You Will Have to Pry My 401(k) Out of My Cold, Dead Hands

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Eakinomics: You Will Have to Pry My 401(k) Out of My Cold, Dead Hands

It doesn't matter what flavor of government bureaucrat is in vogue – nanny-state, nationalistic, progressive, paternalistic – the fight to keep them out of your life is never-ending. The latest edition is the Department of Labor (DOL) rule proposed at the end of June, which stated: "This proposed regulation is designed in part 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."

"ESG" refers to factoring environmental, social, and governance issues into the calculus when buying stocks or choosing a fund in which to invest. The rule has engendered some resistance, with Bloomberg reporting, "The world's largest asset managers are speaking out against a Trump administration plan that would make it more difficult for them to incorporate environmental, social and governance factors when making investment decisions, a move that could limit green investing in 401(k) plans."

One objection is the cost of complying with the rule. At AAF, we take the burden of regulations seriously. But when the mega-giant Black Rock labels the rule "burdensome," it rings slightly hollow. And when Fidelity claims that "the proposal's assumption that ESG investment strategies sacrifice returns, increase risks and promote goals unrelated to financial performance isn't 'well grounded or supported by much of the emerging data,'" it makes you wonder what the problem really is. After all, if you really aren't sacrificing returns, why would you object to the rule?

Does this mean the rule is a good idea after all? No.

First of all, it is none of DOL's business how I choose my portfolio. If asset managers want to offer a licorice 401(k) that exclusively invests in Twizzlers, Red Vines, Good & Plenty, and other licorice brands, I can decide whether I want that unique combination of return, risk, and social virtue. I don't need to have Labor Secretary Gene Scalia second-guessing me, nor, for that matter, second-guessing asset managers by restricting their ability to operate in their own and their shareholders' best interest. Let asset managers manage assets.

Second, such a fund may very well have either a lower return or higher risk because it is less diversified. If nobody is interested, the fund will simply go away. If people are interested in just exactly that, why should they be forced to hold Cadbury, Toblerone, Godiva, and other detestable commodities as well?

Third, the notion that such a licorice 401(k) harms the chocolate industry reveals a misunderstanding of financial markets. Chocolate firms will be as valuable as their future profits; purchasing stock simply gives one the right to those future profits. One can buy the desired investment in the chocolate sector by purchasing stocks directly, by investing in a chocolate-specific fund, by purchasing a broad-based mutual fund, or any combination of the above. The existence of a licorice fund in no way limits the ability of investors to value the chocolate companies for what they are worth, provide them the capital to earn a competitive return, or limit their access to credit. Forcing chocolate into the licorice 401(k) in the interests of no longer “subordinating return” just means there will be less demand for chocolate shares elsewhere and the bottom line will be unchanged.

The DOL followed up this stroke of wisdom with *another* proposed rule just yesterday, this time prohibiting financial advisors from voting on proposals that concern anything other than financial return. These proposed rules are a classic unnecessary, ineffective intrusion into the private sector. It is the Groundhog Day of the regulatory state.