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Office of Regulations and Interpretations, US Department of Labor
Room N-5655
200 Constitution Avenue NW Washington, DC 20210

RE: Proposed rule on Financial Factors in Selecting Plan Investments (RIN 1210-AB95)

To whom it may concern:

This comment is in response to the Department of Labor’s proposed rule, “Financial Factors in Selecting Plan Investments” (RIN 1210-AB95) (the “Proposal”).

The Proposal reveals that the Department does not sufficiently understand the field of investing that considers environmental, social, and governance criteria, describing it as a one-size-fits-all approach that needs further definition and regulation. The simple truth about ESG investing is that there are no universally applied norms or standards, its 50-year-old practice is as diverse as the ways in which professionals manage money. Just as there are varying interpretations of what “value” and “growth” funds are, it is incumbent upon investors and investment professionals to examine the nuances of how managers assemble portfolios using ESG criteria because there are always different approaches. This is normal and healthy, just as it is for investors to use different financial criteria to make “buy” and “sell” decisions, and it is therefore not a problem that needs a solution. Currently, investors are free to decide the approaches to ESG they resonate with, just as they decide which financial analysts and which perspectives on asset allocation, macroeconomics, and market-timing they wish to heed. Imposing special requirements and documentation upon any investor decision to choose an ESG-oriented alternative from among economically equivalent options is burdensome and without a reasonable research-supported basis for singling out the incorporation of ESG criteria for special and heightened scrutiny.

The Proposal further misrepresents the ways in which investment advisors, managers, and fiduciaries use environmental, social and governance (ESG) criteria as an integral part of what fiduciaries do in assessing risk throughout the due diligence process of selecting and managing investments for investors. What are these risks? They fall into many categories and are material to financial performance:

- Reputational (ethical violations)
- Operational/financial (excessive liabilities, insurance, supply chain disruption)
- Legal/regulatory (ethical and regulatory violations)
- Competitive (resulting in lawsuits)
- Physical (environmental harm, supply chain disruption)
- Stranded assets (fossil fuels)

- Externalities impacting “universal owners” (bad behavior by some companies in a diversified portfolio can affect performance of other portfolio holdings)

The claim the Proposal makes – that fiduciaries are either ignoring financial performance or prioritizing ESG factors instead of financial performance - is a wildly irresponsible claim for which there is no evidence. The reason such evidence does not exist is that fiduciaries don’t operate this way. Investment professionals integrating ESG criteria in the investment selection process concur with the fiduciary standard that the economic interests of investors must not be subordinated to “collateral benefits” such as to serve a worthy societal cause. There is no evidence in the Proposal that ESG is non-pecuniary or non-financially material. Claiming that ESG criteria are not material to investment decisions is not evidence, nor is the Proposal’s citing of two newspaper columns proof that fiduciaries “make investment decisions for purposes distinct from providing benefits to participants and beneficiaries,” or that they make decisions “on the basis of purported benefits and goals unrelated to financial performance.” This may be someone’s idea of “what must be happening”, but there is nothing to back it up in the Proposal. Materiality, in fact, as defined by the SEC (in Reg S-K), allows ESG information to be used by investment professionals if they assess it is relevant to financial performance. In fact, the SEC refers to Reg S-K to justify the prohibition of new rulemaking on reporting climate risks that may affect companies because Reg S-K already defines such risks as material. Falsely asserting that ESG proponents believe or behave that they are not focused on materiality, and suggesting the behavior needs to be curtailed via regulatory intervention, is an unnecessary remedy for a nonexistent problem.

