



March 23, 2021

The Honorable Martin Walsh  
Secretary of Labor  
200 Constitution Ave., NW  
Washington, DC 20210

Dear Secretary Walsh:

The American Retirement Association (ARA) and Ceres congratulate you on your confirmation as Secretary of Labor. Surely, this is very exciting for you, as it is exciting for our entire nation.

We write concerning the Department of Labor's (the Department's) regulation "Financial Factors in Selecting Plan Investments" (the Final Rule).<sup>1</sup> We are deeply concerned that the Final Rule's restrictions on investments with environmental, social, and corporate governance (ESG)<sup>2</sup> objectives will curtail, if not eliminate, important investment options for retirement plan participants – to the detriment of their retirement savings. While the Department's March 10 statement<sup>3</sup> – that it will not enforce the Final Rule and will revisit it – promises to be helpful in the near term, we urge the Department to:

- **Issue Frequently Asked Questions clarifying that ESG factors are material financial factors under the Final Rule; and**
- **Modify the Final Rule to reflect that ESG investments are permitted in qualified default investment alternatives (QDIAs) and to establish a clear policy that ESG investments should not be discouraged or treated differently than other retirement plan investment options.**

\* \* \*

The ARA is the coordinating entity for its five underlying affiliate organizations representing the full spectrum of America's private retirement system, the American Society of Pension Professionals and Actuaries (ASPPA), the National Association of Plan Advisors (NAPA), the

---

<sup>1</sup> 85 Fed. Reg. 72846 (Nov. 13, 2020).

<sup>2</sup> Assorted terms are used to describe this and related investment behaviors, including socially responsible investing, environmental, social, and corporate governance investing, impact investing, sustainable and responsible investing, and economically targeted investing.

<sup>3</sup> <https://www.dol.gov/newsroom/releases/ebsa/ebsa20210310>.

National Tax-Deferred Savings Association (NTSA), the American Society of Enrolled Actuaries (ASEA), and the Plan Sponsor Council of America (PSCA). ARA's members include organizations of all sizes and industries across the nation who sponsor and/or support retirement saving plans and are dedicated to expanding on the success of employer sponsored plans. In addition, ARA has nearly 31,000 individual members who provide consulting and administrative services to the sponsors of retirement plans. ARA and its underlying affiliate organizations are diverse but united in their common dedication to the success of America's private retirement system including safeguarding the interests of participants and beneficiaries in retirement savings plans.

Ceres is a nonprofit organization working with institutional investors and companies to build sustainability leadership and drive solutions throughout the economy. Ceres supports the Investor Network on Climate Risk and Sustainability, which consists of almost 200 institutional investors managing more than \$31 trillion in assets, who advance leading investment practices, corporate engagement strategies, and policy and regulatory solutions to address sustainability risks and opportunities. Ceres has worked closely with institutional investors since our founding in 1989, and with an expanding group of investors since the founding of Ceres' Investor Network 18 years ago.

## **Background**

The Final Rule is grounded in the ERISA fiduciary duties of prudence and loyalty – ERISA fiduciaries must act solely in the interests of plan participants and beneficiaries for the exclusive purpose of providing benefits. The Final Rule sets “minimum standards” by codifying principles previously articulated in Department guidance, emphasizing “the primacy of plan participants’ economic interests” in fiduciaries’ decisions about investments for ERISA plans. The Final Rule requires fiduciaries of ERISA plans to evaluate investments based upon *pecuniary* factors when selecting or retaining investment options for plans. While ERISA fiduciaries may choose plan investments that may produce “socially desirable” goals (in particular, ESG factors), the Final Rule requires justification of that choice based solely on pecuniary factors. Specifically, the Final Rule defines pecuniary factor to mean “a factor that a fiduciary prudently determines is expected to have a material effect on the risk and/or return of an investment based on appropriate investment horizons consistent with the plan's investment objectives and the funding policy established pursuant to section 402(b)(1) of ERISA.”

