BNY MELLON

Mitchell E. Harris
CEO
Investment Management

240 Greenwich Street
New York, NY 10286

July 28, 2020

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

Re: Financial Factors in Selecting Plan Investments
RIN 1210-AB95

Dear Director Canary:

On behalf of BNY Mellon Investment Management, thank you for the opportunity to submit comments on the notice of proposed rulemaking entitled "Financial Factors in Selecting Plan Investments"[1] (the "Proposal") published by the U.S. Department of Labor (the "Department"). We support the Department's efforts to clarify the regulatory treatment of environmental, social, and governance ("ESG") factors under Title I of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), however we feel that the Proposal will create confusion and may increase risk for plan fiduciaries and suggest the following with respect to the Proposal:

- Acknowledging the complexity and importance of the Proposal, we respectfully request a 90-day extension of the deadline for public comments on the Proposal and additional hearings for the Department to gather the appropriate information and background regarding the use of ESG Factors by ERISA fiduciaries.
- We recommend that the Department distinguish between: (i) economically targeted investments ("ETI") that are selected in part for collateral, non-pecuniary benefits; and (ii) "ESG integration" strategies in which each potential investment's ESG factors are considered as part of a disciplined investment process that considers all material economic factors.
- We recommend that the Department remove paragraph (c)(1) from Section 2550.404a-1, as proposed, and maintain materiality standard in the definition of "pecuniary factors,"[2] which better reflects the usage of ESG factors in ESG integration strategies and removes the obligation to compare investments selected using pecuniary factors with "alternative investments."[3]
- We recommend that the Department revise the "all things being equal" test to follow the existing Department guidance with respect to when fiduciaries can use non-pecuniary collateral considerations in ETI strategies.

BNY Mellon Investment Management is a division of BNY Mellon, one of the world's largest financial services groups. With a presence in 35 countries, BNY Mellon looks to connect investors with opportunities across every major asset class. BNY Mellon Investment Management encompasses BNY Mellon's affiliated investment firms and global distribution companies, constituting over $2.0 trillion in AUM (as of June 30, 2020).

---

[1] Financial Factors in Selecting Plan Investments, 85 Fed. Reg. 39113-02 (June 30, 2020) (to be codified at 29 C.F.R. 2550.404a-1).
[2] 85 Fed. Reg. at 39,128 (29 C.F.R. § 2550.404a-1(f)(3)).
[3] 85 Fed. Reg. at 39,127 (29 C.F.R. § 2550.404a-1(c)(1)).

BNY Mellon Investment Management follows a multi-boutique investment management model that weds the specialist expertise from its investment firms offering solutions across every major asset class, backed by the strength, stewardship, and global presence of BNY Mellon. Each investment firm has its own unique culture, investment philosophy, and proprietary investment processes, and provides a global perspective. Our seven majority owned investment firms, are as follows (all AUM figures as of June 30, 2020): Alcentra ($35.3B), ARX ($4.4B), Dreyfus Cash Investment Strategies ($266.6B), Insight Investment ($901.7B), Mellon ($534B), Newton Investment Management ($56.3B), and Walter Scott ($74.4B).

Each of BNY Mellon's Investment Management firms considers the incorporation of ESG factors into investment decisions to better manage risk and generate sustainable long-term returns in alignment with its own philosophy. Five of our investment firms—Alcentra, Insight, Mellon, Newton, and Walter Scott—are signatories of the Principles for Responsible Investment ("PRI"). Newton and Insight Investment have A+ PRI rankings for ESG integration in corporate fixed income. Newton also has an A+ PRI ranking in ESG integration in equities, and Insight has an A PRI ranking for sovereign fixed income and securitized assets.

I. ESG Integration

Potential confusion with respect to the use of ESG factors may arise, in part, from the failure to distinguish ETI strategies from ESG integration strategies. ESG integration strategies consider ESG factors as important components of the range of economic information available to investment fiduciaries that are used in the investment decision-making process to make prudent risk-based determinations of risk and return. In contrast, ETIs are investments that aim to provide financial returns as well as collateral, non-financial benefits to parties other than the investor. For example, ETIs often advertise job creation or climate impact as goals of the investment.

