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Working for America's Retirement

December 13, 2021

Office of Regulations and Interpretations
Employee Benefits Security Administration
U.S. Department of Labor
200 Constitution Ave, NW, Ste. 400
Washington DC 20210
via Federal rulemaking Portal at www.regulations.gov

Re: Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights–RIN: 1210–AC03

Dear Department of Labor,

The American Retirement Association (ARA) appreciates the opportunity to provide our views on the Department of Labor's (DOL's) proposed rule, "Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights"–RIN: 1210–AC03 (the Proposal). The ***ARA recommends*** that the final rule should:

- **Allow ESG investments in participant investment alternatives and as QDIAs, as proposed.**
- **Adopt an approach that reflects ERISA's longstanding principle of neutrality in the application of duties of loyalty and prudence regarding the factors for a fiduciary investment analysis by:**
    - **Eliminating the Proposal's inclusion of climate change and other environmental, social, and governance (ESG) factors as required considerations under the prudence safe harbor; and**
    - **Eliminating the examples of discretionary ESG considerations under the prudence safe harbor and reformulating them as preamble discussion.**
- **Modifying the tie-breaker provision to reflect these same principles and to permit selection of investments based on non-economic criteria and not based on the untenable standard of *equally* serving the plan's financial interests.**

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

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Professionals and Actuaries (ASPPA), the National Association of Plan Advisors (NAPA), the 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 30,000 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.

The ARA shares the DOL's objective of safeguarding the interests of participants and beneficiaries in retirement savings plans. We and our underlying affiliate organizations have long been supportive of the principle that informs the Proposal – participants and beneficiaries are best served when plan fiduciaries understand the application of ERISA's fiduciary obligations to the selection of plan investments. The ARA supports guidance that imparts clarity to the fiduciary investment selection process.

Summary

It is well-settled that ERISA's principles of prudence and loyalty require that fiduciaries keep an "eye single" to the interests of participants and beneficiaries.[1] Fiduciaries making plan investment decisions are bound to the narrow objective of prudent management in order to maximize funds available to pay plan benefits—above all else.

ERISA prudence and loyalty as applied to fiduciaries' selection of plan investments have been the subject of multiple iterations of DOL guidance, most recently, the final regulation promulgated in 2020, "Financial Factors in Selecting Plan Investment" (2020 Rule).[2] Months later, in early 2021, under a new Presidential administration, DOL anticipated measures to counteract "artificial impediments – and chilling effect on environmental, social and governance investments – caused by the [2020 Rule]."[3] A chief concern was that the 2020 Rule "created a perception that fiduciaries are at risk if they include any ESG factors in the financial evaluation of plan investments."[4] The

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[1] *Donovan v. Bierwirth*, 680 F.2d 263, 271 (2d Cir. 1982).
[2] 85 Fed. Reg. 72846 (Nov. 13, 2020).
3 "*U.S. Department of Labor Proposes Rule to Remove Barriers to Considering Environmental, Social, Governance Factors in Plan Management,"* (Oct. 13, 2021) https://www.dol.gov/newsroom/releases/ebsa/ebsa20211013.
[4] 86 Fed. Reg. 57272, 57276 (Oct. 14, 2021).The Proposal follows 2021 Executive Orders intended to effectuate the administration's climate objectives, manifested by the premise that climate change and other ESG factors often are material to an investment's performance. *See* The White House Executive Order on Protecting Public Health and the Environment and Restoring Science to Tackle the Climate Crisis (Jan. 20, 2021) available at https://www.whitehouse.gov/briefing-

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Proposal is intended "to ensure that plans do not overcautiously and improvidently avoid considering material climate change and other ESG factors when selecting investments or exercising shareholder rights, as they might otherwise be inclined to do under the 2020 Rule.[5]

The ARA agrees that the Proposal would mitigate disincentives stemming from the 2020 Rule which discourage fiduciaries from considering climate change and other ESG factors as part of a prudent analysis. We believe that the Proposal's changes to the 2020 Rule generally reflect ERISA's core principles as applied to a fiduciary investment selection process. But we are concerned that the Proposal departs from well-established ERISA principle of deference to fiduciaries' judgment by implying that fiduciaries should consider a particular investment strategy. Interjecting any methodology to a fiduciary's prudent process is not supported by the statute, risks a response by a subsequent administration, raises prospects of increased litigation risk, and is not in the best interest of participants and beneficiaries. What's more, there is no clear agreement on nomenclature and analysis of climate change and other ESG concepts. Without uniformity in the relevant terminology, achieving compliance with the Proposal will be problematic for fiduciaries, and hence participants and beneficiaries as well. The ARA believes that the DOL should refocus the Proposal in more general terms and can do so while still effectively supporting policy goals.

