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Comment of Proposed Department of Labor Regulations on ESG Investing, Prudence and Loyalty

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Office of Regulations and Interpretions
Employee Benefits Security Administration
Room N-5655
U.S. Department of Labor
200 Constitution Avenue, NW
Washington, DC 20210
ATT: Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights

RIN 1210-AC03

Sent by Express Mail and electronic submission

Dear sir/madam:

By way of identification, I am the Morris and Annie Trachman Professor of Law at the Benjamin N. Cardozo School of Law of Yeshiva University.[1] I teach and write in the areas of trusts, estates, pensions, and employee benefits including the Employee Retirement Income Security Act of 1974 (ERISA). I hereby comment upon the regulations proposed by the Department of Labor (DOL) on October 14, 2021 to amend and restate 29 CFR § 2550.404a-1.[2]

These proposed regulations address ERISA's fiduciary duties

[1] Neither the Cardozo Law School nor Yeshiva University has reviewed, approved or authorized this testimony or otherwise endorses my comments. I prepared these comments for no client. The views expressed herein are my own personal opinions. In the interests of full disclosure, I also note that I serve as a member of the board of directors of the Connecticut Retirement Security Authority (CRSA). CRSA has not reviewed, approved or authorized this testimony or otherwise endorses my comments.

[2] 86 Fed. Reg. 57272 (Oct. 14, 2021).

of loyalty and prudence. Pursuant to these stringent duties, fiduciaries must exclusively and prudently pursue pecuniary benefits for plan participants and beneficiaries.

The proposed regulations are flawed in four respects. These flaws weaken the duties of prudence and loyalty and thereby jeopardize the retirement assets of America's workers and retirees.

First, the proposed regulations misapply the prudence standard by embracing the "ESG" label which is too new and unproven to be deemed prudent. Prudent investing is cautious and conservative. ESG, as an investment category, lacks sufficient experience to be declared prudent. ESG-investing is unproven as the fundamental claims of ESG advocates are economically implausible. Such advocates purport to consistently outperform and override efficient markets. This claim is unconvincing.

Second, the "ESG" label is ambiguous and often insubstantial. The term "ESG" is too imprecise to provide useful regulatory guidance to ERISA fiduciaries. When the proposed regulations attempt to provide more focused content to the ESG concept, they demonstrate that the ESG concept often lacks any substantial meaning.

Third, the one-sided examples of the proposed regulations will foster misperceptions of ERISA's fiduciary duties. The proposed regulations will thus do what the DOL criticizes its 2020 rule for doing, i.e., promoting misperceptions of ERISA fiduciaries' duties. The unbalanced examples of the proposed regulations will be read by zealous ESG advocates as supporting an overly-expansive notion of the ESG investments ERISA fiduciaries are permitted to make. More balanced drafting with more even-handed examples is needed to minimize the misperception of the proposed regulations as being more generous than they are.

Fourth, the proposed regulations improperly perpetuate and liberalize the unpersuasive canon of "tie-breaking," a canon which violates ERISA's fiduciary duty of loyalty. Under the tenet of "tie-breaking," "ties" among otherwise equivalent investment choices encourage ERISA fiduciaries to pursue collateral, third party benefits otherwise prohibited by the duty of loyalty. However, the duty of loyalty requires *exclusive* consideration of participants' welfare – even in the face of so-called "ties." Under the proposed regulations, fiduciaries desiring to pursue otherwise proscribed collateral benefits will, deliberately or inadvertently, be encouraged to declare ties to free themselves from the duty of loyalty and its prohibition on the pursuit of third party benefits. Contrary to the teaching of the proposed regulations, the duty of loyalty is not suspended in the presence of "ties."

These flaws, by attenuating the duties of prudence and loyalty, jeopardize the retirement assets of workers and retirees. Accordingly, the proposed regulations should be amended to delete the imprudent, unproven and ambiguous term "ESG," to add more balanced examples which reduce misperceptions of ERISA's fiduciary duties, and to expunge altogether the concept of tie-breaking which violates the duty of loyalty by encouraging the pursuit of collateral benefits.