Over the last thirty-years, the sophistication of global financial markets has increased significantly. During this time, the investment management industry has harnessed the power of information technology to better manage risks and identify new areas of profitable investment for clients, including ERISA plans. In a world of often rapid transitions at the economic and corporate levels, such insights allow fiduciaries to better navigate disruption and identify emerging opportunities.

Over that same period, the nature of business has changed markedly with physical assets no longer dominating the balance sheet of issuers in many industries. Intangible assets now account for a significant portion of the market valuation of securities, which has led to an evolution in accounting practices to reflect new ways of doing business.

ESG factors were originally considered "non-financial items" within the industry due to insufficient data regarding the impact of such factors on risk and profitability. Within the last decade, a deep body of research has been produced that demonstrates the material influence of ESG factors on the profitability of an enterprise and the performance of its securities.[4] The assumption that ESG factors are "non-financial" is a misnomer and a legacy of less informed times and insufficient data.

It should not be controversial that certain ESG factors have a material impact on the performance of a company's security, and even on the entity's long-term viability. For example, weak control of environmental activities such as pollution, over-consumption of raw materials or lack of recycling of waste materials readily leads to volatile or lower achieved margins or financial penalties that reduce investor returns.[5] Similarly with social issues: high staff turnover,

---

[4] *See* Gail Glazerman & Jeff Cohen, *"Non-Financial" Is a Misnomer, But Doesn't Have to Be a Missed Opportunity*, 32 J. Appl. Corp. Finance 2 (2020); Mozaffar Khan, George Serafeim, & Aaron Yoon, *Corporate Sustainability: First Evidence on Materiality*, 91 Acct. Rev. 1697 (2016).

[5] *See* Jean Rogers & George Serafeim, *Pathways to Materiality: How Sustainability Issues Become Financially Material to Corporations and Their Investors*, Harv. Bus. Sch. Working Paper, No. 20-056 (2019); Joseph H. Bragdon, Jr. & John A.T.

high strike rates or absenteeism or death or injury rates all have been linked to lower productivity and poor quality control.[6] Regarding governance, we know from years of empirical observation that poorly managed issuers can seriously damage investor returns.[7] To ignore the entire category of information and analysis that comprise ESG factors, therefore, could be deemed an abrogation of a fiduciary's responsibility to consider all material information when assessing the risk and return of any investment opportunity.

The increasing interest in ESG factors is driven by a broad swathe of investors and managers and is not confined to "ethical" investors or "activist" groups. Investment management is a competitive industry where failure to deliver the risk-adjusted returns demanded by clients can lead to commercial failure. Over the last decade, the performance of strategies explicitly integrating ESG information have, in aggregate, delivered no penalty on performance against the broader market or strategies not using such inputs and in many cases such strategies have delivered superior results.[8] It is for this reason that there has been a significant increase in the demand for products that incorporate material ESG factors into their investment decision-making process.

II. The Provision for the "Consideration of Pecuniary vs. Non-Pecuniary Factors" in the Proposal Will Prevent Fiduciaries from Using Otherwise Material Information When Making Investment Decisions.

We agree with the long standing principle that fiduciaries should select "investments and/or investment courses of action based solely on pecuniary factors"[9] for our ERISA clients. However, as drafted, the Proposal creates uncertainty as to the types of information fiduciaries are permitted to include in their investment research and may well prevent the inclusion of material information to the detriment of ERISA plans and participants. The investment industry as a whole is responding to the greater availability and understanding of often complex ESG data in recognition that "ESG factors and other similar factors may be economic considerations."[10]

While the Proposal defines a "pecuniary factor" as a factor that has "a material effect on the risk and/or return of an investment based on appropriate investment horizons consistent with the plan's investment objectives,"[11] it then adds an additional analysis that must be applied to "environmental, social, corporate governance, or other similarly oriented considerations."[12] This requirement for additional analysis implies that such considerations are in fact not pecuniary, and creates an undefined standard in the form of "opportunities that qualified investment professionals would treat as material economic considerations under generally accepted investment theories."[13] We recommend that the Department remove paragraph (c)(1) from Section 2550.404a-1, as proposed, and maintain the materiality standard in the definition of a "pecuniary factor."

