



Mr. Jason A. DeWitt
Office of Regulations and Interpretations
Employee Benefits Security Administration
Room N-5655
U.S. Department of Labor
200 Constitution Ave., N.W.
Washington, DC 20210

Mr. DeWitt:

Please accept this letter for the docket regarding Rule Number RIN 1210-AB95, Financial Factors in Selecting Plan Investments Proposed Regulation.

I write as president of the Institute for Pension Fund Integrity (IPFI), a non-profit organization deeply concerned about the security of pension benefits. The Institute seeks to ensure that local, state and federal leaders are held responsible for their choices regarding pension fund investing and that decisions are rendered according to strict adherence to the principles of fiduciary responsibility, not political ideation and opinion.

While our direct area of interest involves public pensions, we recognize that the Department of Labor often leads the way in public policy regarding all pensions through its authorities under ERISA. We applaud the Employee Benefits Security Administration for its proposed rule titled “Financial Factors in Selecting Plan Investments,” published in the Federal Register on June 30.¹ We believe, however, that the rule can be improved in several ways to secure its intended effect.

I should note at the outset that I have a deep background in finance and management, having served as Chief Financial Officer and Assistant Secretary of the U.S. State Department, Treasurer of the State of Connecticut, Under Secretary General for Management of the United Nations, and vice chairman of Deutsche (Bank) Asset Management

The Department Deserves Praise for Clarifying Its Position on ESG Investing

The IPFI congratulates you for tackling the task of clarifying the Department’s position on ESG investing, which, as you note, is a confusing and ill-defined term. We agree completely with your statement in the proposed rule:

The Department is concerned...that the growing emphasis on ESG investing may be prompting ERISA plan fiduciaries to make investment decisions for purposes distinct from providing benefits to participants and beneficiaries and defraying reasonable expenses of administering the plan.

¹ <https://www.federalregister.gov/documents/2020/06/30/2020-13705/financial-factors-in-selecting-plan-investments>

IPFI has watched in dismay as pension plan fiduciaries have strayed from their absolute responsibility to focus on a single goal: providing the highest risk-adjusted returns for their participants.

You have made it clear that plans are forbidden to make nonpecuniary investments. We embrace ESG as a tried and true tool of management by responsible companies, and certainly individuals are free to invest their personal portfolios in companies that elevate ESG values. But fiduciaries have a different obligation, a “duty of loyalty” to all of their beneficiaries. They cannot allow nonpecuniary preferences of any kind to influence investment decisions.

Citing legal precedents, you correctly state that the proposed regulation is designed “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-pecuniary objectives. The duty of loyalty—a bedrock principle of ERISA, with deep roots in the common law of trusts—requires those serving as fiduciaries to act with a single-minded focus on the interests of beneficiaries.”

Our own position, articulated in a 2018 white paper, is that “ESG investments should be made when they add value to a fund. When such investments will not improve the financial performance of the fund, or the decision to invest in them is based on political motives, they should be forgone.”²

The Proposed Rule Should Not Be Silent on Proxy Voting

While we are in sync with the Department in its position on ESG investing by pension funds, we were disappointed that the proposed rule was silent on the question of proxy voting.

The Employee Benefits Security Administration addressed proxy voting in its Field Bulletin No. 2018-01.³ That bulletin referred to an Interpretative Bulletin issued two years earlier and stated:

The [2016] IB was not intended to signal that it is appropriate for an individual plan investor to routinely incur significant expenses to engage in direct negotiations with the board or management of publicly held companies with respect to which the plan is just one of many investors.

Similarly, the IB was not meant to imply that plan fiduciaries, including appointed investment managers, should routinely incur significant plan expenses to, for example, fund advocacy, press, or mailing campaigns on shareholder resolutions, call special shareholder meetings, or initiate or actively sponsor proxy fights on environmental or social issues relating to such companies.

We believe that further clarification and expansion are required in the current proposed rule. We recommend that the Department expressly forbid ERISA fiduciaries from using plan resources to engage in ESG-related proxy voting or shareholder activism if these engagements do not

² <http://ipfiusa.org/wp-content/uploads/2018/09/IPFI-ESG-Paper.pdf>

³ <https://www.dol.gov/agencies/ebsa/employers-and-advisers/guidance/field-assistance-bulletins/2018-01>

enhance financial value for beneficiaries. Such language in the rule would be consistent with the position that the Department takes with nonpecuniary ESG investments.