Background

ERISA § 404(a)(1)[3] imposes upon employee benefit plan fiduciaries the duties of prudence and loyalty. These stringent statutory duties derive from the common law duties[4] that trustees must act prudently and loyally to solely serve beneficiaries' interests.[5] As a loyal fiduciary, an ERISA trustee must

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[3] 29 U.S.C. § 1104(a)(1).

[4] *Tibble v. Edison International*, 575 U.S. 523, 528 (2015) ("We have often noted that an ERISA fiduciary's duty is derived from the common law of trusts.") (internal quotation marks deleted); *Central States, Southeast & Southwest Areas Pension Fund v. Central Transport, Inc.*, 472 U.S. 559, 570-571 (1985) ("under ERISA...Congress invoked the common law of trusts to define the general scope of [fiduciaries'] authority and responsibility."); John H. Langbein, David A. Pratt, Susan J. Stabile and Andrew W. Stumpff, PENSION AND EMPLOYEE BENEFIT LAW 475-476, 507-508 (6th ed. 2015); Lawrence A. Frolik and Kathryn L. Moore, LAW OF EMPLOYEE PENSION AND WELFARE BENEFITS 308-309 (3rd ed. 2012).

[5] The "principle of undivided loyalty" to the beneficiary is "fundamental" to trust law. Restatement 3d of Trusts, § 78, General Comment a. "Trust law frames the duty of *loyalty* as a `sole' interest rule..." Robert H. Sitkoff, *Fiduciary Principles in Trust Law*, in Evan J. Criddle, Paul B. Miller, and Robert H. Sitkoff (eds.), THE OXFORD HANDBOOK OF FIDUCIARY LAW 41 (2019). See also Internal Revenue Code § 401(a), 26 U.S.C. § 401(a) (qualified plan and trust are "for the exclusive benefit" of employees and their beneficiaries); Stewart E. Sterk and Melanie B. Leslie, ESTATES AND TRUSTS: CASES AND MATERIALS 673-674 (6th ed. 2019).

"discharge his duties with respect to a plan *solely* in the interest of the participants and beneficiaries"[6] "for the *exclusive* purpose of...providing benefits to participants and their beneficiaries."[7] An ERISA fiduciary must also act "with the care, skill, prudence, and diligence...[of] a prudent man."[8] As the Restatement of Trusts declares, the standard of prudence has "substantive content"[9] that impels "caution"[10] and "conservatism"[11] when fiduciaries invest.

Under the banner of "economically targeted investing" (ETI), the DOL has encouraged the deployment of ERISA-regulated funds to pursue alleged third party economic benefits.[12] ETI is often justified on the ground that ERISA fiduciaries confront economically equivalent investment choices. In the face of such "ties," it is argued, the pursuit of third party benefits can serve as the tie-breaking consideration.

In response, critics (myself included[13]) observe that a fiduciary's pursuit of third party benefits under the ETI banner violates the stringent duty of loyalty. Similarly, the duty of loyalty is violated when third party benefits are used to break

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[6] ERISA § 404(a)(1), 29 U.S.C. § 1104(a)(1) (emphasis added).

[7] ERISA § 404(a)(1)(A)(i), 29 U.S.C. § 1104(a)(1)(A)(i) (emphasis added).

[8] ERISA § 404(a)(1)(B), 29 U.S.C. § 1104(a)(1)(B).

[9] Restatement of Trusts (3rd) § 90, comment f.

[10] *Id.* at § 90a and comment e.

[11] *Id.*, comment e(1).

[12] Albert Feuer, *Ethics, Earnings, and ERISA: Ethical-Factor Investing of Savings and Retirement Benefits*, NEW YORK UNIV. REV. OF EMPLOYEE BENEFITS AND EXECUTIVE COMPENSATION § 6.03[4] (2020, David Pratt, ed.); Edward A. Zelinsky, *Economically Targeted Investments: A Critical Analysis*, 6 KANSAS J. OF LAW & PUBLIC POLICY 39 (1997); Edward A. Zelinsky, *ETI, Phone the Department of Labor: Economically Targeted Investments, IB 94-1 and the Reincarnation of Industrial Policy*, 16 BERKELEY J. OF EMP. AND LAB. LAW 333 (1995).