A wide range of ESG criteria is used by thousands of investors and investment professionals because these factors impact financial performance, as academic and industry studies have shown for decades. The Center for Fiduciary Studies (now Fi360), since 2003 the standard-bearer of establishing fiduciary standards that also accredits investment fiduciaries, has, among its 21 prudent practices, a specific standard for the use of ESG investments, as found in its 2019 edition of “Prudent Practices for Investment Advisors”:
https://www.fi360.com/uploads/media/handbook_advisors_2019.pdf, which on page 63 defines Practice 2.7 as, “Investment due diligence using environmental, social, and governance (ESG) factors conforms to governing documents and the fiduciary obligations of investment decision-makers.” The guide states:

“Research has confirmed that applying credible ESG factors in a robust due diligence process is highly unlikely to result in inferior investment choices as compared to what would result from due diligence performed without those factors. Research also suggests that consideration of ESG factors may improve the efficacy of investment due diligence.”

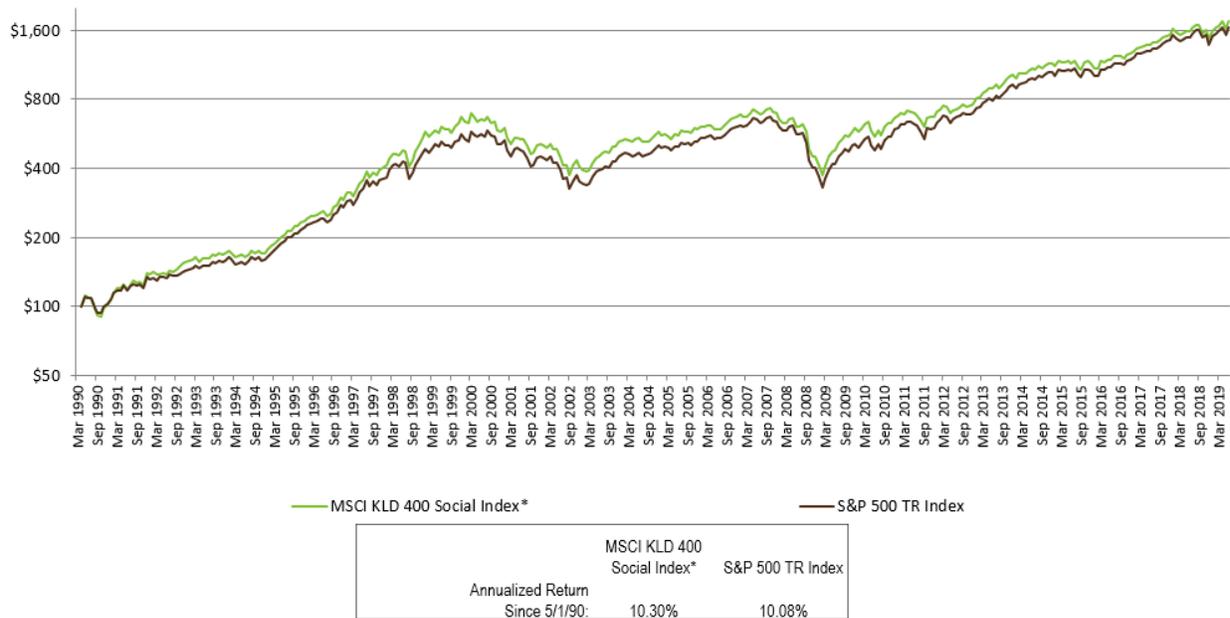
The CFA Institute, in 2015, in its guide “Environmental, Social, and Governance Issues in Investing: A Guide for Investment Professionals” notes that 73% of Certified Financial Analyst (CFA) designees working as portfolio managers and research analysts use ESG in their research and decision- making. This is, in essence, the new professional standard of investment analysis.

It is therefore not surprising that the guide also notes that 63% of CFAs indicate that the use of ESG issues helps manage investment risk. The guide states, “systematically considering ESG issues will likely lead to more complete analyses and better-informed investment decisions”:

<https://www.cfainstitute.org/-/media/documents/article/position-paper/esg-issues-in-investing-a-guide-for-investment-professionals.ashx>

In the US SIF Foundation’s 2018 survey of sustainable investment firms in the United States, 141 money managers with aggregate assets of more than \$4 trillion responded to a question on their motivations for incorporating ESG criteria into their investment process. Three-quarters of these managers cited the desire to improve returns and to minimize risk over time. Fifty-eight percent cited their fiduciary duty obligations as a motivation.