Discussion

ESG Investments in Qualified Default Investment Alternatives (QDIAs)

The Proposal permits fiduciaries of participant-directed defined contribution plans to select QDIAs that include ESG investments as investment options. This is a significant change from the 2020 Rule, one that the ARA fully supports. We agree that the onerous limitations on ESG investments in QDIAs as set forth in the 2020 Rule should not be included in a final rule.

"Appropriate Considerations" under the Investment Duties Safe Harbor

The Proposal also would amend the 2020 Rule's safe harbor for investment prudence duties by adding language to the factors that fiduciaries are required to consider. Specifically, the Proposal adds to the factor the "projected return of the portfolio relative to the funding objectives of the plan," the qualifier: "***may often require*** an evaluation of the economic effects of climate change and other environmental, social, or governance factors on the particular investment or investment course of action." (Emphasis added). That is, the Proposal introduces an assumption that ESG

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room/presidential-actions/2021/01/20/executive-order-protecting-public-health-and-environment-and-restoring-science-to-tackle-climate-crisis/. *See* The White House Executive Order on Climate-Related Financial Risk (May 20, 2021) available at https://www.whitehouse.gov/briefing-room/presidential-actions/2021/05/20/executive-order-on-climate-related-financial-risk/.
[5] 86 Fed. Reg. at 57296.

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factors *usually*[6] are essential to a fiduciary's analysis of projected return – essentially underscoring their relevance even though, as the preamble states, climate change and other ESG factors are "no different" than other traditional material risk-return factors.[7]

The investment duties prudence safe harbor iterates the factors that must be considered in a fiduciary's investment analysis. These safe harbor considerations are unchanged since the regulation was promulgated in 1979. As originally proposed in 1978, the investment duties safe harbor provided that a fiduciary's consideration ***may*** include these same factors.[8] When finalized, the language was changed to provide that consideration of these factors is ***required***. The change was made "so as to indicate the factors which should under all circumstances be considered by any fiduciary who wishes to rely on the provisions of the rule,"[9] according to the DOL.

The ARA agrees that a fiduciary may determine that ESG factors are material to risk and return analyses and, *in these cases*, those factors should be viewed no differently than other relevant risk-return factors.[10] And while nothing in the Proposal gives fiduciaries license to pursue ESG objectives unmoored from or indifferent to an investment's underlying economic merits, ***the ARA is concerned*** that the phrase "may often require," included in the required considerations, taken together with the Proposal's preamble, strongly implies that fiduciaries not only have the option to consider ESG investments but ***should be*** considering climate change and other ESG factors.[11] As noted above, in the first iteration of the regulation in 1979, the DOL was clear that the factors set forth in the safe harbor regulation must be considered in all cases. By this logic, the Proposal would potentially shift the burden for fiduciaries from having to show why ESG investments are pecuniary in order to add them to the investment menu (as under the 2020 Rule) to requiring them to show why climate change and other ESG factors were *not* considerations in evaluating all of a plan's investment options (if they were not).

Whether or not shifting this burden was intended, based on our survey of plan sponsor and plan advisor stakeholders, that ARA firmly believes that the Proposal will be interpreted and applied this way. We cannot emphasize enough how sensitive these stakeholders are to possible litigation

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[6] "Often" means "many times; frequently." Synonyms include again and again, constantly, continually, frequently, hourly, much, oft, oftentimes (or ofttimes), over and over, repeatedly. *At Merriam-Webster.com/dictionary/often.*

[7] This is the justification offered for new paragraph (b)(4) of the Proposal and the examples thereunder ("This paragraph clarifies and confirms that a fiduciary may consider any factor material to the risk-return analysis, including climate change and other ESG factors…as no different than other "traditional" material risk-return factors, and to remove any prejudice to the contrary.") 57276. In fact, the DOL first acknowledged as early as 2015. *Field Assistance Bulletin 2018–01, citing Interpretive Bulletin 2015–01, now superseded.*

[8] 44 Fed. Reg. 37221, 37223, n.6 (June 26, 1979).