[13] *Id.*

"ties." ERISA's duty of loyalty is an exacting obligation to exclusively pursue the retirement savings interests of plan participants and beneficiaries. This duty commands that an ERISA fiduciary's "decisions must be made with an eye single to the interests of the participants and beneficiaries"[14] – to the exclusion of other agendas, as commendable as those agendas might otherwise be. Alleged "ties" do not permit a trustee to take into consideration third party benefits in violation of the trustee's demanding duty of loyalty.

Reinforcing the message of this critique, the U.S. Supreme Court has unanimously confirmed that ERISA requires fiduciaries to exclusively pursue pecuniary, "financial" benefits for plan participants and beneficiaries.[15]

ESG funds are today typically marketed like ETI has been promoted, i.e., as investments which generate third party benefits for the environment and social justice.[16] Insofar as the ESG label is used in this fashion, it is subject to the same criticism as ETI: The duty of loyalty requires an ERISA trustee to maximize exclusively financial benefits for ERISA participants and beneficiaries, not to pursue another agenda as worthy as that agenda may be.

In apparent recognition that the duty of loyalty prohibits the pursuit of third party benefits, ESG proponents often argue that ESG investments consistently produce higher rates of return. The proposed regulations have obviously been influenced by this economically implausible argument.

It is important to separate an ERISA trustee's personal views from her fiduciary obligations as a trustee.[17] In her role

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[14] *Donovan v. Bierwirth*, 680 F.2d 263, 271 (2nd Cir. 1982).

[15] *Fifth Third Bancorp v. Dudenhoeffer*, 573 U.S. 409, 420-421 (2014) (emphasis omitted).

[16] See, e.g., Sustainable Investing at Schroders: Beyond Profit ("impactIQ is our set of tools that aims to measure the impact that companies have on society and the environment. They examine the externalities of companies..."); John Hancock Investment Management, jhinvestments.com/esg ("Making a difference in the world").

[17] Edward A. Zelinsky, *Is Bitcoin Prudent? Is Art Diversified? Offering Alternative Investments to 401(k)*

as a citizen and as a private investor of her own personal funds, an individual is free to favor any policies she wants to pursue. But when that individual serves as an ERISA-regulated trustee, the legal rules change because she is then investing, in Louis Brandeis' famous phrase, "other people's money."[18] In these and similar contexts, the law, including ERISA, imposes upon fiduciaries stringent obligations of loyalty and prudence to constrain the exercise of discretion and to focus the trustee's decisionmaking exclusively upon economic benefits for plan participants and beneficiaries.

DOL characterizes the proposed regulations as a response to the rule which the DOL itself issued in 2020. This 2020 rule, DOL now says, "created... uncertainty"[19] about the proper use by an ERISA fiduciary of ESG considerations when making investment decisions. The result, DOL states, is "a chilling effect" on proper fiduciary decisionmaking,[20] "putting a thumb on the scale against the consideration of ESG factors."[21] The 2020 rule, we are told, created misperceptions.[22] Of particular concern to DOL in this context is "climate-related financial risk."[23] The proposed regulation, DOL tells us, "is intended to counteract negative perception of the use of climate change and other ESG factors in investment decisions caused by the 2020 Rules."[24] "[T]here could be instances when ESG issues present material

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Participants, 54 CONN. L. REV. ___ (forthcoming), Cardozo Legal Studies Research Paper No. 643, Available at SSRN: https://ssrn.com/abstract=3825199 at pages 8-9, 17, 52, 56, 59.

[18] Louis Brandeis, OTHER PEOPLE'S MONEY AND HOW THE BANKERS USE IT (1914).

[19] 86 Fed. Reg. 57275.

[20] *Id.* ("the Department believes there is a reasonable basis for these concerns.").

[21] *Id.*

[22] *Id.* at 57279.

[23] *Id.* at 57276 and *id.* at 57289 ("climate change as a material risk-return factor").