Regarding financial performance, the Proposal’s use of the Winegarden’s report, which compares every fund to an S&P 500 index fund, is not how fiduciaries assess performance. At the very least, funds and managers must always be compared to the relevant asset category benchmark. But since Winegarden brought up the S&P 500, it should be noted that in the past 30 years, the MSCI KLD 400 Social Index has consistently outperformed the S&P500 since 1990:



ESG investing is indeed adequately economically informed. Many studies demonstrate that ESG considerations do not compromise performance, including:

2007. Demystifying Responsible Investment Performance, UNEP Finance Initiative, a meta-study of 30 academic and industry studies, showed early on that there is either a neutral or positive correlation between the inclusion of ESG criteria and financial performance:
https://www.unepfi.org/fileadmin/documents/Demystifying_Responsible_Investment_Performance_01.pdf

2015. “ESG and Financial Performance: Aggregated Evidence from More than 2000 Empirical Studies” | Friede, Gunnar and Busch, Timo and Bassen, Alexander. *Journal of Sustainable Finance & Investment*, Volume 5, Issue 4, p. 210-233.
https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2699610

2015. “From Stockholder to the Stakeholder: How Sustainability Can Drive Financial Outperformance” Gordon L. Clark, Andreas Feiner and Michael Viehs.

https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2508281

Abstract: In this enhanced meta-study we categorize more than *200 different sources*. Within it, we find a remarkable correlation between diligent sustainability business practices and economic performance. The first part of the report explores this thesis from a strategic management perspective, with remarkable results: 88% of reviewed sources find that companies with robust sustainability practices demonstrate better operational performance, which ultimately translates into cashflows. The second part of the report builds on this, where 80% of the reviewed studies demonstrate that prudent sustainability practices have a positive influence on investment performance. This report ultimately demonstrates that responsibility and profitability are not incompatible, but in fact wholly complementary. When investors and asset owners replace the question “how much return?” with “how much sustainable return?”, then they have evolved from a stockholder to a stakeholder.

2019. Morgan Stanley Institute for Sustainable Investing. ‘Sustainable Reality. Analyzing Risks and Returns of Sustainable Funds’

[https://www.morganstanley.com/content/dam/msdotcom/ideas/sustainable-investing-offers-financial-performance-lowered-](https://www.morganstanley.com/content/dam/msdotcom/ideas/sustainable-investing-offers-financial-performance-lowered-risk/Sustainable_Reality_Analyzing_Risk_and_Returns_of_Sustainable_Funds.pdf)

[risk/Sustainable_Reality_Analyzing_Risk_and_Returns_of_Sustainable_Funds.pdf](https://www.morganstanley.com/content/dam/msdotcom/ideas/sustainable-investing-offers-financial-performance-lowered-risk/Sustainable_Reality_Analyzing_Risk_and_Returns_of_Sustainable_Funds.pdf)

and <https://www.morganstanley.com/ideas/sustainable-investing-competitive-advantages>

“Despite the 53% of individual investors who believe investing sustainably requires a financial trade-off, these findings show that perceived trade-off is a myth.” and “Research conducted on the performance of nearly 11,000 mutual funds from 2004 to 2018 shows there is no financial trade-off in the returns of sustainable funds compared to traditional funds, and they demonstrate lower downside risk.” and “incorporating environmental, social and governance (ESG) criteria into investment portfolios *may* help to limit market risk ... a layer of stability for investors looking to reduce volatility”.