[9] *Id.*

[10] Some of MSCI's research shows different ESG factors being more or less impactful based on industry/sector and timeframe. *See* https://www.msci.com/www/research-paper/deconstructing-esg-ratings/01921647796.

[11] 86 Fed. Reg. 57276.

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risk.[12] Many members of the PSCA (one of ARA's five underlying affiliate organizations) who oversee larger plans view avoiding the risk of litigation as one the most important elements of prudently carrying out their fiduciary responsibilities. This means that any language, reasonably read, implying, or even suggesting a particular course or fiduciary approach will be perceived as a directive and will be reacted to as such. Further, as discussed in more detail below, it is not clear whether plan fiduciaries would be able to "evaluate" a sizable percentage of the plan investment options typically offered in a 401(k) plan for the economic effects of climate change and other ESG factors due to the lack of analytical tools and consensus around how to assess these factors as well as nomenclature. The ARA is concerned, due to perceived litigation risk, many plan fiduciaries will prophylactically eliminate longstanding investments options that participants have successfully relied upon and/or limit the investments considered for inclusion in the plan because practically, they cannot be adequately evaluated for such factors.[13] We strongly believe that the unintended consequence of limiting the investments available for inclusion in plans is not in the best interest of participants and beneficiaries, and therefore should be reconsidered.

As currently crafted, the proposed language in question represents a striking change from the DOL's original rulemaking on fiduciary investment duties without contemporaneous modifications of the underlying statute. In promulgating the first such rule, the DOL said it was not appropriate to include in the regulation any list of investments, classes of investment, or investment techniques that might be permissible under the "prudence" rule.[14] It added, "[n]o such list could be complete; moreover, the Department does not intend to create or suggest a 'legal list' of investments for plan fiduciaries." With these principles in mind, the ARA believes that the language currently proposed could make it vulnerable to challenge on ERISA principles and by a subsequent administration.

As principles-based standards, ERISA's fiduciary obligations require neutral application of loyalty and prudence to all investment decisions without favoring or disfavoring a particular investment strategy.[15] ERISA does not characterize particular considerations or investments as prudent or imprudent. Indeed, the prudent investor rule eschews presumptions for or against any particular type or kind of investment strategy or vehicle. ***The ARA strongly believes*** that a regulatory preference for investment theories that "often" evaluate climate-change and ESG considerations

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[12] After a steady increase in initiations of excessive-fee lawsuit, over 100 such suits were filed in Federal courts in 2020—a five-fold increase over the prior year—and many more in 2021, according to the U.S. Chamber of Commerce wrote in its amicus brief in In re Am. Nat'l Red Cross ERISA Litig., D.D.C., No. 1:21-cv-00541 (filed 8/23/21).
[13] Moreover, relative to many equity asset categories, fixed income categories are particularly likely to lack adequate ESG factors for evaluation, which could lead to decreased diversification in plan investment menus.
[14] 44 Fed. Reg. at 37225.
[15] 85 Fed. Reg. at 72858.

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contravenes ERISA's fundamental deference to fiduciaries' judgment.[16] We believe that neutrality should be the goal of a prudence and loyalty regulation and that the Proposal would inappropriately influence fiduciaries' judgment, mindful of the required nature of the safe harbor considerations. We believe that omitting the proposed new language (that consideration by a fiduciary of ESG factors "may often [be] required[d]") is more consistent with well-established principles of ERISA, and will more likely provide enduring policy, in service of participants and beneficiaries.

Discretionary ESG Considerations as Part of a Fiduciary's Prudence Analysis

The ARA recognizes that the central policy impetuses of the Proposal are "counteract[ing] negative perception of the use of climate change and other ESG factors in investment decisions" stemming from the 2020 Rule and "to clarify that a fiduciary's investment analysis may often require an evaluation of the effect of climate change and/or government policy changes to address climate change."[17] While we understand and appreciate this intent, we have concerns that the particular language of the Proposal may generate unintended negative outcomes.