[24] *Id.* at 57276. *See* Prop. Reg. § 2550.404a-1(b)(4)(i), 86 Fed. Reg. 57302 ("Climate change-related factors").

business risk or opportunities."[25]

ESG is Too New and Unproven to Be Deemed Prudent

As the Restatement of Trusts declares, the standard of prudence has "substantive content"[26] that impels "caution"[27] and "conservatism"[28] when fiduciaries invest. Trendy is not prudent. Tulips, the Bitcoins of the 17th century,[29] were fashionable but were never prudent. Widely-accepted investments which are today prudent were once new, novel and thus not yet prudent. It took time for these investments to achieve the broad acceptance which makes them prudent today.

For example, mutual funds[30] and real estate investment trusts[31] are now prudent investment categories because they have stood the test of time. But it takes time to satisfy the test of time. Modern portfolio theory is not so modern any more which is why it is today prudent.[32] It too has stood the test of time to today be substantively conventional and cautious.

"[C]oncern over ESG is a relatively new phenomenon coming to the fore during the past 10 years or so."[33] In comparison with

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[25] *Id.* at 57274.

[26] Restatement of Trusts (3rd) § 90, comment f.

[27] *Id.* at § 90(a) and comment e.

[28] *Id.*, comment e(1).

[29] Shan Li, *Rare Plant Market Grows In Pandemic – Greenery attracts flippers, thieves; "it's too crazy,"* WALL ST. J. (Sept. 19, 2020) A1 ("The 1600s had the Dutch tulip market bubble."); Christian C. Day, *Risky Business: Popular Images and Reality of Capital Markets Handling Risk – From the Tulip Craze to the Decade of Greed,* 133 PENN. ST. L. REV. 461, 463-474 (2008).

[30] Zelinsky, *supra*, note 17 at page 6.

[31] *Id.* at pages 9, 32-35.

[32] Langbein, et al., *supra*, note 4, at 554-558.

[33] Bradford Cornell and Aswath Damodaran, *Valuing ESG: Doing Good or Sounding Good?* (March 20, 2020) available at https://ssrn.com/abstract=3557432 at 13.

other investment vehicles which have stood the test of time, ESG is too new and unproven to be deemed prudent as an investment category.

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.[34]

The other major claim of ESG advocates is that ESG investing, with its often high fees[35] and active management, can consistently outperform competitive markets. This claim too is also economically unpersuasive. If a corporation's superior governance or more humane labor practices improve a corporation's financial prospects, the corporation's stock price will capture that projected income. A conventional, passive investment device,

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[34] Edward A. Zelinsky, *The Continuing Battle Over Economically Targeted Investments: An Analysis of DOL Interpretative Bulletin 2015-01*, 2016 CARDOZO L. REV. DE NOVO 161, 169-170, reprinted in Kathryn J. Kennedy (ed.), NEW YORK UNIVERSITY REVIEW OF EMPLOYEE BENEFITS AND EXECUTIVE COMPENSATION (2017); Max M. Schanzenbach and Robert H. Sitkoff, *Reconciling Fiduciary Duty and Social Conscience: The Law and Economics of ESG Investing by a Trustee*, 72 STAN. L. REV. 381, 399 (2020).

[35] Rebecca Moore, Morningstar Finds ESG Funds Are More Expensive Than Conventional Funds (Oct. 26, 2021). https://www.planadviser.com/morningstar-finds-esg-funds-expensive-conventional-funds/. See also Cornell and Damodaran, *supra*, note 33 at 22 ("The potential to make money on ESG for consultants, bankers and investment managers has made them cheerleaders for the concept, with claims of the payoffs based on research that is ambiguous and inconclusive"). The DOL repeatedly states that the proposed regulations reflect the views of "stakeholders." See, e.g., 86 Fed. Reg. 57275, 57277, 57279 and 57280. It appears that such "consultants, bankers and investment managers" were among the stakeholders who influenced the proposed regulations.

such as a low fee index fund, will reflect that increased value without invoking the ESG label and without paying fees for ESG investing services. As Justice Breyer noted for a unanimous court,[36] "a major stock market . . . provides the best estimate of the value of the stocks traded on it." It is implausible that ESG funds will consistently outperform competitive markets in which prices efficiently reflect corporations' projected earnings including anticipated income stemming from so-called ESG factors.

