

July 30, 2020

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

Attention: Financial Factors in Selecting Plan Investments Proposed Regulation [RIN 1210- AB95]

Dear Mr. DeWitt:

Thank you for the opportunity to comment on the proposed amendments to the “Investment duties” regulation under Title I of the Employee Retirement Income Security Act of 1974, as amended (ERISA), that requires plan fiduciaries to select investments based solely on financial considerations relevant to its risk-adjusted economic value.

Calvert Research and Management (“Calvert”) is an investment management firm based in Washington, DC with \$21.3 billion assets under management (as of April 30, 2020). We incorporate into our investment decisions across global capital markets information about corporations’ (and other issuers of securities) exposure to, and management of, financially material environmental, social, and governance (“ESG”) factors. We respectfully submit this letter in response to the proposed amendments, which is informed by our extensive history of ESG investing, our robust, proprietary research, and reliable third-party data. We strongly urge the Department of Labor (DOL) to withdraw this proposal, which as written will hinder the ability of plan sponsors to provide for the retirement security of beneficiaries. If the DOL wishes to proceed, it will need to provide evidence of the need for this regulation and a clear standard by which plan sponsors and investment advisers can implement the proposal, both of which are lacking in the current proposed rule.

The proposed amendments fail to acknowledge and distinguish pecuniary ESG benefits. Calvert supports the principle that ERISA plan sponsors must maximize investment returns at a reasonable risk to fulfill its fiduciary responsibility to plan participants. Calvert applies this same principle to our investments for our clients by focusing on financially material ESG factors that drive financial performance of companies. However, the proposed amendment states that “[t]he purpose of this action is ... to separate the legitimate use of risk-return factors from inappropriate investments that sacrifice investment return, increase costs, or assume additional investment risk to promote non-pecuniary benefits or objectives.”¹ First, the DOL does not explain how the integration of ESG factors into an investment analysis with the express purpose of improving returns is incompatible with a secondary goal of creating beneficial social or environmental outcomes if such goals do not interfere with the pursuit of maximized returns at an optimal level of risk. We acknowledge the “tie-breaker” standard, but believe this analysis fails to acknowledge that pecuniary and non-pecuniary ESG goals can co-exist and are not mutually

¹ 85 FR 39116 (June 30, 2020)

exclusive. Secondly, the proposed amendments fail to distinguish for investors “legitimate” pecuniary ESG benefits from “inappropriate” non-pecuniary ESG benefits.

The proposed amendments may impose an unreasonable burden of proof on asset managers. Calvert does not believe that any test or criteria established by the DOL to distinguish between “legitimate” pecuniary ESG benefits and “inappropriate” non-pecuniary ESG benefits for ERISA plans would be effective. We are concerned that such a test or list of factors would create an unfair disadvantage to pecuniary ESG analyses relative to non-ESG investment strategies to the detriment of efficient markets. Specifically, the proposed amendments would create a significant burden on pecuniary ESG strategies surrounding disclosure, marketing strategies, performance metrics, and the like, relative to other investment strategies that are not identified as ESG. We noted that numerous traditional investment managers integrate ESG factors into their investment process in a variety of ways. Some investment managers acknowledge their practices as ESG-related, while others do not. Without clearly delineating what factors are considered ESG, the proposed amendments would create confusion about the degree to which these factors may be used without triggering the provisions of the rule. Additionally, the proposed amendments do not indicate what the burden of proof would be for those investment strategies that use ESG factors to improve risk/return (i.e., pecuniary ESG benefits).

Calvert’s investment strategy is informed by a belief that that ESG offers unique benefits to investment analyses, including:

- **Better insights into the intangible value of companies.** Over 80% of company value is understood to be intangible, such as reputation, human capital, intellectual property, and customer relationships.² ESG analysis provides a perspective on these issues not available through a company’s regulated filings.
- **Anticipation of macro risks.** As noted below, ESG funds outperformed the market during the initial downturn at the beginning of the pandemic, similar to the performance of ESG funds at the start of the global financial crisis.* We believe (and a reasonable investor may conclude) that ESG analysis allows us to identify companies more likely to perform better in downturns.³ Academic research demonstrates that “firms with good performance on material sustainability issues significantly outperform firms with poor performance on these issues, suggesting that investments in sustainability issues are shareholder-value enhancing. Further, firms with good performance on sustainability issues not classified as material do not underperform firms with poor performance on these same issues, suggesting investments in sustainability issues are at a minimum not value-destroying.”⁴
- **Proactively address systemic risks.** Investors face future potential macro level risks including climate change, financial crises, cybersecurity, and social unrest. We believe that approaches to ESG, including active ownership and ESG integration, may not only improve the risk/return performance of individual companies but may help to mitigate these risks at the portfolio level.⁵

