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December 13, 2021

Submitted electronically

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

Re: Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights: RIN 1210-AC03

To Whom It May Concern:

After more than three decades working to build America's workplace savings system, I welcome this opportunity to share Putnam Investments' thoughts and suggestions about the recent rule proposal *Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights: RIN 1210-AC03* (the "Proposal") from the Employee Benefits Security Administration of the Department of Labor (the "Department") on prudence and loyalty in selecting plan investments and exercising shareholder rights for plans subject to the Employee Retirement Income Security Act of 1974 ("ERISA").

Founded in 1937, Putnam Investments is a leading global money management firm with approximately $198 billion in assets under management as of November 30, 2021. Putnam provides investment management services both to individual investors – primarily through their financial advisors – as well as to institutional investors worldwide. Putnam manages 97 mutual funds, four semi-transparent exchange-traded funds, a suite of collective investment trusts and 60 institutional strategies across a range of asset classes and investment styles. We offer active management across a variety of strategies in equity, fixed-income, asset allocation, and alternative investments, including several strategies that have a central focus on environmental, social and governance ("ESG") considerations, as well as others that do not.

As an initial matter, we applaud the Department's efforts on this Proposal, which amends regulations adopted in 2020 (the "2020 Regulations"). We fully endorse the idea that any investment option must be evaluated through the lens of expected investment risk and net-of-fee performance. In many ways, the 2020 Regulations had the potential to have a chilling effect on the

inclusion of investment options that take into account ESG considerations in ERISA plans. We support the efforts of the Department to remove barriers to the prudent integration of ESG-considerations for ERISA fiduciaries and to treat ESG considerations in the same manner as all other financially material information.

At Putnam, we focus on integration of financially material environmental, social, and governance issues, with the goal of enhancing financial returns. In some contexts and some respects, this type of integration has become a standard practice that is as common as analysis of valuation metrics, credit assessment, or free cash flow. We believe that the evidence that thoughtful integration of relevant ESG considerations may in fact improve returns and reduce risk is compelling.[1]

Funds can thereby pursue strong returns by identifying companies that are managing material ESG issues in a proactive and value-enhancing way, mitigating related risks, creating new business opportunities, and improving long-term fundamental prospects. Context and materiality are key factors. The ESG considerations that investors may bring to bear vary by, among other things, sector, issuer, and point in the market cycle. Fundamentally, integrated ESG analysis is another tool in the modern investment toolkit, and is best used in combination with other essential tools like traditional fundamental analysis, valuation assessment, or quantitative analysis. This is true both in products that specifically pursue an ESG-focused strategy, and in those that do not, but that incorporate ESG considerations into their fundamental research.

There is growing evidence that ESG options may offer younger savers a point of new engagement with and interest in their plans.[2] As ESG integration becomes increasingly widespread in the industry, and demand for ESG-focused products grows, it is essential that regulation in this area provides a framework that is neutral and balanced and that will stand the test of time.

Neutral and balanced framework

We believe that the Proposal goes a long way toward creating a framework that is neutral and balanced with respect to ESG considerations. For example, the 2020 Regulations prohibited a plan from designating a fund as a Qualified Default Investment Alternative (QDIA) under § 2550.404c-5 if its investment objectives or goals or its principal investment strategies include, consider, or indicate the use of one or more non-pecuniary factors. We fully support the deletion of this section in the Proposal, as we agree that there is no reason to specifically prevent a fund that takes into

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[1] See, for example, Mozaffar Khan, George Serafeim and Aaron Yoon, Corporate Sustainability: First Evidence on Materiality (Harvard Business School, March 9, 2015). The authors mapped SASB's Materiality Map general issue categories to MSCI KLD data for 2,307 unique firms over 13,397 unique firm-years across six SICS® sectors. Using both calendar-time portfolio stock return regressions and firm-level panel regressions, they found that firms with good ratings on SASB's material sustainability issues significantly outperformed firms with poor ratings on these issues. In contrast, firms with good ratings on immaterial sustainability issues (ESG issues not identified by SASB for a given industry) did not significantly outperform firms with poor ratings on the same issues. Lastly, they found that, all else equal, firms scoring in the top quintile on the material issues have higher future return-on-sales growth.

[2] See, for example, Morgan Stanley Institute for Sustainable Investing, Sustainable Signals: Individual Investor Interest Driven by Impact, Conviction and Choice (White Paper, 2019). This study finds that 95% of millennials and 85% of all investors are interested in sustainable investing, and that 88% of all surveyed investors are interested in pursuing sustainable investing in 401k plans, but only 42% have known options to do so.

account ESG considerations from being a QDIA if all of the other requirements of the QDIA regulations are met. Furthermore, we support the Department's decision to omit the term "pecuniary" and support a principles-based approach focused on factors that have a material effect on the return or risk of an investment. The Department has historically hewed close to the principle of even-handedness, neither favoring nor disfavoring, as a general matter, any particular style or strategy of investing, so long as plan fiduciaries act with prudence and an eye single to participants' interests. We believe it is critical that the Department maintain a level playing field among investment options, leaving plan menus to be driven by market forces and the power of informed fiduciaries' choices.