The DOL itself acknowledges that much evidence finds "that ESG investing has resulted in lower returns"[37] while other studies about ESG investing are "mixed or inconclusive."[38] In this same vein, Professors Cornell and Damodaran conclude "that the evidence that markets reward companies for being `good' is weak to non-existent."[39] This confirms that it is at best premature to be incorporating the unproven ESG label into DOL's ERISA regulations concerning the duty of prudence.

The Ambiguity and Insubstantiality of the ESG Label

The "ESG" label is ambiguous and often insubstantial. Is ESG investing about doing good by the world or about doing good for the trustee's beneficiary? When firms market their (often high fee[40]) ESG products, this tension is typically ignored by claiming to do both. As a result, the term "ESG" is often ambiguous, a talisman with little substantive content.

Consider, for example, investments in nuclear power. Do these qualify as ESG investments since nuclear power doesn't send carbon into the air? Or should an ESG investor eschew nuclear power because of such power's own risks? The imprecise ESG label does not resolve this inquiry.

Some investment vehicles are, DOL states with apparent

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[36] *Fifth Third Bancorp v. Dudenhoeffer*, 573 U.S. 409, 427 (2014) (internal quotations and citations omitted).

[37] 86 Fed. Reg. 57290.

[38] *Id.* at 57291.

[39] Cornell and Damodaran, *supra*, note 33 at 19.

[40] Rebecca Moore, *supra,* note 35.

approbation, “ESG-themed.”[41] This kind of marketing label lacks objective content. Any fund can call itself an “ESG” investment, particularly to justify its active management and correspondingly high fees.

Illustrating “the inherent subjectivity of the ESG rubric,” Professors Schanzenbach and Sitkoff pose the quandary presented by “an environmentally sound firm” with “weak corporate governance” or which “mistreat[s] its workforce.”[42] “[I]s such a firm a good or a bad ESG bet?” they ask.[43]

Legal standards often raise difficult interpretative issues. But the failure of the ESG label to solve basic questions indicates that, in the ERISA context at least, that label lacks substantive content.

DOL’s attempt to provide clarifying detail reveals how often the ESG label is insubstantial, adding nothing to the traditional rules of prudence and loyalty. For example, implementing its concern about climate change, the DOL tells us that an investor should consider such possibilities as “wildfires, and flooding.”[44] This tells us nothing new. A prudent fiduciary making a real estate investment has always been concerned with the kind of neighborhood in which the property is located. Labeling this conventional concern as “ESG” may be trendy, but it illuminates nothing new.

Consider, as well, the DOL’s argument that a prudent ESG investor favors “a shift from carbon-intensive investments.”[45] In my capacity as a citizen, I strongly favor a stiff carbon tax and have driven a hybrid car for the last 16 years. But an ERISA-fiduciary who acted on DOL’s ESG-based investment advice this

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[41] 86 Fed. Reg. 57294; *id.* at 57297.

[42] Schanzenbach and Sitkoff, *supra*, note 34 at 430.

[43] *Id. See also* Cornell and Damodaran, *supra*, note 33 at 2 (“a ranking of companies from good to bad by Greenpeace bears little resemblance to a listing of good and bad companies by a group focused on labor rights.”); Allysia Finley, *How Did Activision Pass the ESG Test?* THE WALL STREET JOURNAL (Nov. 26, 2021) page A15.

[44] 86 Fed. Reg. 57276.

[45] *Id.* at 57277.

last year disserved her beneficiaries as fossil fuel stocks have outperformed other stocks.[46]

In short, the DOL was right to delete the term "ESG" when it finalized the 2020 rule. That term is ambiguous[47] and often lacks any substantial meaning. Incorporating that imprecise and insubstantial term into the DOL regulations weakens the protection of the retirement assets of workers and retirees.