The Proposal adds discretionary considerations to the "Investment Prudence Duties" with a new paragraph (b)(4). Using permissive language, this paragraph it provides that a fiduciary "*may consider*" the factors explicated in the paragraph's examples. This contrasts with considerations that fiduciaries are required to take into account under the safe harbor. The preamble explains the intent of this new paragraph is to establish that material climate change and other ESG factors are "no different" than other "traditional" material risk-return factors, and to remove prejudice to the contrary.[18]

The ARA agrees that fiduciary best practices do not preclude discretionary ESG considerations in an investment analysis. Indeed, including them may comport with a fiduciary's core obligations under ERISA depending on the relevant facts and circumstances. As with the "appropriate considerations" required for the safe harbor, we are concerned that by invoking discretionary ESG factors in the regulatory text, while at the same time emphasizing them in the preamble, the Proposal elevates these factors in a fashion that will likely, notwithstanding the intent for them to be merely exemplary, be seen as requiring their consideration by plan fiduciaries who are highly sensitive to litigation risk.

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[16] Whether any particular investment strategy is prudent depends on the facts and circumstances involved Adv. Op. 2006-08A (Oct. 2, 2006). ERISA prudence has been interpreted by DOL to mean that a plan fiduciary understands the complexity of an investment, its risks, and how it fits into the Plan's portfolio. Information Letter to Hon. Eugene A. Ludwig (March 21, 1996).
[17] 86 Fed. Reg. at 57276.
[18] 86 Fed. Reg. at 57279.

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Further, the ARA believes the inclusion of the ESG factors as examples in the regulatory language significantly increases the likelihood of further regulatory action. First, by distinguishing ESG factors as such, a subsequent administration may want to modify the Proposal merely for political reasons. More importantly, the definitions themselves may not remain accurate or comprehensive over time. After all, ESG investing is a relatively nascent concept. As discussed below, evaluation and nomenclature of such investments is still developing.

The Proposal's examples of ESG factors include climate change-related factors, governance factors, and workforce practices. However, the Proposal does not include other ESG-related themes commonly used, such as supply-chain practices including the use of child labor or suppressed-wage workers[19] or concepts relating to the ethical treatment of customers.[20] As ESG concepts continue to develop, the inclusion of some considerations but not others, risks the perception that evolving concepts should not be considered or are not sufficiently economic in nature.

Arguably, the definitions themselves contained in the Proposal already are limiting. For example, the Proposal references:

> Climate change-related factors, such as a corporation's exposure to the real and potential economic effects of climate change including exposure to the physical and transitional risks of climate change and the positive or negative effect of Government regulations and policies to mitigate climate change.[21]

This would seem to include the strategic impact of climate change on a corporation's operations and strategic planning. But is unclear whether it incorporates consideration of the impact the corporation itself has on the environment. For example, an automobile manufacturer may be changing its product line to put much greater emphasis on producing electric vehicles in response to Government regulatory policy, but it still may be viewed as a "polluter" by some environmental activists because, for instance, it uses coal-fired plants to build those electric vehicles. As discussed more fully below, such a corporation may be viewed differently by investment managers depending on their varying approaches to ESG. As a consequence, we suggest that the DOL modify paragraph (b)(4) as follows and reposition the examples as preamble discussion:

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[19] See 2020 MFS Sustainable Investing Annual Report, p. 15, discussing modern slavery as part of its thematic research, *at* https://tinyurl.com/yckp3pzu.

[20] *See* Calvert Fund Prospectus, dated February 1, 2021, Appendix A, The Calvert Principles for Responsible Investment, discussing, for example, respecting consumers by marketing products and services in a fair and ethical manner, maintaining integrity in customer relations and ensuring the security of sensitive consumer data (*attached as Exh. 1).*

[21] 86 Fed. Reg. at 57277.

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> A prudent fiduciary may consider any **economic** factor in the evaluation of an investment or investment course of action that, depending on the facts and circumstances, is material to the risk-return analysis.~~, which might include, for example:~~

Modified this way, the regulation would not explicitly name ESG factors but would establish that in a prudence analysis, a fiduciary may consider any economic factor which, in the fiduciary's judgment, is material to risk and return.[22] Examples of such economic factors – including climate change and other ESG factors – could appear in preamble discussion. Because economic factors which may be relevant to investment analysis very likely will change over time, this structure creates a dynamic rule that will endure.[23] As a flexible, principles-based standard that will not constrain fiduciaries' considerations to limited factors, it will stand the test of time.