2020. Majority of ESG funds outperform wider market over 10 years. *Financial Times*.

<https://www.ft.com/content/733ee6ff-446e-4f8b-86b2-19ef42da3824>

“Morningstar found that sustainable funds have greater survivorship rates than non-ESG vehicles. On average, 77 per cent of ESG funds that were available 10 years ago still exist, compared with 46 per cent for traditional funds.” and ““The findings debunk the myth that there is a performance penalty associated with ESG investing,” said Hortense Bioy, director of passive strategies and sustainability research at Morningstar.”

2020. “Sustainable investing: resilience amid uncertainty,” BlackRock.

<https://www.blackrock.com/corporate/literature/investor-education/sustainable-investing-resilience.pdf>

Summary: The recent downturn was a key test of this conviction. In the first quarter of 2020, we have observed better risk-adjusted performance across sustainable products globally, with 94% of a globally-representative selection of widely-analyzed sustainable indices outperforming their parent benchmarks. While this short time period is not determinative, it aligns with the resilience we have seen in sustainable strategies during prior downturns, explored below in section “Sustainability Performance in the Markets.” Furthermore, these results are consistent with the research BlackRock has been publishing since mid-2018, demonstrating that sustainable strategies do not require a return tradeoff and have important resilient properties.

2020. “ESG Outperformance Due to Supply Chain Risk Management”, ValueEdge.

[ESG Outperformance Due to Supply Chain Risk Management](#)

Why have companies with good ESG ratings outperformed in the recent crisis? That is a question many investors are asking now. Tensie Whelan of NYU Stern Center for Sustainable Business had an interesting new answer to offer: supply chains.

2014. Socially Responsible and Conventional Investment Funds: Performance Comparison and the Global Financial Crisis,” Leonardo Becchetti, Rocco Ciciretti, Ambrogio Dalo and Stefano Herzel.” CEIS Working Paper No. 310, Feb. 2014.

https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2397939

Abstract: We investigate the performance of Socially Responsible Funds (SRFs) and Conventional Funds (CFs) in different market segments during the 1992-2012 period. From an unbalanced sample of more than 22,000 funds, we define a matched sample using a beta-distance measure to match any SRF with the “nearest neighbor” CF in terms of risk factors. Using this novel matching approach and a recursive analysis, we identify several switch points in the lead/lag relationship between the two investment styles over time in different market segments (geographical area and size). A relevant finding of our analysis is that SRFs played an “insurance role” outperforming CFs during the 2007 global financial crisis.

2015. “Why Diversity Matters,” Vivian Hunt, Dennis Layton and Sara Prince, McKinsey.

<https://www.mckinsey.com/business-functions/organization/our-insights/why-diversity-matters>

Summary: Companies in the top quartile for racial and ethnic diversity are 35 percent more likely to have financial returns above their respective national industry medians. Companies in the top quartile for gender diversity are 15 percent more likely to have financial returns above their respective national industry medians.

2016, “ESG: Good Companies Can Make Good Stocks,” Savita Subramanian, Dan Suzuki, CFA, Alex Makedon, Jill Carey Hall, CFA, Marc Pouey and Jimmy Bonilla, Bank of America Merrill Lynch.

Summary: “Two reasons investors need to add ESG to their dashboard. It’s not just for tree-huggers - incorporating environmental, social and corporate governance (ESG) considerations into one’s framework is critical. First, these metrics have been strong indicators of future volatility, earnings risk, price declines and bankruptcies. Second, trends in the US investment landscape suggests that trillions of dollars could be allocated to ESG-oriented equity investments, to stocks that are attractive on these attributes, over the next few decades— inflows equivalent to the size of the S&P 500 today! In this first in a series of notes, we present our findings based on the Thomson Reuters ESG dataset, and conclude that ESG may be too costly to ignore. ESG could have helped investors avoid 90% of bankruptcies. Based on our analysis of companies with ESG scores that declared bankruptcy, an investor who only held stocks with above average-ranks on both Environmental and Social scores would have avoided 15 of the 17 bankruptcies we have seen since 2008. ESG has signaled future volatility & stock price declines... Large companies within the highest quartile of the ESG framework tended to have consistently lower future price volatility than poorly ranked companies. Stocks with extreme price declines – over 90% - had average initial Environmental/Social scores in the 40th or lower percentiles. And the better a stock’s score, the lesser the price decline. ...as well as earnings risk and return on equity ESG scores have been strongly correlated with companies’ future earnings volatility, both at a market level and within sectors. Moreover, companies with two or more downgrades on S&P Common Stock ranks (a gauge of earnings/dividend stability) had average Environmental and Social scores in the 40th percentile or lower (weak), whereas those with two or more upgrades had ranks in the 70th percentile or higher (strong). And companies that ranked well had, on average, a 5% higher subsequent return on total equity than did their poorly ranked counterparts..”