Under the Final Rule, if fiduciaries are unable to distinguish investments based on pecuniary factors (a circumstance the Department envisions to be “rare”<sup>4</sup>), the Final Rule permits fiduciaries to consider non-pecuniary factors – ESG factors, for example – as tie-breakers, provided that documentation requirements in the Final Rule are satisfied. Notwithstanding, the

---

<sup>4</sup> 85 Fed. Reg. at 72878.

preamble to the Final Rule (Preamble) encourages fiduciaries to make “tie-breaker” decisions based on pecuniary factors alone. Perhaps most significantly, the Final Rule prohibits using ESG-inclusive investments as a plan’s QDIA by prohibiting fiduciaries from offering as QDIAs investments whose investment strategies “consider, include, or indicate the use of non-pecuniary factors.”

## Discussion

- **The Department should expeditiously issue Frequently Asked Questions clarifying that ESG factors are material financial factors under the Final Rule**

The ARA and Ceres believe that the Final Rule convolutes fiduciaries’ duties in selecting investments for ERISA plans and increases uncertainty for plan advisors and plan sponsors in this setting. It makes the process of selecting investments more complex, confusing, and burdensome than is necessary to protect plans, participants, and beneficiaries from undue financial risk. And it may in fact encourage a dangerously narrow conception of risk that exposes participants’ retirement savings to avoidable future losses. As a result, fewer investment options ultimately will be available to plan sponsors and participants, increasing the possibility for worse outcomes across the landscape of retirement savings.

A central problem of the Final Rule is its confused conceptualization of “pecuniary.” The Preamble acknowledges that an ESG-type factor *could* be considered a “pecuniary” factor under certain circumstances. But it also cautions against concluding too hastily that ESG-type factors are *actually* “pecuniary.” Instead, the Preamble discusses extensively what *should* appropriately be considered a pecuniary factor.” However, given the complex interplay of ESG factors in investment decision-making, it acknowledges, the term “ESG” is not necessarily synonymous with “non-pecuniary.” For example, a fiduciary *may* reasonably conclude that board or management diversity or a company’s environmental record would have a material financial effect on the investment.

Moreover, the Final Rule requires that with participant-directed individual account plans, fiduciaries must “carefully review the prospectus of other investment disclosures” including marketing materials for each fund to determine if the statement of the fund objectives or investment strategies include non-pecuniary factors. Mindful that ESG factors may in some instances be “pecuniary” while considered non-pecuniary in others, this ongoing analysis of potentially thousands of pages of materials is overly complex and burdensome for plan advisors and plan sponsors. While the Department may not have intended this juxtaposition to “inappropriately chill fiduciaries from considering investments that incorporate ESG factors,” plan advisors and plan sponsors remain hesitant as they await further guidance.

Amidst this complexity, the ARA and Ceres believe that the Final Rule has created obstacles to advisors and plan sponsors to even considering investments that may have ESG features. By now, plan participants have already lost access to ESG investment options because advisors and plan fiduciaries fear making the wrong classification of an ESG-type factor. Ironically, this comes amidst an upward trend in the availability ESG-focused investment vehicles, increasing evidence that ESG funds deliver superior performance at lower risk,<sup>5</sup> and the desire of a growing majority of working Americans to align their investment decisions with their personal beliefs.<sup>6</sup> In a 2019 survey, 61% of retirement plan participants said they would increase plan contributions if they knew their investments were “doing social good.” The survey also showed that two-thirds of employees those who choose not to enroll in their company’s retirement plan said they would be more likely to participate if they knew their assets delivered societal benefits.<sup>7</sup>

While the Department’s March 10, 2021, enforcement policy statement will be extremely helpful, the ARA and Ceres wish to emphasize that we do not believe that non-enforcement by itself will give plan sponsors and plan advisors sufficient comfort and confidence to begin to consider ESG investments. After all, the private right of action relating to the standards of the Final Rule remains a concern. Accordingly, the ARA and Ceres urge the Department to act expeditiously to issue Frequently Asked Questions clarifying that ESG factors are material financial factors thereby removing artificial barriers to considering ESG investments as designated investment alternatives as part of a prudent fiduciary analysis of all plan investment options. We believe that Frequently Asked Questions would be an effective means for the Department to respond to stakeholders on this important topic.

