occur once the rule becomes final, which may delay the implementation of the rule.

How to Submit Your Comment

Comments may be submitted online at www.regulations.gov. You may find the proposed rule [here](#) and the summary [here](#):

Electronic comments:

- Open the comment page [here](#).
- You may upload your comment file or paste the text in the text box.
- Follow the prompts to complete the submission.
- Comments submitted to the record may be viewed [here](#).
- The sample letter below includes information about where to direct the letter.

Contact Your Member of Congress

Share your concerns about the Proposal with your members of Congress.

- Find your representatives: [House](#) | [Senate](#)
- Call the US Capitol Switchboard at (202) 224-3121; they'll direct you to your Senator's or Representative's office. Remember to be courteous, and if you don't get through, try looking up the phone number for your nearest district office instead.
- When you are connected, identify yourself as a constituent and, if appropriate, where you work. Tell them you are concerned with the Department of Labor's "Financial Factors in Selecting Plan Investments" rulemaking. Succinctly explain why you oppose the rulemaking. Then ask for the member of Congress to contact DOL to express concern or opposition to the proposed rule.
- You may also email your comment letter to your representatives.

SAMPLE LETTER

[firm letterhead]

Submitted via regulations.gov

July XX, 2020

Office of Regulations and Interpretations
US Department of Labor
Room N-5655
200 Constitution Avenue NW
Washington, DC 20210

RE: Proposed rule on Financial Factors in Selecting Plan Investments (RIN 1210-AB95)

To whom it may concern:

I write to provide comments in response to the Department of Labor's proposed rule, "Financial Factors in Selecting Plan Investments" (RIN 1210-AB95) (the "Proposal").

[insert paragraph about your firm. Consider including what your firm does, your AUM (if you have AUM), what type of clients you serve, etc.]

The Proposal reveals a fundamental misunderstanding of how professional investment managers use environmental, social and governance criteria as an additional level of due diligence and analysis in the portfolio construction process. Investment managers increasingly analyze ESG factors precisely because they view these factors as material to financial performance. In the US SIF Foundation's 2018 survey of sustainable investment firms in the United States, 141 money managers with aggregate assets of more than \$4 trillion responded to a question on their motivations for incorporating ESG criteria into their investment process. Three-quarters of these managers cited the desire to improve returns and to minimize risk over time. Fifty-eight percent cited their fiduciary duty obligations as a motivation.

[Raise the concerns you have with rule here. You may refer to the talking points above.]

Where possible, include supporting data or reports.]

Numerous studies show that the consideration of ESG criteria in investment analysis generally produces investment performances comparable to or better than non-ESG investments. There is no doubt that funds that use ESG criteria are consistent with long-term retirement objectives.

The Proposal is likely to have the perverse effect of dissuading fiduciaries, even against their better judgment, from offering options for their plans that consider ESG criteria in addition to more traditional financial criteria. As a result, it will unfairly, and harmfully, limit plan participants' options and diversification opportunities.

I respectfully request that the Proposal be withdrawn.

Thank you for your consideration of these comments.

Sincerely,

[Name

Title]

Selected Research Reports to Consider Referencing in Comment Letters

[Sustainable Investment - Exploring the Linkage between Alpha, ESG, and SDG's](#), Madelyn Antoncic, Geert Bekaert, Richard V Rothenberg and Miquel Noguer (June 2020)

“First, we explore whether utilizing ESG factors can improve performance vis a vis the MSCI US index. By constructing a sector-neutral portfolio using MSCI ESG momentum scores from 2013 to 2018, we determine that it is feasible to generate positive alpha from an ESG momentum strategy.”

[Sustainable Funds Weather the First Quarter Better Than Conventional Funds](#), Morningstar (April 2020)

“Like all equity funds, sustainable equity funds suffered sudden and large losses during the first quarter of 2020 because of the coronavirus pandemic, but they held up better than conventional funds. Seven out of 10 sustainable equity funds finished in the top halves of their Morningstar categories, and 24 of 26 environmental, social, and governance-tilted index funds outperformed their closest conventional counterparts.”

[The ESG premium: New perspectives on value and performance](#), McKinsey & Company (February 2020)

In a new survey, executives and investment professionals largely agree that environmental, social, and governance programs create short- and long-term value—though perceptions of how have changed over the past decade.

[Corporate Governance, ESG, and Stock Returns around the World](#), Mozaffar Khan, *Financial Analysts Journal* (October 2019)

“Non-financial performance measures, such as environmental, social, and governance (ESG) measures, are potentially leading indicators of companies’ financial performance. In the study reported here, I drew on prior academic literature and the concept of ESG materiality to develop new corporate governance and ESG metrics. The new metrics predicted stock returns in a global investable universe over the tested period, which suggests potential investment value in the ESG signals.”

[Environmental, Social, and Governance \(ESG\) Investment Tools: A Review of The Current Field](#), Ogechukwu Ezeokoli (December 2017)

A 2017 study commissioned by DOL also reported that while some investors may continue to perceive that incorporating ESG factors entails accepting lower investment performance, its review of the academic literature suggests that incorporating ESG factors generally produced investment performances comparable to or better than non-ESG investments.

[Responsible Investing: Delivering Competitive Performance](#), Nuveen TIAA Investments (July 2017)

After assessing the leading SRI equity indexes over the long term, the firm “found no statistical difference in returns compared to broad market benchmarks, suggesting the absence of any systematic performance penalty. Moreover, incorporating environmental, social and governance criteria in security selection did not entail additional risk.” It added that SRI indexes had similar risk profiles to their broad market counterparts, based on Sharpe ratios and standard deviation measures.

[ESG And Financial Performance: Aggregated Evidence From More Than 2000 Empirical Studies](#), Gunnar Friede, Timo Busch, Alexander Bassen, *Journal of Sustainable Finance & Investment* (Volume 5, 2015 – Issue 4)

“The study combines the findings of about 2200 individual studies. Hence, this study is by far the most exhaustive overview of academic research on this topic and allows for generalizable statements. The results show that the business case for ESG investing is empirically very well-founded. Roughly 90 percent of studies find a nonnegative ESG–CFP relation. More importantly, the large majority of studies report positive findings.”

[From the Stockholder to the Stakeholder: How Sustainability Can Drive Financial Outperformance](#), Oxford University and Arabesque Partners, (March 2015)

This is a meta-study that categorized more than 200 sources, including academic studies, industry reports, newspaper articles and books. According to their results, “88 percent of reviewed sources find that companies with robust sustainability practices demonstrate better operational performance, which ultimately translates into cash flows.” Furthermore, “80 percent of the reviewed studies demonstrate that prudent sustainability practices have a positive influence on investment performance.”

Selected Law Firm Assessments

[DOL Proposes Rule to Crack Down on ESG](#) (Groom Law Group)

[DOL Proposes Rule to Severely Restrict ESG Considerations in Selecting ERISA Plan Investments](#) (Ropes & Gray)

[US Department of Labor Issues Proposed Regulation on Environmental, Social & Governance Investing](#) (Goodwin)

[US Department of Labor Issues Proposed Restrictions on ESG Investing](#) (Paul Weiss)