

National Legal and Policy Center

"promoting ethics in public life"



Co-Founder
Ken Boehm 1949-2018

Board of Directors
Peter Flaherty, Chairman
Kurt Christensen, Vice-Chairman
Michael Falcone
Richard F. LaMountain
David Wilkinson

Since 1991

December 13, 2021

Office of Regulations and Interpretations
Employee Benefits Security Administration
Room N-5655
U.S. Department of Labor
200 Constitution Avenue, NW
Washington, DC 20210

ATTN: Prudence and Loyalty in Selecting
Plan Investments and Exercising
Shareholder Rights
RIN 1210-AC03

Re: NLPC Comments Opposing the Proposed Rule

Dear Sir/Madam,

The National Legal and Policy Center (NLPC) hereby submits these comments opposing the Department of Labor's Proposed Rule that would allow retirement plan fiduciaries under ERISA-covered retirement plans to consider environmental, social, and governance (ESG) factors in making investment decisions for employees' retirement funds as a means of promoting collateral social policy or goals.¹

As the former Deputy Secretary of Labor aptly characterized the proposed rule:

Virtue-signaling with other people's money is the icing on the cake of woke capitalism. Large sums of money accumulated from assembly-line workers, construction crews, independent contractors, and small-business owners are placed in the hands of fiduciaries who get to maximize risk rather than returns.²

¹ 86 Fed. Reg. 57272 (Oct. 14, 2021).

² Patrick Pizzella, *Protect Retirees from Woke Pension-Fund Managers*, National Review (June 10, 2021) <https://www.nationalreview.com/magazine/2021/07/01/protect-retirees-from-woke-pension-fund-managers>. See also Vivek Ramaswamy, *Woke, Inc. - Inside Corporate America's Social Justice Scam* (2021).

Interests of NLPC

NLPC is a nonprofit, public interest and policy center founded in 1991, whose overall mission is to promote ethics in public life. NLPC has a Corporate Responsibility Project that promotes integrity in corporate governance, including honesty and fair play in relationships with shareholders, employees, business partners and customers. In doing so, NLPC places special emphasis on the responsibility of the corporation to defend and advance the interests of the people who own the company, the shareholders, not someone else's political agenda.

In that regard, NLPC has over the years attended stockholder meetings as a shareholder to advocate the interests of shareholders and oppose calls by activists to advance one-sided special interests that are often hypocritical.³ In addition, NLPC filed comments earlier this year opposing the SEC's proposed Nasdaq's Board Diversity Rule, which was subsequently adopted as a final rule, as violative of constitutional and federal law prohibiting racial and gender quotas as well as a solution in search of a problem inasmuch as Nasdaq companies have become increasingly diversified.⁴

Comments

The Proposed Rule singles out certain ESG factors that a fiduciary may consider in the evaluation of an investment, which include:

- Climate change-related factors, such as a corporation's exposure to the real and potential economic effects of climate change, including its 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;
- Governance factors, such as those involving board composition, executive compensation, and transparency and accountability in corporate decision-making, as well as a corporation's avoidance of criminal liability and compliance with labor, employment, environmental, tax, and other applicable laws and regulations; and

³ See, e.g., *Flaherty Rips Alphabet/Google at Annual Meeting for Caving to 'Left-Wing Mob'* (June 19, 2019)

<https://nlpc.org/2019/06/19/flaherty-rips-alphabet-google-at-annual-meeting-for-caving-to-left-wing-mob/>; *Facebook Opposes Shareholder Proposal on Ideological Diversity* (May 28, 2019)

<https://nlpc.org/2019/05/28/facebook-opposes-shareholder-proposal-on-ideological-diversity/>; see also Letter to Editor from NLPC Chairman Peter Flaherty, Wall Street Journal (May 27, 2020) (criticizing Blackrock's CEO Larry Fink for disinvesting in fossil fuel companies but not China companies complicit in human-rights abuses, because neither Fink's "idea of moral and socially responsible investing nor that of his so-called "progressive" critics takes into account these human-rights issues."). <https://nlpc.org/2020/05/27/wall-street-journal-letter-poor-larry-fink/>

⁴ <https://www.nlpc.org/corporate-integrity-project/sec-approves-nasdaq-diversity-rule-over-nlpc-objections/>

- Workforce practices, including the corporation’s progress on workforce diversity, inclusion, and other drivers of employee hiring, promotion, and retention; its investment in training to develop its workforce’s skill; equal employment opportunity; and labor relations.

See 29 CFR 2550.404a–1 **Investment duties**. 83 Fed. Reg. 57302-03 (Oct. 14, 2021). Alden J. Bianchi, The Department of Labor’s ESG Proposed Rule: A Retirement Committee Perspective <https://www.mintz.com/insights-center/viewpoints/2226/2021-11-12-department-labors-esg-proposed-rule-retirement-committee>

As for Governance Factors, such as Board Composition and “workforce diversity,” inasmuch as those factors are mandated by government policies or rules, such as Nasdaq’s Board Diversity Rule, NLPC submits that those are impermissible ESG factors because they are unlawful racial or gender quotas and encourage tokenism.

More importantly, putting a thumb on the investment scales in favor of ESG funds or companies, fiduciaries violate their duty of loyalty and prudence to employees and retirees to maximize the financial return in their pension funds.