- **The Final Rule should be modified (1) to reflect that ESG investments are permitted in QDIAs and (2) to establish a clear policy that ESG investments should not be discouraged and should be treated no differently than other retirement plan investment options**

ESG investing is an important part of retirement investing. Because QDIAs are popular features in employer-sponsored retirement plans, ARA and Ceres believe prohibiting QDIAs from including ESG investments is unnecessarily constraining and ultimately could deny participants the full benefit of prudent investment selections. According to a 2020 survey conducted by the

---

<sup>5</sup> Morgan Stanley, Sustainable Funds Outperform Peers in 2020 During Coronavirus, <https://www.morganstanley.com/ideas/esg-funds-outperform-peers-coronavirus>; and Morningstar, Sustainability Matters: Sustainable Equity Funds Turn In Another Strong Quarter, <https://www.morningstar.com/articles/1007824/sustainability-matters-sustainable-equity-funds-turn-in-another-strong-quarter>.

<sup>6</sup> 85 Fed. Reg. at 72848.

<sup>7</sup> Natixis Investment Managers, Survey of US Defined Contribution Plan Participants conducted by CoreData Research, January and February 2019. The survey included 1,000 US workers, including 700 plan participants and 300 non-participants. Of the 1,000 respondents, 503 were Millennials (age 23- 38), 249 were Gen X (age 39-54) and 248 were Baby Boomers (age 55-73).

Plan Sponsor Council of America, 66.6% of employer-sponsored defined contribution plans include QDIAs. In plans with more than 5,000 participants, the percentage was 80.9%.<sup>8</sup>

Strikingly, the Final Rule prohibits fiduciaries from designating an investment alternative as a QDIA “if it, or any of its components, has investment objectives or goals or principal investment strategies that include, consider, or indicate the use of one or more non-pecuniary factors.”<sup>9</sup> That is, even if the investment alternative could involve an otherwise permitted use of non-pecuniary factors in accordance with the Final Rule, it would not be permitted to be used as the QDIA. The Final Rule also prohibits identifying as QDIAs, any fund that uses “screening strategies,” which might, for example prohibit investing in certain sectors (e.g., fossil fuels, weapons, or gaming).

The effect of this “heightened prophylactic approach for QDIAs” of the Final Rule is to constrain the use of otherwise-qualified investment options in ERISA plans and particularly in QDIAs solely because their investment objectives, goals, or principal strategies include a “non-pecuniary” factor. For example, where evaluating the governance process of a potential corporate investment is part of a prudent investment process, the Final Rule means that if a fund incorporates such a process in its investment management, it would be precluded from being a QDIA. Such a result would be incongruous with the underlying objective of the Final Rule, which is to promote prudent investing of plan assets in the best interests of participants. The ARA and Ceres believe that if a fund performs well under a fiduciary’s prudent process and participants can redirect the investment of their account, as required by the rules for QDIAs,<sup>10</sup> the presence of ESG factors should not inhibit the investment from being used as the default. While the March 10, 2021, enforcement policy statement explicitly extends to QDIAs, we believe that as the Department revisits the Final Rule, the Final Rule should be modified to permit ESG investments to be included in QDIAs.

Further, as the Final Rule is revisited, the ARA and Ceres believe that the Department should disclaim the Preamble’s characterization of ESG considerations as incongruous with a prudent fiduciary analysis. The Preamble explains that ESG investing “raises heightened public concerns under ERISA” and “often come[s] with higher fees, because additional investigation and monitoring are necessary to assess an investment from an ESG perspective.” It also asserts that the growing emphasis on ESG investing may prompt ERISA fiduciaries to make investment decisions for purposes distinct from providing benefits to participants and beneficiaries and satisfying their other fiduciary duties.<sup>11</sup> At the same time, according to the Preamble, there is not

---

<sup>8</sup> <https://www.pasca.org/sites/pasca.org/files/Research/2020/QDIA.png>

<sup>9</sup> The Final Rule applies prospectively, meaning that fiduciaries do not have to divest any current investments selected using nonpecuniary factors in a way that is prohibited by the Final Rule. However, if a plan used nonpecuniary factors as a primary investment objective in selecting a QDIA, then the QDIA must be removed from the plan by April 30, 2022.

