Department of Labor rules on both sides of the social investing issue

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MarketWatch Blog by Alicia H. Munnell

Alicia H. Munnell is a columnist for ***MarketWatch*** and director of the Center for Retirement Research at Boston College.

Telling fiduciaries of private plans to steer clear, but Board of TSP to avoid Chinese stocks

Candidly, I'm confused by our Department of Labor (DOL). On June 23 the DOL released **a strongly worded rule** for private pensions covered by the Employee Retirement Income Security Act of 1974 (ERISA) saying that: "It is unlawful for a fiduciary to sacrifice return or accept additional risk to promote a public policy, political, or any other nonpecuniary goal."

As I said in **an earlier blog post**, I applaud this rule. Pension fund investing is not the place to solve the ills of the world. Social investing is a diversion that enriches financial managers, reduces participants' retirement investment returns, and makes people think they are addressing a problem without doing anything substantial. No one can seriously think that stock selection is going to fix climate change or lead to world peace.

While clearly condemning social investing in ERISA plans, the DOL Secretary issued a letter on May 11 to the Thrift Savings Plan – the retirement saving vehicle for federal government employees – ordering it to not include equities in Chinese companies in its investment options.

My understanding of the back story is as follows. In 2017, the Board managing the Thrift Savings Plan – the Federal Retirement Thrift Investment Board (FRTIB) – made the decision to change its international benchmark index for the TSP's I Fund from the MSCI EAFE Index to the MSCI All Country World ex USA Index, with a target date in 2019. This new index contains **equities in Chinese companies** whereas the previous index did not. As of March 2020, Chinese equities accounted for about 11 percent of the All Country World ex USA Index.

In 2019, the Board reviewed its decision after bipartisan **appeals from six U.S. Senators**, but reaffirmed its position, with an effective date of June 1, 2020. In April 2020, several former military leaders **issued an open letter** warning of the dangers of such a change in policy. Press accounts indicate the letter was released in coordination with the Committee on the Present Danger: China, a group established last year by Stephen K. Bannon, former chief strategist to President Trump.

On May 11, Labor Secretary Eugene Scalia **issued a letter** to the Chairman of the FRTIB stating that, at the order of President Trump, the Board was to "immediately halt all steps associated with" changing the benchmark index, and "to reverse its decision to invest Plan assets on the basis of that…index." The letter indicated that changing the tracking index would place billions of dollars "in risky companies that pose a risk to U.S. national security."

Thus, the argument appears to be both national security and investment risk. Indeed, SEC Chairman Jay Clayton warned in April that Chinese disclosures are inadequate and that investors should be careful when considering investments in Chinese equities.

Following this letter, the FRTIB voted to delay its implementation of the benchmark change, also citing the coronavirus pandemic and the change in its board membership. Although a delay was announced, there was no mention of how long this pause would last, and they did not reverse their existing intention to change the benchmark.

In my view, none of the arguments against the MSCI All Country World ex USA Index seem persuasive. It’s hard to believe that federal workers holding about $5 billion of Chinese equities could be a serious threat to national security. And one would think that Morgan Stanley, the controlling shareholder of MSCI, would have addressed the reporting issues when selecting which Chinese companies to include in its index.

The Department of Labor should heed its own advice and steer clear of social investing.