The One-Sided Examples of the Proposed Regulations Will Encourage Misperceptions

The DOL now criticizes its 2020 rule for encouraging misperceptions of ERISA's fiduciary duties. Its 2020 rule, the DOL tells us, has "been interpreted as putting a thumb on the scale against" the consideration of ESG factors.[48] As a result, "many stakeholders misperceive" their legal authority and responsibilities.[49] DOL characterizes its proposed regulations as clarifying the rule which the DOL itself issued in 2020, a rule which "may have led to a misunderstanding among some..."[50]

This same criticism of creating misperceptions applies to the proposed 2021 regulations. As drafted, these proposed

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[46] Jeff Sommer, *The Planet Is Warming, but Coal Is on Fire*, THE NEW YORK TIMES (Oct. 24, 2021) § BU, page 4; Amrith Ramkumar, *Climate-Focused Investors Miss Oil-and-Gas Rally*, THE WALL STREET JOURNAL (Oct. 25, 2021) page A1.

[47] Schanzenbach and Sitkoff, *supra,* note 34 at 388 ("ESG investing resists precise definition") and at 397 ("inherently ambiguous").

[48] 86 Fed. Reg. 57294.

[49] *Id.* at 57279. See also *id.* ("created a blanket perception"), *id.* at 57275 ("created a perception"), *id.* at 57288 ("had a chilling effect"), *id.* ("the negative perception"), *id.* ("doubt caused by the current regulation") *id.* ("unwarranted concerns"), *id.* ("ambiguity or uncertainty, resulting from the Department's prior guidance."), *id.* ("uncertainty"), *id.* at 57289 ("many stakeholders continue to have confusion or doubt on the matter") and *id.* ("lingering uncertainty").

[50] 86 Fed. Reg. 57292. See also *id.* at 57285 ("Responses to the 2020 rules, however, suggest that the new rules may have inadvertently caused more confusion than clarity.").

regulations, with their one-sided examples, will be read by zealous ESG advocates as supporting an overly-expansive approach to ESG investing. The proposed regulations do what the DOL criticizes the 2020 rule for doing, i.e., encouraging misperceptions of ERISA's fiduciary duties. More balanced drafting including more even-handed examples is needed to minimize the misinterpretation of the proposed regulations as being more generous than they are.

In the proposed regulations, every example of a factor "material to the risk-return analysis" involves a so-called "ESG" consideration.[51] While the DOL admits that "ESG factors are [not] material in every instance,"[52] the proposed regulations contain no example when this is so. The unbalanced nature of these examples creates the same possibility for which the DOL now criticizes its 2020 regulations, i.e., creating misperceptions. The unbalanced examples of the proposed regulations will foster an overly-expansive notion of the prevalence of ESG factors.

The one-sided examples of the proposed regulations cite not a single instance of a nonESG factor which makes an investment prudent, e.g., that a company makes good products or has a compelling strategy for the future or has excellent cost controls. Examples along these lines are needed for balance.

A careful reading of the proposed regulations leads to a more nuanced understanding. But that was also true of the 2020 rule. A subtext of DOL's criticism of the 2020 rule is implicit concern for how casual or skittish readers may perceive the import of administrative pronouncements. Under that standard, the proposed regulations suffer from the same malady do as the 2020 rule: Many casual and risk-averse readers of the proposed regulations and their one-sided examples will infer from that one-sidedness that all ESG factors are relevant to prudent investment decisions, that only ESG factors are relevant to prudent investment decisions, and that ESG investing is mandatory for ERISA fiduciaries.

Such misperception can best be eliminated by deleting from the proposed regulation the ambiguous, unproven and imprudent ESG moniker. If DOL will not go this far, misperception can be minimized by pruning the examples of the proposed regulations and

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[51] See proposed regulation § 2550.404a-1(b)(4) at 86 Fed. Reg. 57302-57303.

[52] 86 Fed. Reg. 57290.

by adding counterbalancing examples. These additional examples should illustrate when it is not prudent to consider so-called ESG factors as well as add illustrations of economically material nonESG investment factors, e.g., good products, compelling corporate strategy, tight cost controls. In the absence of these kinds of illustrations, the one-sided examples of the proposed regulations may cause a casual or risk-averse reader to misperceive that ESG factors are always relevant, that nonESG factors are of minimal import, and that ESG investing is mandatory.