Sophisticated investors and regulators recognize the concept of "materiality" as an important element of financial disclosure. Indeed, the U.S. Securities and Exchange Commission ("SEC") mandates that public issuers fully disclose material risks. The Investor-as-Owner Subcommittee of the SEC Advisory Committee recently recommended better

---

Marlin, *Is Pollution Profitable?,* 19 Risk Mgmt. 9 (1972). *See also* Antoine Dechezleprêtre & Misato Sato, *The Impacts of Environmental Regulations on Competitiveness*, 11 Rev. Environ. Econ. Policy 2 (2017).

[6] See Zeynep Ton & Robert S. Huckman, *Managing the Impact of Employee Turnover on Performance: The Role of Process Conformance*, 19 Org. Sci. 56 (2008). *See also* Tensie Whelan & Carly Fink, *The Comprehensive Business Case for Sustainability*, Harv. Bus. Rev. (Oct. 21, 2016), https://hbr.org/2016/10/the-comprehensive-business-case-for-sustainability.

[7] William Lazonick, *Profits Without Prosperity*, Harv. Bus. Rev. (Sept. 2014), https://hbr.org/2014/09/profits-without-prosperity.

[8] Gunnar Friede, Timo Busch & Alexander Bassen, *ESG and Financial Performance: Aggregated Evidence from More Than 2000 Empirical Studies*, 5 J. Sustainable Fin. & Inv. 210 (2015).

[9] 85 Fed. Reg. at 39,127 (29 C.F.R. § 2550.404a-1(b)(1)(ii)).

[10] *Id.* at 39,117. We note that governance factors are not limited to corporate issuers and can be material considerations with respect to sovereign issuers.

[11] *Id.* At 39,128 (29 C.F.R. § 2550.404a-1(f)(3)).

[12] 85 Fed. Reg. at 39,127 (29 C.F.R. § 2550.404a-1(c)(1)).

[13] *Id.*

and more standardized disclosure of material ESG information to better aid investors as they assess issuer risk.[14] Similarly, the Government Accountability Office has highlighted that existing ESG disclosures by issuers are insufficiently clear or inadequate for investors to make informed decisions.[15] These prior statements implicitly acknowledge that ESG factors are material information that should be available for use by fiduciaries and investors. In addition, academic research demonstrates that effective management of the material and salient risks facing a company is associated with better business performance.[16].

A. The Additional Test for an ESG Factor to be Considered Pecuniary Adds Uncertainty and Confusion for Fiduciaries using ESG Integration

The Proposal assumes that factors can easily be classified as "environmental, social, corporate governance, or similarly oriented considerations."[17] This is not always true. A factor can include economic elements and simultaneously be considered an ESG factor. For example, a threatened labor strike can clearly impact production costs and future revenue, but can also involve employee relations factors considered social. It is unclear how to classify this information under the Proposal.

If a factor is considered ESG, the Proposal requires fiduciaries to show that the factor presents "economic risks or opportunities that *qualified investment professionals* would treat as material economic considerations under *generally accepted investment theories*."[18] However, the rule does not further define what would amount to a qualified investment professional or how to determine which investment theories have been generally accepted. The resulting uncertainty regarding which factors must be considered ESG and when a fiduciary can treat an ESG factor as pecuniary will cause fiduciaries to limit the use of ESG factors to reduce their regulatory and litigation risk. Thus, plan investors would not receive the benefit of strategies and investment options that take into account the full range of material information regarding their portfolio investments.

B. Comparing Investments Chosen Using an ESG Factor with "Alternative Investments" Misunderstands How Fiduciaries Use ESG Factors in ESG Integration Strategies and Will Harm Plans by Preventing Fiduciaries from Incorporating Material Information.