The "Tiebreaker Rule" Is Not Compatible With Participant-Directed Investments

Plan sponsors and participants are increasingly interested in "ESG-type" investments.[24] However, approaches to ESG investing can vary significantly depending on the investment manager. In fact, there is not even agreement on the number of varying ESG investment strategies, which seem to range from three to as many as seven.[25] For example, Amundi Pioneer, an investment manager with a long history of ESG-type investing, describes four categories: Integrated, Thematic, Exclusion/Inclusion, and Impact Only.[26] "Integrated" investments are defined as strategies "that seamlessly blend ESG considerations with other fundamental insights to gain a more complete

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[22] We acknowledge that by adding the word "economic" before "factor" it might be suggested that we are merely replacing "pecuniary" with a different word. We believe the word is necessary to differentiate the ESG-related economic factors that are material to the risk-return analysis and the pantheon of other ESG factors that are arguably non-economic in nature but nonetheless would have an impact on such analysis (*see also* note 25). In our view, the former appropriately belong as part of the prudence safe harbor whereas the latter does not. For example, when looking at a company as a potential investment reviewing the company's governance model and compliance with government regulations would seem to be a fundamental economic factor as part of the risk-return analysis of the company. By contrast, a decision to exclude from a portfolio all companies, for example, that operate gambling casinos or participate in the gaming business is not an economic ESG factor per se but rather a "values-based decision" which will nonetheless have a material impact on the risk-return analysis of the portfolio.

[23] ARA considered the idea of expanding the list to include other economic factors such as inflation, interest rates, consumer confidence, etc., but ultimately concluded like the DOL did in its original rulemaking that "no such list would be complete" and, as already pointed out, the inclusion of some would raise doubt about what is not included.

[24] *See* ESG Investing Survey: Investors Want the Best of Both Worlds, *at* https://www.im.natixis.com/us/research/esg-investing-report-2019.

[25] *See, e.g.,* Deloitte, Sustainable Finance Disclosure Regulation, discussing seven categories, *at* https://tinyurl.com/2p84ee2u *and* Morningstar, SFDR: Four Months After Its Introduction, discussing the three categories outlined by the EU Sustainable Finance Disclosure Regulation (*attached as Exh. 2).*

[26] *See* Amundi Pioneer white paper (*attached as Exh. 3).*

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perspective on a company's business prospects."[27] This definition would seem to be comparable to the Proposal's example definitions.

"Exclusion/Inclusion" investments, by contrast, are defined as strategies "that seek to exclude companies with poor ESG ratings or overweight those with positive ratings without consideration of other factors." So, for example, a prospectus in discussing ESG investment policies might indicate that a fund generally will not invest in companies significantly involved in certain business activities like the production of controversial weapons, civilian firearms, and tobacco-related products[28] or the operation of gambling casinos or other gaming businesses.[29] None of these exclusions appear to be addressed in the ESG examples contained in the Proposal.

Assuming not, would they otherwise be considered economic factors or would they alternatively be viewed as values-driven factors? If the latter, then it would presumably be a question as to whether the investment satisfied the duty of loyalty prong of the safe harbor.

What's more, under the Proposal, after a prudent analysis (which may employ the ESG factors described in paragraph (b)(4)) if a fiduciary determines that "competing alternative investments equally serve the financial interests of the plan" they may select an investment based on "collateral benefits other than investment returns."[30] We are concerned that the phrase "equally serve the financial interests of the plan" does not practically reflect that nature of ESG investment considerations and may unduly constrain fiduciaries' choices. Further, given the sensitivities to litigation discussed previously, a plan fiduciary would likely conclude that if an investment alternative cannot be affirmatively shown to "equally" serve the financial interests of the plan, the Proposal precludes its selection.