<sup>10</sup> 29 CFR § 2550.404c-5.

<sup>11</sup> 85 Fed. Reg. 72848.

a consensus in the marketplace as to what constitutes a “genuine ‘ESG’ investment.” Despite this confusion, ESG investing has increased, according to the Preamble.<sup>12</sup>

The ARA and Ceres believe that this characterization of ESG investing in general is misguided and unduly discourages ERISA plan fiduciaries from considering investment strategies that consider ESG factors, even where they are used solely to evaluate the economic benefits of investments and identify economically superior investments. There is no policy justification for treating ESG investments differently than any other potential retirement plan investment. For example, a mutual fund classified as a “technology fund”<sup>13</sup> will have investment holdings with significant similarities to an “ESG or sustainable” fund.<sup>14</sup> However, despite similar investment approaches, the Preamble makes it clear that the latter requires special scrutiny. We believe that ESG investments should be treated just like any other investment option be considered by a plan fiduciary. As the Department revisits the Final Rule and considers further action, the ARA and Ceres ask the Department to recharacterize ESG factors to reflect that they may be worthwhile and important elements of a fiduciary’s prudent investment selection process and we urge the Department to disavow statements to the contrary in the Preamble.

***The Department Should Act Expeditiously***

President Biden directed the Department to review the Final Rule, in connection with the Executive Order 13990, titled “Protecting Public Health and the Environment and Restoring Science to Tackle the Climate Crisis,”<sup>15</sup> (Executive Order) and to take action as appropriate and consistent with applicable law. The ARA and Ceres commend the Department for its nonenforcement policy regarding the Final Rule and urge the Department to act by expeditiously:

- **Issuing Frequently Asked Questions clarifying that ESG factors are material financial factors under the Final Rule; and**
- **Modifying the Final Rule to reflect that ESG investments are permitted in QDIAs and to establish a clear policy that ESG investments should not be discouraged or treated differently than other retirement plan investment options**

The ARA and Ceres very much appreciate the Department’s commitment to assuring the security of the retirement benefits of America’s workers and their families. We share this goal and look forward to working with the Department on these important issues. We would welcome the

---

<sup>12</sup> 85 Fed. Reg. 72847.

<sup>13</sup> See for example, Putnam Global Technology Fund (<https://www.putnam.com/individual/mutual-funds/funds/625-global-technology-fund/A>).

<sup>14</sup> See for example, Morgan Stanley Global Sustain Fund (<https://www.morganstanley.com/im/en-la/intermediary-investor/funds-and-performance/morgan-stanley-investment-funds/equity/global-sustain.html>).

<sup>15</sup> <https://www.whitehouse.gov/briefing-room/statements-releases/2021/01/20/fact-sheet-list-of-agency-actions-for-review/>; 86 Fed. Reg. 7037 (Jan. 25, 2021).

opportunity to discuss these issues further with you. Please contact Brian Graff, CEO, American Retirement Association at [bgraff@usaretirement.org](mailto:bgraff@usaretirement.org) or at (703) 516-9300, or Steven M. Rothstein, Managing Director, Ceres Accelerator for Sustainable Capital Markets at [srothstein@ceres.org](mailto:srothstein@ceres.org) or at (617) 308-5538.

Thank you for your time and consideration.

Sincerely,

/s/ Brian H. Graff, Esq., APM  
Executive Director/CEO  
American Retirement Association

/s/ Mindy Lubber  
CEO and President  
Ceres Accelerator for Sustainable Capital Markets

/s/ Allison Wielobob  
General Counsel  
American Retirement Association

/s/ Steven M. Rothstein  
Managing Director  
Ceres Accelerator for Sustainable Capital Markets

cc: Ali Khawar, EBSA  
Tim Hauser, EBSA  
Joe Canary, EBSA