With respect to the "tie-breaker" standard included in paragraph (c) of the Proposal, we support the removal of the requirement of the 2020 Regulations that called for the special documentation of a fiduciary's analysis under the "tie-breaker" standard where a fiduciary concluded that pecuniary factors alone were insufficient to be the deciding factor. We would further ask that the Department consider removing the new disclosure requirement in the Proposal, which would call for the "collateral-benefit characteristic of the fund" to be displayed in disclosure materials provided to participants and beneficiaries. Fundamentally, we do not think this requirement will improve participant understanding. In addition, we worry that the practical impact of the disclosure requirement will be a negative one. We have faith in the abilities of plan fiduciaries, working with their advisors, to review investment options on behalf of plans and their participants. While we agree that appropriate documentation of the investment selection process is important for a prudent fiduciary, ERISA does not specifically require a fiduciary to disclose the detail of that process to participants and beneficiaries. We believe that in this case, the additional disclosure requirement could be a deterrent to fiduciaries including investment options that may factor in ESG considerations, to the detriment of plan participants and beneficiaries. In today's litigation climate, in which hindsight is 20/20, including additional disclosure for a particular option is likely to be viewed by plan sponsors as a "red flag."

To the extent that the Department determines to include the disclosure requirement, we would appreciate clarification that the disclosure requirement would apply only when the "tie-breaker" test was used, and would not be required if a plan fiduciary determined to include an ESG fund in addition to other non-ESG funds in a line up, or if an ESG fund was included based on non-ESG economic risk and return factors.

Fundamentally, the "tie breaker" concept, while helpful in principle, risks missing the point: fiduciaries are often faced with a mix of strong options, no one of which can be clearly identified in advance as the optimal choice. So long as the fiduciary's decisions are grounded in a prudent review of appropriate risk/return considerations, whether a fund has an ESG strategy or not should not lead to a difference in how the resulting investment lineup is communicated to participants. In practical terms, we suspect that the disclosure requirement will simply mean that the tie-breaker provision is not used.

Longevity

Plan fiduciaries need regulatory stability in order to select investment options for retirement plan participants with confidence. Ideally, regulation in this area would stand the test of time and

would not be so overly prescriptive as to prompt revisions by future administrations, or to become stale as information, metrics and measures in various ESG arenas change over time. In light of these considerations, we would propose that the Department consider moving the list of specific climate change-related factors, governance factors, and workforce factors detailed in paragraph (b)(4) in the Proposal to the preamble of the new regulation. We have some concern that the inclusion of a specific list of factors in the body of the regulation could prompt revision of the regulation as a whole in the future and/or that the list (and, therefore, the regulation) could become stale over time.

The Proposal makes clear that a fiduciary may consider any factor material to the risk-return analysis. While Putnam believes focus on the integration of financially material environmental, social, and governance issues has the potential to enhance financial returns, we do not believe that the inclusion of a list of ESG factors in the body of the regulation is necessary for clarity on this point.

In the same manner, we would propose that the Department consider removing the following underlined language from clause (b)(2)(ii): **"**The projected return of the portfolio relative to the funding objectives of the plan, <u>which may often require an evaluation of the economic effects of climate change and other environmental, social, or governance factors on the particular investment or investment course of action</u>." We agree that these considerations are often relevant to the analysis of an investment; however, we are concerned that by singling out ESG considerations in this manner, the Department runs the risk of inviting later revisions to the regulation, resulting in potential uncertainty going forward.

Importance of proxy voting

Finally, we are fully supportive of the changes to the regulations related to proxy voting in the Proposal. Proxy voting is an essential cornerstone of strong governance and effective engagement, and, in our view, can strengthen issuer accountability and overall market discipline, potentially reducing risk and improving returns over time. At Putnam, the proxy voting functions are undertaken with the consistent goal of promoting strong corporate governance, acting in the best interests of our shareholders and clients. We believe that the proxy-related changes in the Proposal will help to support appropriate levels of proxy voting by plan fiduciaries going forward, while also recognizing that professional advisors, including investment managers that vote proxies across many accounts (and often perform this service as part of their overall portfolio management, without incremental expense to the plan), can have a practical role to play in alleviating the costs and burdens of voting at the plan level.

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We reiterate our support for the Proposal and the Department's overall policy goal of ensuring that fiduciaries consider appropriate, investment-based considerations when selecting investments for ERISA plans. We are encouraged by the progress made by the Proposal in creating a neutral and balanced framework that will work in the long-term. We appreciate the opportunity to work with you on the Proposal as it moves forward.

Sincerely,

Robert L. Reynolds

President and Chief Executive Officer, Putnam Investments