The practical reality is that deviations in the financial features of an alternative ESG-type investment make it literally impossible to demonstrate that it is "equally serving" the interests of plan beneficiaries. In fact, pursuant to SEC regulations, funds that employ ESG investment strategies have to disclose the risk associated with such strategies, including the risk that the fund may underperform relative to a fund that does not utilize a similar responsible investment

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[27] For an example of another investment manager that takes an "Integrated' approach, *see* Lord Abbett, Responsible Investing Policy, providing that they "recognize that ESG factors can materially impact investments in the portfolios we manage," and "seek to analyze and understand ESG factors in order to properly assess both the risk and return potential of all investments.", *at* https://www.lordabbett.com/en/campaigns/esg-investing/responsible-investing-policy.html.
[28] See Prospectus for BlackRock Sustainable Advantage Large Cap Core Fund, dated December 1, 2021, p. 4 (*attached as Exh. 4)*.
[29] See Prospectus for Amundi Pioneer Fund, dated May 1, 2021, p. 4 (*attached as Exh. 5).*
[30] 86 Fed, Reg. at 57300.

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strategy.[31] As such, if it is at all unclear whether the strategy of an ESG investment is based on economic factors as opposed to values-driven factors, under the Proposal a prudent plan fiduciary would effectively be precluded from choosing it.

Is it DOL's intent for the Proposal to exclude relatively common ESG investments like these as 401(k) plan investment options? If so, the ARA would request that be made explicitly clear in the preamble. In our view, satisfying ERISA's fiduciary obligations requires a prudent process and analysis, but it should not, particularly in the context of a plan with participant investment direction, prioritize how closely two or more otherwise prudent investments theoretically might perform. The ARA believes that it is more appropriate for a "tie-breaker" provision, or perhaps better stated, an "alternative investment provision," to be focused on whether investment selections are the outcome of a prudent fiduciary process rather than on analysis of the equivalence of financial characteristics. As such, we suggest the following revised language:[32]

> If, after the analysis in paragraph (c)(2) of this section, a fiduciary prudently concludes that ~~competing~~ *alternative* investments, or ~~competing~~ *alternative* investment courses of action *that are based on non-economic criteria* ~~equally~~ *also* serve the financial interests of the plan over the appropriate time horizon, the fiduciary is not prohibited from selecting the alternative investment, or alternative investment course of action, based on ~~collateral benefits~~ *non-economic criteria* other than investment returns. However, if the plan fiduciary makes such a selection in the case of a designated investment alternative for an individual account plan, the plan fiduciary must ensure that the ~~collateral-benefit characteristic~~ *non-economic criteria* of the fund, product, or model portfolio is prominently displayed in disclosure materials provided to participants and beneficiaries. A fiduciary may not, however, knowingly accept expected reduced returns or greater risks when selecting such ~~additional benefits~~ *alternative investments*.

Modified as such, the language establishes that plan fiduciaries may consider non-economic factors – including ESG factors that are more "values-driven factors" in their plan investment decisions.[33]

ESG Nomenclature and Definitions

As 2021 comes to a close, interest in ESG strategies and products reportedly continues to grow, but as a data-driven strategy, ESG investing is still a relatively new concept. A central problem of

[31] *See, e.g.,* Calvert Fund Prospectus, dated February 1, 2021, p.7 (*attached as Exh. 1).*
[32] Suggested deletions are represented by strike-through text and additions as italicized and underlined terms.
[33] We recognize this approach may be more suitable in a defined contribution environment with participant investment direction where there would be a number of alternative investment options that may or may not include ESG considerations.

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its novelty is that consensus on common concepts and definitions is lacking, as is widely available data on ESG topics -- as suggested by the SEC's request for comment relating to the gap in standardization of climate-change investment terminology.[34] Furthermore, the industry lacks consistency in how to measure risk. For example, MSCI, a leader of ESG investing and rating, does not currently cover many fixed income funds (the portfolios must be >65% covered securities to be rated...does not cover securitized debt or sovereign debt, for example) or collective investment trusts (although individual holdings from the CIT manager could theoretically manually be collected and uploaded into the MSCI database). Morningstar covers some of these investments, however, the data is inconsistent. According to Morningstar, only 33% of JCBUX's (as an example) portfolio is used to calculate a Carbon Risk Score, whereas MSCI does not currently cover the fund at all.[35] Practically speaking, a plan sponsor would be reduced to measuring climate change and other ESG risks through qualitative analysis of the manager's assessment of climate change and other ESG factors on their portfolio. If the fund manager does not take those factors into consideration, is the investment still prudent? Why or why not? In the proposed rule, the cost assessment of incorporating and evaluating climate change and other ESG risks is assumed to be zero. While in the future, access to this data and coverage of investments may improve, today it would be a more manual process for plan sponsors and add additional cost through time and resources spent.