2017 “Sustainable Investing Myth Busters,” Morgan Stanley Institute for Sustainable Investing. https://www.morganstanley.com/ideas/sustainable-investing-myth-busters?et_mid=16000&et_mkid=0232d9d436b7a4fad956135be8740563

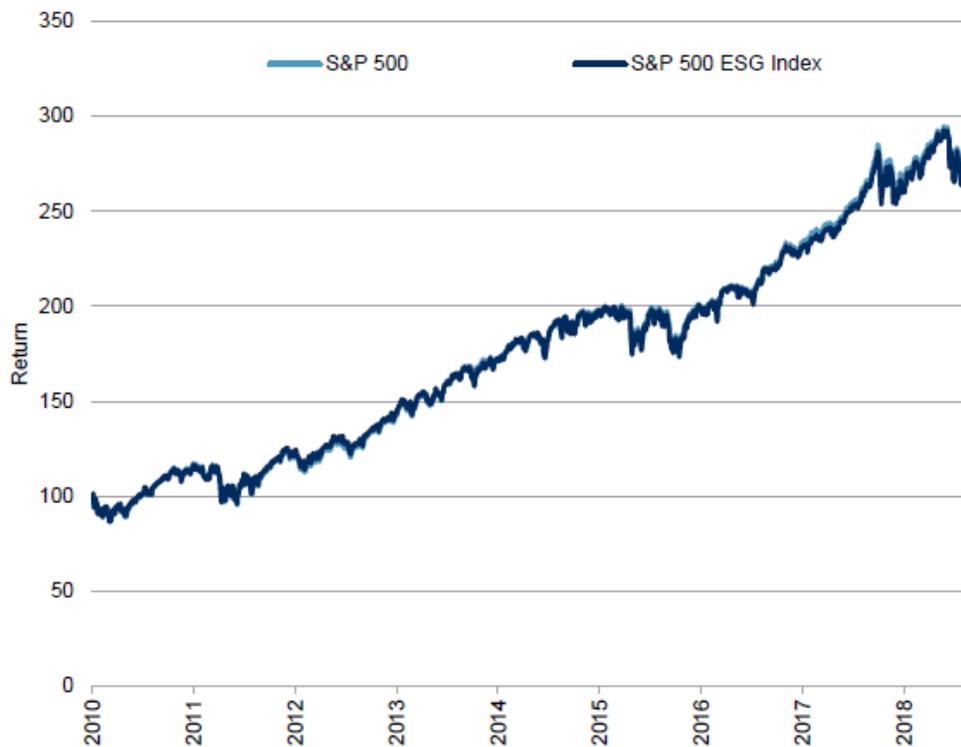
Summary: Analysis by the Institute shows that sustainable strategies have often performed in line with or even better than their traditional counterparts. The Institute conducted a proprietary study in 2015 called Sustainable Reality, which examined seven years’ performance of more than 10,000 mutual funds and 2,800 Separately Managed Accounts. The results showed that sustainable investments usually met, and often exceeded, the performance of traditional investments. A Harvard study in 2016 also found that firms with good ratings on sustainability issues most relevant to their industries significantly outperformed firms with poor ratings on these issues.