When a fiduciary determines that a specific ESG factor is pecuniary, the Proposal requires the fiduciary to compare investments made using that ESG factor with "other available alternative investments that would play a similar role in" the plan's portfolios.[19] In an ESG integration strategy, ESG factors form only one part of the complete range of information used by a fiduciary when identifying the material factors that influence the future performance of a security. An ESG factor on its own would not be determinative with respect to an investment decision. In addition, when considering investments, there is no "alternative" menu of investments where ESG factors are unknown. As previously noted, many material factors that could be considered to include environmental, social, and particularly governance considerations, such as whether a company has an independent board, have become common diligence considerations for fiduciaries selecting securities within a broad range of strategies, including many non-ESG themed strategies. To require such a comparison would add an unreasonable burden to a fiduciary and prevent them from incorporating otherwise material information into its decision-making.

---

[14] Inv. Advisory Comm., *Recommendation from the Investor-as-Owner Subcommittee Relating to ESG Disclosure* (May 14, 2020), https://www.sec.gov/spotlight/investor-advisory-committee-2012/recommendation-of-the-investor-as-owner-subcommittee-on-esg-disclosure.pdf.

[15] GAO, *Public Companies: Disclosure of Environmental, Social, and Governance Factors and Options to Enhance Them*, GAO-20-530 (Washington, D.C.: July 2, 2020), https://www.gao.gov/products/GAO-20-530.

[16] Jean Rogers & George Serafeim, *Pathways to Materiality: How Sustainability Issues Become Financially Material to Corporations and Their Investors*, Harv. Bus. Sch. Working Paper, No. 20-056 (2019).

[17] 85 Fed. Reg. at 39,127 (29 C.F.R. § 2550.404a-1(c)(1)).

[18] *Id*.

[19] *Id*.

C. Reducing Availability of ESG-Integration Strategies Will Limit Investment Options and Reduce Diversification

Markets thrive on diversity of thought and action so that they can correctly price the full range of information and views. ESG-themed investment strategies may constitute only a portion of a plan's investments. On the other hand, many non-ESG-themed strategies may consider certain ESG factors as a routine part of their overall investment process. By having access to a broad range of different investment strategies that integrate ESG factors at varying levels, plan fiduciaries are able to achieve additional and customized levels of diversification within their respective investment portfolios. Limiting the consideration of ESG factors would reduce these options and, as a result, increase volatility and risk for plans.

III. The "All Things Being Equal" Test.

Firms that offer strategies that include various levels of ESG integration typically do not rely on the "all things being equal" test, since an ESG integration strategy by its nature focuses on the ESG factors that are believed to have a material impact on the return or risk of each potential portfolio investment. Accordingly, the "all things being equal" test is more appropriate for ETI strategies. We believe that distinguishing between ETI and ESG integration in the preamble to any final rule would clarify the application of the "all things being equal" test.

We are also concerned that the Proposal effectively imposes a new "burden of proof" standard on fiduciaries that use ETI under the "all things being equal" test. Under the prior Department guidance, and as recently as 2018, the Department described the "all things being equal" test as "when competing investments *serve the plan's economic interests equally well*, plan fiduciaries can use such [non-pecuniary] collateral considerations as tie-breakers for an investment choice".[20] However, under the Proposal's "all things being equal test," a fiduciary can only use non-pecuniary ESG factors when it is choosing between two "*economically indistinguishable*" investment options.[21] We suggest that the Department revise the "all things being equal" test to reflect the standard under prior Department guidance.

* * * * *

We support the Department's efforts to clarify the existing treatment of ESG factors under ERISA. The Proposal, however, does not fully account for the increasingly common integration of ESG factors into investment strategies. We suggest that the Department extend the comment period and hold hearings to give the Department the opportunity to gather information from fiduciaries and managers regarding the use of ESG factors by fiduciaries and incorporate the changes to the Proposal discussed above.

Sincerely,

Mitchell E. Harris

Mitchell E. Harris
CEO
BNYM Investment Management

---

[20] DOL Field Assistance Bulletin No. 2018-01 (Apr. 23, 2018) (citing DOL Interpretive Bulletin 2015-01 (published at 80 Fed. Reg. 65,135) (codified at 29 C.F.R. 2509.2015–01)).
[21] 85 Fed. Reg. at 39,127 (29 C.F.R. § 2550.404a-1(c)(2)).