The Proxy-Advisory System Is Badly Flawed

IPFI has been a strong supporter of reforming the current proxy-advisory system,⁴ one effect of which has been for the two firms that dominate that market pressure U.S. corporations to adopt ESG practices of questionable value.

An extensive 2018 study by Joseph Kalt, Ford Foundation Professor (Emeritus) of International Political Economy at the John F. Kennedy School of Government at Harvard University, and colleagues looked at shareholder proposals seeking disclosure of climate risks and then examined “statistically the reaction of each company’s stock price to a climate risk disclosure proposal that was...voted on at its annual shareholders’ meeting.”

The researchers concluded, “We do not find statistical support for the proposition that the adoption of shareholder resolutions seeking greater disclosure affects company returns one way or the other. Similarly, when we apply statistical analyses to the impact of voluntary disclosure of climate-related information on shareholder value, we do not find material support for the view that shareholder value is affected by disclosure.”⁵

The authors add, importantly:

Our results should not be taken to mean, however, that such resolutions are harmless. First, such proposals can often cost millions of dollars. Second, and perhaps of greater importance, such activism may open the door to the diversion of resources towards goals besides shareholder returns, with consequent harm to good corporate governance. It raises the question, for example, of which issues are to be considered “significant” by whom and, thus, warrant the use of management resources and consumption of corporate assets.

The fact is that the proxy-voting system, especially as it regards pension plans, has been abused by activists with no fiduciary responsibility and with undisclosed conflicts of interest that prevent sound advice for the nation’s pension and investment funds and retail shareholders.

Two companies, Institutional Shareholder Services (ISS) and Glass Lewis, comprise a duopoly in the market. Both firms are inclined to make recommendations on principles that promote environmental and social causes. Rather, their aim should be to provide the best risk-adjusted returns as fiduciaries must. IPFI explains its concerns about proxy advisors in the white paper, “ESG and the Proxy Process: What Does the Research Say?” The SEC last year proposed changes to proxy voting, seeking to reform a broken process.⁶ We recommend that the

⁴ <http://ipfiusa.org/2019/09/19/reformingtheproxyadvisoryfirmduopoly/>

⁵ https://corpgov.law.harvard.edu/wp-content/uploads/2018/06/ESG-Paper-FINAL_reduced-size-002.pdf A disclaimer states, “While the National Association of Manufacturers has provided financial support for this study, the authors have retained and exercised editorial control.”

⁶ <https://www.sec.gov/news/press-release/2019-232>

Department of Labor include similar changes to clarify the status of proxy advisors as fiduciaries.

We also agree with the conclusions of a study of the proxy-advisory system by the Spectrum Group.⁷ The study's leader, J.W. Verret of the George Mason University law faculty, concluded that pension plans and other institutional investors "should be able to establish a default voting process."

The SEC has been unclear on this point. The Commission has observed that there may be times when "refraining from voting a proxy is in the client's best interest, such as when the adviser determines that the cost of voting the proxy exceeds the expected benefit to the client."⁸ But the Commission has not explicitly permitted "funds to adopt voting policies that reflect the lack of value in many voting contests," writes Verret. "Asset managers should be able to adopt policies that eschew voting in general in instances of shareholder proposals, or adopt policies tailored to vote with management unless red flags listed by the fund's management are triggered (such as a recent restatement)."

While Verret's comments are aimed at the SEC, this is another case where the Department of Labor can assume a leadership position through changes in its current proposed ESG rule.

Quantifying Increased Returns from Rules Barring Nonpecuniary ESG Investments

We note that the Department appropriately focuses on the harm that the ESG investing can do to participants in pension plans. These are people that IPFI seeks to protect as well. They have worked all their lives to secure a stable retirement. Their assets must not be diverted to political or social purposes favored by plan fiduciaries.

This language, late in the proposed rule, is an excellent summary of the Department's intent:

To the extent that ESG investing sacrifices return to achieve non-pecuniary goals, it reduces participant and beneficiaries' retirement investment returns, thereby compromising a central purpose of ERISA. Given the increase in ESG investing, the Department is concerned that, without rulemaking, ESG investing will present a growing threat to ERISA fiduciary standards and, ultimately, to investment returns for plan participants and beneficiaries.

