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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:

I write to provide comments in response to the Department of Labor's proposed rule, "Financial Factors in Selecting Plan Investments" (RIN 1210-AB95) (the "Proposal").

The Proposal reveals a fundamental misunderstanding of how professional investment managers use environmental, social and governance criteria as an additional level of due diligence and analysis in the portfolio construction process. Investment managers increasingly analyze ESG factors precisely because they view these factors as material to financial performance. 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.

I have managed portfolios since 1995 for institutional and retail clients, and managed the first global ESG portfolio in the US starting in 2000 as an institutional mandate. At MIT Sloan, I have nurtured our impact investing initiative, emphasizing the need for investments that combine financial goals with environmental and/social objectives. ESG is an important proxy for risk, business as well as operational, as shown by numerous studies. Please see below for my detailed concerns.

- The Proposal is out of step with professional investment managers who increasingly analyze ESG factors precisely because of risk, return and fiduciary considerations. In the US SIF Foundation's 2018 survey of sustainable investment in the United States, 141 money managers with aggregated 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.
- The proposed rule reflects a fundamental misunderstanding of the use of ESG criteria and sustainable investing. While the Proposal states that there may be circumstances

where ESG information is material, it fundamentally equates ESG criteria with non-pecuniary, or non-financially material, information. Also, it incorrectly characterizes ESG as a monolithic criterion or strategy when, in fact, ESG is not a one-size-fits-all investment approach.

- The Proposal cites no credible sources to support its claims that ESG criteria are not material to investment decisions. Citing two newspaper columns, the Department expresses concern that the rise of ESG investing may be prompting fiduciaries “to make investment decisions for purposes distinct from providing benefits to participants and beneficiaries,” and to make decisions “on the basis of purported benefits and goals unrelated to financial performance.” In fact, many studies demonstrate that ESG considerations do not compromise performance.
- The Proposal would put a substantial additional burden on fiduciaries who wish to offer ESG investment options by requiring additional investment analysis and documentation requirements. The rules require special documentation for any decision to choose an ESG-oriented alternative from among economically equivalent options. There is no reasonable basis for singling out the incorporation of ESG criteria for special and heightened scrutiny.
- The Proposal will restrict the choices in retirement platforms. Consequently, plan beneficiaries may lose some of the benefits of diversification. This rule could lead to plan participants losing access to ESG options—many of which have outperformed their indices over time and especially during the market shock related to COVID-19 (see Research Reports section below).
- The DOL seeks to limit plan participants ability to access ESG retirement options by prohibiting funds using ESG criteria to be ‘added as, or a component of, a qualified default investment alternative.’ The Department’s stated rationale for prohibiting an “ESG-themed fund” from being selected as the default investment option is that it is not appropriate to select “investment funds whose objectives include non-pecuniary goals.”

Numerous studies show that the consideration of ESG criteria in investment analysis generally produces investment performance comparable to or better than non-ESG investments. There is no doubt that funds that use ESG criteria are consistent with long-term retirement objectives. A selected list of research studies is appended to this letter.

The Proposal is likely to have the perverse effect of dissuading 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 and diversification opportunities.

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



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Selected Research Reports

Sustainable Investment - Exploring the Linkage between Alpha, ESG, and SDG's, Madelyn Antoncic, Geert Bekaert, Richard V Rothenberg and Miquel Noguera (June 2020)

"First, we explore whether utilizing ESG factors can improve performance vis a vis the MSCI US index. By constructing a sector-neutral portfolio using MSCI ESG momentum scores from 2013 to 2018, we determine that it is feasible to generate positive alpha from an ESG momentum strategy."

Sustainable Funds Weather the First Quarter Better Than Conventional Funds, Morningstar (April 2020)

"Like all equity funds, sustainable equity funds suffered sudden and large losses during the first quarter of 2020 because of the coronavirus pandemic, but they held up better than conventional funds. Seven out of 10 sustainable equity funds finished in the top halves of their Morningstar categories, and 24 of 26 environmental, social, and governance-tilted index funds outperformed their closest conventional counterparts."

The ESG premium: New perspectives on value and performance, McKinsey & Company (February 2020)

In a new survey, executives and investment professionals largely agree that environmental, social, and governance programs create short- and long-term value—though perceptions of how have changed over the past decade.

Corporate Governance, ESG, and Stock Returns around the World, Mozaffar Khan, *Financial Analysts Journal* (October 2019)

"Non-financial performance measures, such as environmental, social, and governance (ESG) measures, are potentially leading indicators of companies' financial performance. In the study reported here, I drew on prior academic literature and the concept of ESG materiality to develop new corporate governance and ESG metrics. The new metrics predicted stock returns in a global investable universe over the tested period, which suggests potential investment value in the ESG signals."



Environmental, Social, and Governance (ESG) Investment Tools: A Review of The Current Field, Ogechukwu Ezeokoli (December 2017)

A 2017 study commissioned by DOL also reported that while some investors may continue to perceive that incorporating ESG factors entails accepting lower investment performance, its review of the academic literature suggests that incorporating ESG factors generally produced investment performances comparable to or better than non-ESG investments.

Responsible Investing: Delivering Competitive Performance, Nuveen TIAA Investments (July 2017)

After assessing the leading SRI equity indexes over the long term, the firm “found no statistical difference in returns compared to broad market benchmarks, suggesting the absence of any systematic performance penalty. Moreover, incorporating environmental, social and governance criteria in security selection did not entail additional risk.” It added that SRI indexes had similar risk profiles to their broad market counterparts, based on Sharpe ratios and standard deviation measures.

ESG And Financial Performance: Aggregated Evidence From More Than 2000 Empirical Studies, Gunnar Friede, Timo Busch, Alexander Bassen, *Journal of Sustainable Finance & Investment* (Volume 5, 2015 – Issue 4)

“The study combines the findings of about 2200 individual studies. Hence, this study is by far the most exhaustive overview of academic research on this topic and allows for generalizable statements. The results show that the business case for ESG investing is empirically very well-founded. Roughly 90 percent of studies find a nonnegative ESG–CFP relation. More importantly, the large majority of studies report positive findings.”

From the Stockholder to the Stakeholder: How Sustainability Can Drive Financial Outperformance, Oxford University and Arabesque Partners, (March 2015)

This is a meta-study that categorized more than 200 sources, including academic studies, industry reports, newspaper articles and books. According to their results, “88 percent of reviewed sources find that companies with robust sustainability practices demonstrate better operational performance, which ultimately translates into cash flows.” Furthermore, “80 percent of the reviewed studies demonstrate that prudent sustainability practices have a positive influence on investment performance.”