The proposed amendments are superfluous. The proposed amendments fail to address any realized burgeoning issues, but merely state inflated concerns perpetuated by a lack of understanding and solid data. The proposed rule states, “[t]he Department is concerned, however, that the growing emphasis on

² “Intangible Assets Represent 80% of the Value of the S&P 500,” Jonathan Knowles, LinkedIn (July 19, 2019): <https://www.linkedin.com/pulse/intangible-assets-represent-80-value-sp-500-jonathan-knowles>

³ “ESG Fund Performance in Volatile Markets,” Michael Geraghty, Cornerstone Capital Group (April 7, 2020): <https://cornerstonecapinc.com/esg-fund-performance-in-volatile-markets/>

⁴ Khan, Mozaffar N., George Serafeim, and Aaron Yoon. “Corporate Sustainability: First Evidence on Materiality.” Harvard Business School Working Paper, No. 15-073, March 2015. (<http://nrs.harvard.edu/urn-3:HUL.InstRepos:14369106>)

⁵ The 21st Century Investor: Ceres Blueprint for Sustainable Investing, Peter Ellsworth and Kirsten Snow Spalding (June 2013): https://iasj.org/wp-content/uploads/21st_century_investor_ceres_blueprint_for_sustainable_investing_3.pdf

ESG investing may be prompting ERISA plan fiduciaries to make investment decisions for purposes distinct from providing benefits to participants and beneficiaries and defraying reasonable expenses of administering the plan. The Department is also concerned that some investment products may be marketed to ERISA fiduciaries on the basis of purported benefits and goals unrelated to financial performance.”⁶ Existing rules already assert that fiduciaries cannot place non-pecuniary concerns above the financial best interest of plan participants.⁷ The DOL has not cited any evidence that plan sponsors have actually violated this principle. Without substantiated claims regarding noncompliance, it is unclear why further amendments would be necessary or appropriate.

The proposed amendments are ineffective. The DOL has failed to demonstrate that ESG investments increase risk or reduce returns, despite significant, available evidence to the contrary.⁸ “More than 2,200 research studies conducted since the 1970s have considered the connection between ESG criteria and investment performance. . . . The results of these studies have consistently confirmed that social screens do not compromise investment performance.”⁹ We note that our review of academic research also shows that firms with strong ESG policies are likely to outperform peers with weaker performance.⁴ Additionally, “[t]he Department does not believe that investment funds whose objectives include non-pecuniary goals—even if selected by fiduciaries only on the basis of objective risk-return criteria . . . should be the default investment option in an ERISA plan.”¹⁰ Such statement illustrates the DOL’s failure to establish that plan sponsors are currently neglecting fiduciary responsibilities in their due diligence of managers by either selecting or neglecting ESG investments. Specifically, based on the data that demonstrates ESG funds outperform conventional funds in periods of volatility, by defaulting to conventional funds and intentionally forgoing ESG investments that prioritize pecuniary benefits, plan sponsors may be sacrificing improved risk/returns. At the very least, preventing an ESG investment as a qualified default investment alternative (QDIA), including those that use ESG data to improve risk/return results, would have the perverse result of restricting the ability of plan sponsors to adopt strategies that they believe will be in the best long-term financial interests of their beneficiaries, in contradiction to the stated objective of the rule. In Calvert’s experience, the market is capable of distinguishing ESG investment strategies that are consistent with fiduciary duty to maximize cash flows available to beneficiaries, particularly for QDIAs.

Fees associated with ESG funds are comparable to those of conventional funds. The DOL suggests that “on average” ESG increases the costs of investment strategies, especially passive strategies. However, in fact, the fees of ESG funds are comparable to those of conventional funds. Calvert believes that the perception of higher fees is associated with the small asset managers that began to offer ESG funds around the turn of the century and charged higher fees at that time. A review of the expense ratios of all

⁶ 85 FR 39116 (June 30, 2020)

⁷ Section 404(a)(1)(A) of ERISA; 80 FR 65135 (October 26, 2015); 81 FR 95879 (Dec. 29, 2016); and DOL Field Assistance Bulletin No. 2018-01.