Tie-Breaking Violates the Duty of Loyalty

The proposed regulations improperly liberalize the rule of tie-breaking.[53] DOL should instead abolish the notion of tie-breaking altogether.[54] 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*[55] 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.

The rule of tie-breaking invites a fiduciary who wants to pursue collateral benefits to declare a tie to relieve himself of his obligation of loyalty to the plan's participants and beneficiaries. Even if a fiduciary is not consciously aware of this proclivity, the lessons of behavioral economics[56] suggest

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[53] *Id.* at 57279 ("proposed broadening" of the tie-breaking rule) and *id.* at 57289 ("a formulation that is intended to be broader"). See proposed regulation § 2550.404a-1(c)(3) at 86 Fed. Reg. 57303.

[54] Zelinsky, *supra,* note 34 at 165-169; Schanzenbach and Sitkoff, *supra,* note 34 at 408-411.

[55] ERISA § 404(a)(1)(A), 29 U.S.C. § 1104(a)(1)(A) (emphasis added).

[56] In vocabulary which has become widely accepted, decisionmakers are perceived to be affected by the way possible

that fiduciaries may be "nudged" to find ties among investment alternatives so that they can pursue third party benefits as the tie-breaking consideration.

The stringent duty of loyalty precludes the deliberate or inadvertent pursuit of third party benefits. The exacting terms used to describe that duty – "exclusive,"[57] "solely,"[58] "undivided loyalty"[59] – forbid consideration of third party benefits, even in the face of so-called ties.

If two investment alternatives are equally good choices, ERISA's command to prudently diversify[60] indicates that the plan trustee should buy some of each equally good alternative. 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.

The DOL tells us that the proposed regulations embody "a more flexible version of the tie-breaker concept."[61] This suggested liberalization of the tie-breaking rule moves the regulations in the wrong direction by attenuating the protection of retirement assets. ERISA fiduciary "decisions must be made with an eye single to the interests of the participants and

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decisions are "framed." Framing "nudges" decisionmakers to particular outcomes. Permitting consideration of third party benefits in the case of "ties" frames the investment decision in a way which nudges the fiduciary to find "ties" so she can consider third party benefits. *See* Cass R. Sunstein, THE ETHICS OF INFLUENCE: GOVERNMENT IN THE AGE OF BEHAVIORAL SCIENCE 5-6 (on nudging) and 116-117 (on framing) (2016); Margot E. Kaminski and Guy A. Rub, *Copyright's Framing Problem*, 64 UCLA L. REV. 1102 (2017); Jessica L. Roberts, *Nudge-Proof: Distributive Justice and the Ethics of Nudging*, 116 MICH. L. REV. 1045 (2018).

[57] ERISA § 404(a)(1)(A), 29 U.S.C. § 1104(a)(1)(A).

[58] ERISA § 404(a)(1), 29 U.S.C. § 1104(a)(1).

[59] Restatement 3d of Trusts, § 78, General Comment a.

[60] ERISA § 404(a)(1)(C), 29 U.S.C. § 1104(a)(1)(C).

[61] 86 Fed. Reg. 57294; *id.* at 57300.

beneficiaries."[62] The rule of tie-breaking flunks this demanding test of loyalty by encouraging ERISA fiduciaries to pursue third party benefits in the face of such ties.[63] Contrary to the teaching of the proposed regulations, the duty of loyalty is not suspended in the presence of "ties."

Conclusion

The flaws of the proposed regulations weaken the duties of prudence and loyalty and thereby jeopardize the retirement assets of America's workers and retirees. Accordingly, the proposed regulations should be amended to delete the imprudent, unproven and ambiguous term "ESG," to add more balanced examples to reduce misperceptions of ERISA's fiduciary duties, and to expunge altogether the concept of tie-breaking which violates the duty of loyalty by encouraging the pursuit of collateral benefits.

Sincerely,

Edward A. Zelinsky

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[62] *Donovan v. Bierwirth*, 680 F.2d 263, 271 (2nd Cir. 1982).

[63] *See* Bernard S. Sharfman, *ESG Investing Under ERISA*, 38 YALE J. ON REG. BULLETIN 112, 130-131 (2020).