In that regard, NLPC endorses the excellent comments recently filed by Professor Edward A. Zelinsky of Benjamin N. Cardozo School of Law opposing the proposed rule.⁵ In his comments, Professor Zelinsky notes that:

ESG-investing is also unproven because the fundamental claims of ESG advocates are economically implausible. Such advocates purport to consistently outperform and override efficient markets. This claim is unconvincing.

ESG proponents assert that the person making an ESG investment is overriding the market’s allocation of resources to pursue a greater good. This assertion is unpersuasive. When a self-declared ESG-investor sells a stock in a competitive market, another investor without her qualms buys it. This is simply a game of musical chairs which, while it makes the ESG-investor feel better, shuffles ownership without altering the market-driven allocation of resources (footnote omitted).⁶

The notion that ESG funds and investments may be a good investment vehicle ignores not only their lackluster performance but also the hidden fees associated with investing in such funds. As former Deputy Secretary of Labor Patrick Pizzella noted:

We should all keep in mind that annual expenses for so-called sustainable exchange-traded funds (ETFs) are more than ten times higher than those for the cheapest index funds, according to the financial-services firm Morningstar. As Jason Zweig, a well-

⁵ file:///C:/Users/Owner/AppData/Local/Temp/00256.pdf

⁶ See also Ramaswamy, Woke Inc., Ch. 5, “The ESG Bubble” pp. 106-125.

respected financial analyst, recently wrote in the Wall Street Journal: “ESG is the last best hope for investment firms seeking to hang onto fat fees.”

The skeptics of ESG investing include a growing list of distinguished financial experts, such as Alicia Munnell, executive director of the Center for Retirement Research at Boston College (“I really have no respect for ESG investing”); Tariq Fancy, former chief investment officer for sustainable investing at BlackRock, the largest asset manager in the world (“The financial services industry is duping the American public with its pro-environment, sustainable investing practices. This multitrillion dollar arena of socially conscious investing is being presented as something it’s not. . . . In truth, sustainable investing boils down to little more than marketing hype, PR spin and disingenuous promises from the investment community”); and Securities and Exchange commissioner Hester Peirce (“The first issue is we don’t even know what ESG means”; “Not only is it difficult to define what should be included in ESG, but, once you do, it is difficult to figure out how to measure success or failure”).⁷

The Proposed Rule also is defective by endorsing the dubious concept of “tie-breaker,” namely, that fiduciaries, faced with two investments that ostensibly have the same investment profile, can opt to invest in an ESG product. In the first place, it is likely that fiduciaries will give more weight to ESG investments to the detriment of non-ESG investments. As Professor Zelinsky notes in his comments:

The proposed regulations improperly liberalize the rule of tie-breaking. DOL should instead abolish the notion of tie-breaking altogether. The rule of tie-breaking violates the rigorous duty of loyalty and thereby weakens protections for workers and retirees. The duty of loyalty requires exclusive concentration on participants’ welfare – even in the face of so-called “ties.”

Tie-breaking introduces into the fiduciary decisionmaking process a consideration – the pursuit of third party benefits -- which does not belong in that process. Fiduciaries desiring to seek third party benefits will, deliberately or inadvertently, be encouraged to declare ties to free themselves from the duty of loyalty (footnote omitted).

But even if there is truly a “tie” between an ESG and non-ESG investment with respect to the risk/reward potential, Professor Zelinsky notes that the solution is not to favor the ESG over the non-ESG investment:

If two investment alternatives are equally good choices, ERISA’s command to prudently diversify indicates that the plan trustee should buy some of each equally good alternative.

⁷ Patrick Pizzella, *Protect Retirees from Woke Pension-Fund Managers*, National Review (June 10, 2021) <https://www.nationalreview.com/magazine/2021/07/01/protect-retirees-from-woke-pension-fund-managers>

If 100 common shares of Corporation A are exactly equivalent to 100 common shares of Corporation B, the trustee should buy 50 shares of each. In the rare case where the trustee cannot diversify in this fashion among equivalent choices, it is better for the fiduciary to flip a coin rather than introduce into the fiduciary decisionmaking process consideration of collateral benefits (footnote omitted).

More importantly, NLPC is concerned that the employees and retirees will not be given the opportunity to meaningfully consent to such ESG investments. While maximum disclosure of the ESG investment should be required, that is a necessary but not sufficient process for getting informed consent. The Proposed Rule seems to adopt a negative opt-out, whereby if the investor does not affirmatively reject or opt-out of the investment, it is presumed that the investor approves the ESG investment. NLPC submits that the proposed rule should require an affirmative consent by the holders of the account. That affirmative “opt-in” process is preferable as a matter of public policy since it requires informed consent in this and other contexts where consumers are unaware that they have been unwittingly charged with goods and services they did not want.

Conclusion

For the foregoing reasons, NLPC urges that the Proposed Rule not be adopted. In the alternative, it should be amended to eliminate the “tie-breaker” provision as suggested by Professor Zelinsky. Furthermore, there should be maximum disclosure of ESG investments to employees and pensioners with an affirmative opt-in requirement evidencing their consent to such investments.

Sincerely,



Paul D. Kamenar, Esq.
1629 K Street, N.W.
Suite 300
Washington, D.C. 20006
paul.kamenar@gmail.com
301-257-9435
Counsel to NLPC