2019. “Integrating ESG into Core around the World: The S&P 500™ ESG Index and Beyond,” Reid Steadman and Daniel Perrone.

<https://www.savvyinvestor.net/sites/default/files/node/paper/file/integrating-esg-into-core-around-the-world.pdf>

The S&P 500 ESG Index tracks the S&P 500 closely (see Exhibit 7), and it has done so despite excluding more than 30% of constituents based on the various eligibility criteria. Realized tracking errors for the one-, three-, and five-year periods were consistently within 1%, and the index volatility was nearly identical to the S&P 500 over those same periods. This return profiles holds for the rest of the indices in the S&P ESG Index series as well.

Exhibit 7: Historical Returns of the S&P 500 ESG Index versus the S&P 500



Source: S&P Dow Jones Indices LLC. Data as of May 31, 2019. Past performance is no guarantee of future results. Chart is provided for illustrative purposes and reflects hypothetical historical performance. Please see the Performance Disclosure at the end of this document for more information regarding the inherent limitations associated with back-tested performance.

2018. “The Impact of Sustainability Practices on Corporate Financial Performance: Literature Trends and Future Research Potential,” Ali Alshehhi, Haitham Nobanee and Nilesh Khare https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3127668

Abstract: “This paper presents an analysis of the literature concerning the impact of corporate sustainability on corporate financial performance. The relationship between corporate sustainable practices and financial performance has received growing attention in research, yet a consensus remains elusive. This paper identifies developing trends and the issues that hinder conclusive consensus on that relationship. We used content analysis to examine the literature and establish



the current state of research. A total of 132 papers from top-tier journals are shortlisted. We find that 78% of publications report a positive relationship between corporate sustainability and financial performance. Variations in research methodology and measurement of variables lead to the divergent views on the relationship.”

2018. “The case for sustainable bond investing strengthens,” Barclays.

<https://www.investmentbank.barclays.com/content/dam/barclaysmicrosites/ibpublic/documents/our-insights/ESG2/BarclaysIB-ImpactSeries4-ESG-in-credit-5MB.pdf>

Summary: “In 2016, we researched the effect of ESG on US IG bond returns. We found: • ESG is not an “equity-only” phenomenon and can be applied to credit markets without being detrimental to bondholders’ returns. • A positive ESG tilt in bond portfolios resulted in a small but steady performance advantage. • No evidence of a negative performance effect. • ESG attributes did not significantly affect the price of corporate bonds, and no evidence was found that the performance advantage was due to a change in relative valuation over the study period. . . The findings of our expanded study • We confirm our 2016 findings that tilting a credit portfolio in favor of high-ESG bonds, while keeping all other risk characteristics unchanged, tends to lead to higher performance in all three markets considered.”

The Proposal’s characterization that the fees of ESG products are higher across the board is not an argument against their inclusion, for the differences between ESG and conventional fees vary depending on the asset class, whether the fund is an index or actively-managed, and the size of the fund. Regardless, the use of the cheapest products is not required, as fees are not as important as total return in considering whether or not an investment is prudent. Fee levels don’t necessarily correlate to total return profiles either.

There is no doubt that funds that use ESG criteria are consistent with long-term retirement objectives. The Proposal, therefore, is likely to dissuade fiduciaries, even against their better judgment, from offering options for their plans that consider ESG criteria in addition to more traditional financial criteria. As a result, it will unfairly, and harmfully, limit plan participants’ options, diversification opportunities, and opportunities for financial outperformance.

I request that the Proposal be withdrawn. Thank you for your consideration of these comments.

Sincerely,

Michael Kramer, Managing Partner

Natural Investments is a federally-registered investment adviser that has been managing ESG portfolios for retail and institutional investors since 1985 via its advisors nationwide. The firm has \$1.2 billion in assets under management.