The Department then states that it needs assistance in quantifying higher returns from switching out of ESG funds and into traditional investments:

For the plans and participants that would be affected by a reduced use of nonpecuniary factors, the benefits they would experience from higher investment returns, compounded over many

⁷ [http://e09ef08898c431bcc4e7-](http://e09ef08898c431bcc4e7-11b950890bc8bd0c93487608b72ae520.r72.cf2.rackcdn.com/Exile%20of%20Main%20Street-%20A%20Spectrem%20Group%20Whitepaper%20Providing%20a%20Voice%20to%20Retail%20Investors%20on%20the%20Proxy%20Advisory%20Industry.pdf?_sm_au_=iVVq70QntN5n71QP01TfKK3Qv3fc4)

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⁸ <https://www.sec.gov/rules/interp/2019/ia-5325.pdf>

years, could be considerable. The Department seeks information that could be used to quantify the increase in investment returns. The Department also invites comments addressing the benefits that would be associated with the proposed rule.

While there have been numerous studies of ESG vs. traditional investing, many of them are flawed or biased. We endorse recent research by Wayne Winegarden of the Pacific Research Institute,⁹ (cited in the proposed rule in Footnote 15). Dr. Winegarden analyzed 18 ESG funds and found that an equally weighted portfolio of these funds would be 43.9% smaller over 10 years compared to an investment in a broader S&P 500 fund. Just two of the 18 funds beat the S&P over the 10 years.

In a simple comparison, as I write, the most popular ESG exchange-traded fund (ETF), iShares MSCI KLD 400, has trailed the SPDR S&P 500 Trust ETF by an annual average of 0.5 percentage points over the past 10 years (through July 8, 2020), a significant difference. An investment of \$10,000 made 10 years ago in the S&P 500 fund would be \$1,901 greater today than an investment in the ESG fund.¹⁰

Additionally, IPFI released a paper in May that looks deeper into the world's largest asset manager, BlackRock, and their recent ESG push. Not only do ESG funds produce less returns, but fund manager's push to ESG might have more to do with the fees they can charge than the idealistic, do-gooder motivation that some might think. "Index investing has become intensely competitive...ESG investing permits much higher fees (BlackRock's iShares Global Clean Energy ETF, one of the largest ESG funds in the world, carries an expense ratio 11 ½ times as great as the expense ratio for BlackRock's S&P 500 ETF.)"¹¹

ESG investing produces less return on investment and incurs much higher costs. Those are undoubtedly pecuniary factors that should dissuade the use of the ESG investing for investment plans. The threat that pension plans will be turned into political vehicles is pernicious. If individual investors want to tilt their portfolios in an ESG direction, that is their prerogative, but fiduciaries of pension plans have "duty of loyalty" to their beneficiaries, and ESG-style investment decision-making violates that bedrock principle.

I hope that the Department can improve its otherwise-excellent proposed rule to make beneficiary protections, including in the realm of proxy voting, inviolate.

Yours sincerely,

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⁹ <https://www.pacificresearch.org/new-study-finds-esg-funds-underperform-broader-investment-funds-over-long-term/>

¹⁰ <https://www.morningstar.com/etfs/arcx/spy/performance> and
<https://www.morningstar.com/etfs/arcx/dsi/performance>

¹¹ <https://ipfiusa.org/wp-content/uploads/2020/05/Behind-BlackRocks-ESG-Shift.pdf>

Enclosures:

- Barron's Op-ed by Chris Burnham: "[BlackRock's ESG Strategy Plays Politics with Public Pensions](#)" (May 28, 2020)
- IPFI Issue Brief: [Behind BlackRock's ESG Shift](#) (May 2020)
- IPFI Issue Brief: [SEC Rulemaking and What It Means for Proxy Advisory Firms](#) (January 2020)
- IPFI Issue Brief: [ESG and the Proxy Process – What Does the Research Say?](#) (April 2019)
- IPFI White Paper: [ESG Investing For Public Pensions: Does it Add Financial Value?](#) (September 2018)