^{*8} “U.S. ESG Funds Outperformed Conventional Funds in 2019,” Jon Hale, PhD, CFA, *Morningstar* (April 16, 2020):

<https://www.morningstar.com/articles/973590/us-esg-funds-outperformed-conventional-funds-in-2019>; [Despite the coronavirus pandemic, funds that focused on companies with strong ESG profiles and less exposure to energy lost less than their peer groups, while the majority outperformed their closest conventional counterparts.] “Sustainable Funds Weather the First Quarter Better Than Conventional Funds,” Jon Hale, PhD, CFA, *Morningstar* (April 3, 2020): <https://www.morningstar.com/articles/976361/sustainable-funds-weather-the-first-quarter-better-than-conventional-funds>; [For the year to date, all 26 ESG index funds outperformed their conventional index-fund counterparts.] “Sustainable Stock Funds Held Their Own in Second-Quarter Rally,” Jon Hale, PhD, CFA, *Morningstar* (July 8, 2020):

<https://www.morningstar.com/articles/991091/sustainable-stock-funds-held-their-own-in-second-quarter-rally>; [Companies committed to ESG are finding competitive advantages in product, labor, and capital markets, and portfolios that have integrated “material” ESG metrics have provided average returns to their investors that are superior to those of conventional portfolios, while exhibiting lower risk.] Kotsantonis, Sakis, Christopher Pinney, and George Serafeim. “ESG Integration in Investment Management: Myths and Realities.” *Journal of Applied Corporate Finance* 28, no. 2 (Spring 2016): 10–16.; [The International Monetary Fund found the performance of “sustainable” funds is comparable to that of conventional equity funds.] “International Monetary Fund’s Global Financial Stability Report, October 2019; Lower for Longer, Chapter 6 – Sustainable Finance: Looking Farther,” October 10, 2019.

⁹ “Sacrifice Nothing: A fresh look at investment performance of sustainable and impact strategies by asset class,” *Cornerstone Capital Group*: https://cornerstonecapinc.com/wp-content/uploads/Sacrifice-Nothing_A-Fresh-Look-at-Performance.pdf.

¹⁰ 85 FR 39119 (June 30, 2020)

U.S. sustainable open-end funds compared with their peers at the end of 2017 by Morningstar suggests that, sustainable funds' expense ratios, like conventional funds, were evenly ranged from low to high.¹¹ Additionally, since 2013, impact funds have experienced an 80% reduction in annual fees on their assets.¹² We also note the emergence of low-cost passive ESG ETF strategies. Calvert believes that plan sponsors are capable of conducting a comprehensive cost-benefit analysis in the selection and retention of ESG investment strategies in the same manner that such analyses are conducted for conventional funds. We request that the DOL explain its evidence of a gap in information or capability that plan sponsors would require to make these decisions.

Robust, standard ESG disclosure is one of the most effective ways to achieve improved risk/returns.

Calvert believes that the market is intended to incorporate competition among different investment approaches, including ESG. Investors should have access to disclosure that provides clear and meaningful information to help them make informed investment decisions. In fact, a large part of our ESG strategy relates to driving disclosure about financially material issues through engagements with corporate issuers. However, we acknowledge that current ESG data lacks consistency, clarity, and completeness. Outside of regulated filings, investors are often forced to seek information from media reports, expert analyses, and manager conversations. Given the benefits of ESG analyses as noted above, we believe that the most effective way to achieve the pecuniary benefits of improved risk/returns is to support ongoing improvements in the quality of information available to investors. Although Calvert would not support creating a standard of robust ESG reporting that is not consistent with how investors generally use information, there are ongoing efforts at the U.S. Securities and Exchange Commission to streamline material ESG information. Calvert believes that such efforts would better address the concerns of the DOL. Thank you for your time and consideration.

Sincerely,



John Streur
President and Chief Executive Officer
Calvert Research and Management

¹¹ "Myths About Sustainable Funds," Jon Hale, Ph.D., CFA, *Morningstar* (Sep 18, 2019): <https://www.morningstar.com/articles/946453/3-myths-about-sustainable-funds>

¹² "Money moving into environmental funds shatters previous record," Greg Iacurci, CNBC (January 14, 2020): <https://www.cnbc.com/2020/01/14/esg-funds-see-record-inflows-in-2019.html>.