The SEC reportedly expects to unveil a proposed rule for climate risk disclosures by early 2022.[36] The agency has said that is intends to increase and improve the disclosures that public companies make to investors concerning ESG considerations generally and will have a strong focus on collecting data and assessing the regulatory burden on those charged with reporting. It will likely ask for companies to either make more ESG-related disclosures or explain why they have not.[37] The ARA believes that rules supporting common understandings of ESG investment terminology are necessary to facilitate prudent evaluations of investments by ERISA fiduciaries.

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[34] *Public Input Welcomed on Climate Change Disclosures, available at* www.sec.gov/news/public-statement/lee-climate-change-disclosures (March 15, 2021).

[35] As another example, using Sustainalytics (Morningstar) analysis, MFS Value shows a below category average Carbon Risk. Fossil fuel exposure for the fund is also listed slightly under category average. Using MSCI's Carbon Intensity rating, MFS Value rates as "High" and shows 0.00% fossil fuel based revenues. Carillon Eagle Mid-Cap Growth fund is another example. It is designated by Sustainalytics as a "Low Carbon" investment but MSCI lists it as a moderate Carbon Risk. In an MIT Sloan paper "Aggregate Confusion: The Divergence of ESG Ratings" analyzing different ESG rating systems, the authors found that based on data from six prominent rating agencies divergence in ESG scores stems from three areas: scope of category evaluated, weights of categories evaluated, and measurement of categories evaluated. Scope and measurement are found to be the primary drivers of inconsistency among providers. The overall correlation between ratings is on average 0.54 and range from 0.39 to 0.71. *See* https://tinyurl.com/mrezb65s.

[36] *See supra* note 34.

[37] https://www.sec.gov/rules/other/2020/ic-33809.pdf.

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Until then, required or presumed-required consideration of ESG factors by ERISA fiduciaries risks inconsistent results. Without commonly-accepted metrics for ESG factors to measure and evaluate ESG risks, compliance with a requirement or presumption that ESG factors usually are considered will be difficult and expose plans to increased litigation risk, generating increased costs to participants in defending frivolous litigation. Fiduciaries will be unreasonably challenged to comply with the Proposal's strong implication that they *should* be considering climate change and other ESG factors in selecting all plan investments.

Recommendations

In general, the ARA recommends that DOL develop neutral language clarifying that prudence does not preclude consideration of ESG factors, which are no different than other relevant risk-return factors. The language should establish that fiduciaries should be free to consider any factor that is, in their judgment, material to a risk-return analysis. The ARA's recommendations are as follows:

- **The final rule should permit ESG investments in participant investment alternatives and as QDIAs, as in the Proposal.**

- **The final rule should adopt an approach that reflects ERISA's longstanding principle of neutrality in the application of duties of loyalty and prudence regarding whether and how ESG factors are material in a fiduciary investment analysis by removing references to ESG factors from the regulatory text, instead relying on references to discretionary non-economic considerations. Specifically,**
    - **The Proposal, including preamble discussion, should be modified to eliminate the implication that prudent evaluations of investment options *often* involve consideration of ESG factors. This language implies that a prudence nearly always requires evaluation of ESG factors. This means that in paragraph (b)(2)(ii)(C) of the Proposal, the following language should be deleted: "which may often require an evaluation of the economic effects of climate change and other environmental, social, or governance factors on the particular investment or investment course of action;" and**
    - **The discretionary factors in proposed paragraph (b)(4) should eliminate the examples, which should be moved to preamble discussion.**

- **The tie-breaker provision should be modified to reflect the evolving diversity of ESG approaches and investments and to permit selection of an alternative investment based on non-economic criteria and not based on the untenable standard of *equally* serving the plan's financial interests.**

The ARA very much appreciates the DOL's commitment to safeguarding America's workers' interests in their workplace retirement savings plans. The ARA shares this goal and would welcome the opportunity to discuss our comments on the Proposal with you. Please feel free to contact Allison Wielobob, General Counsel, at AWielobob@USARetirement.org or (703) 516-9300.

Thank you for your time and consideration.

Sincerely,

/s/	/s/
Brian H. Graff, Esq., APM Executive Director/CEO American Retirement Association	Allison Wielobob General Counsel American Retirement Association