July 30, 2020

The Office of Regulations and Interpretations
Employee Benefits Security Administration
Attention: Financial Factors in Selecting Plan Investments Proposed Regulation
Room N-5655
U.S. Department of Labor
200 Constitution Avenue, N.W.
Washington, DC 20210

Submitted Electronically via Federal eRulemaking Portal: www.regulations.gov

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

Ladies and Gentlemen:

Natixis Investment Managers appreciates the opportunity to comment on the Department of Labor's ("Department") notice of proposed rulemaking ("Proposal") regarding financial factors used to select plan investments by Employee Retirement Income Security Act ("ERISA") fiduciaries.

Natixis Investment Managers is a multi-affiliate organization with more than 20 specialized investment firms in the Americas, Europe and Asia. We apply Active Thinking® to deliver proactive solutions that help clients pursue better outcomes in all markets. Natixis Investment Managers ranks among the world's largest asset management firms[1] with $908.9 billion in assets under management.[2]

Nearly 750,000 ERISA-covered retirement plans holding roughly $10 trillion in assets provide retirement benefits to about 140 million workers and their families.[3] One of the keys to ERISA's success is the strong protection it provides to plan participants, including the fiduciary duties of prudence and loyalty applicable to plan fiduciaries charged with the responsibility of selecting plan investments. These legal duties are among the highest known to law.[4] The Proposal is making fundamental changes to the basic legal framework for fiduciary investment selection

[1] Cerulli Quantitative Update: Global Markets 2019 ranked Natixis Investment Managers as the 17th largest asset manager in the world based on assets under management ("AUM") as of December 31, 2018.

[2] AUM as of March 31, 2020. AUM, as reported, may include notional assets, assets serviced, gross assets, assets of minority-owned affiliated entities and other types of non-regulatory AUM managed or serviced by firms affiliated with Natixis Investment Managers.

[3] "Private Pension Plan Bulletin Abstract of 2017 Form 5500 Annual Reports Data," Employee Benefits Security Administration, July 19, 2019.

[4] See, e.g., Donovan v. Bierwirth, 680 F.2d 263, 271 (2d. Cir. 1982), and Tibble v. Edison Int'l, 843 F.3d 1187, 1197 (9th Cir. 2016).

under ERISA, and it is important that the Department fully consider the intended *and the unintended* consequences of the new requirements and restrictions it proposes on the use of environmental, social, and corporate governance ("ESG") factors.

Executive Summary

Let us be very clear—Natixis Investment Managers strongly supports the Department's legal view that fiduciaries may not subordinate the economic interests of participants to collateral goals. We agree that ERISA's fiduciary requirements put the economic ("pecuniary") interests of the participants first, and that fiduciaries cannot sacrifice returns or increase risks to pursue non-economic ("non-pecuniary") interests. As a result, we agree that some investment products and strategies simply are not prudent for ERISA plans.

However, we urge the Department to reconsider the valuable role that properly utilized ESG factors play in reducing risk and increasing returns for ERISA plan participants under generally accepted investment theories, especially in investment options designated as Qualified Default Investment Alternatives ("QDIAs").

First, numerous studies and the academic literature make it clear that integrating ESG factors into investment analysis can help reduce risk and increase performance—these are generally accepted investment theories. Where ESG factors are used as pecuniary factors material to the analysis of investments intended to promote the economic interests of participants, they are no different than any other relevant factors fiduciaries routinely consider. They are, in fact, "objective risk-return criteria" just like "benchmarks, expense ratios, fund size, long-term investment returns, volatility measures, investment manager investment philosophy and experience, and mix of asset types."[5] The blanket prohibition on using ESG factors in QDIAs, regardless of their pecuniary nature, is not only unjustified as a matter of policy but has a significant unintended consequence. As explained in the Preamble to the Proposal, any investment taking into account the pecuniary factor of "dysfunctional corporate management" is also taking into account an ESG factor. In our experience, nearly all investment managers would take into account this factor, and therefore, nearly any investment could be ineligible for use in a QDIA simply by doing so. The Department should focus on whether a factor is pecuniary or non-pecuniary, not whether it has to do with ESG. Pecuniary ESG factors present no risks that should concern the Department.

Second, contrary to ERISA's legislative intent and the Department's own regulatory precedent, the Proposal would overrule investment professionals applying generally accepted investment theories. It would substitute instead the Department's arbitrary and capricious judgement that ESG factors—even when deemed "pecuniary" interests central to the evaluation of an investment—cannot prudently be used as, or even serve as a component of, a QDIA. Under ERISA, that decision should not be made by the Department at all, but especially not in a rulemaking that will establish a static and unchanging position, preventing fiduciaries from ever being able to apply generally accepted investment theories with regard to ESG factors.

[5] Proposed 29 CFR 2550.404a-1(c)(3)(i).

Finally, despite the importance of these issues, the risks of unintended consequences, and contrary to the Executive Orders governing the regulatory process, the Department rushed to publish this Proposal in only a few months without fully appreciating the role of ESG factors in generally accepted investment theories. The Department then provided only a 30-day period for public comments, which is not sufficient to give a meaningful opportunity to comment.

For all of these reasons, we urge the Department to withdraw the rulemaking while it holds a public hearing to receive testimony on the role of ESG factors in investment analysis under generally accepted investment theories, information it did not fully consider in developing the Proposal. If the Department does choose to proceed with a final rulemaking, we urge the Department to eliminate the prohibition on ESG factors in QDIAs. The Department should be concerned with whether a factor is pecuniary, not whether it is related to ESG. This would serve the Department's primary objective—preventing fiduciaries from using plan investments for their own collateral goals—without putting ESG factors in regulatory stasis, preventing participants from benefiting from innovative uses or changes necessitated by different market conditions.

We explain these issues in more detail below.

Integrated ESG Factors are Pecuniary under Generally Accepted Investment Theories—the Department Should Be Concerned with a Factor's Pecuniary Status, Not Whether it is ESG

As the Department notes, the broad category of ESG investments includes a wide array of strategies and products. Some of these would utilize ESG factors in a way that is not pecuniary under the Proposal. We agree these types of ESG investments generally are not consistent with ERISA's requirements, and we are not addressing them in our comments. However, many investment advisers integrate ESG factors into their investment processes for pecuniary reasons, such as to reduce risk and/or increase returns. As such, ESG factors may be economically relevant and, therefore, can impact the value of investments.

At Natixis Investment Managers, we integrate ESG factors into our investments to serve pecuniary interests. We do this using generally accepted investment theories. Our investment products that incorporate ESG factors compare favorably to other investments based on their risk/return profiles over time, and serve the needs of participants very well. A majority of our 20+ investment management firms globally, many of which are world-renowned in their respective disciplines and have strong, decades-long track records, have formal policies in place describing their processes for integrating financially material ESG factors as part of broader investment frameworks. Our managers generally identify ESG considerations as financially material and, therefore, inextricably linked to an issuer's ability to create value for investors over time, creditworthiness, default risk, and so on. For our managers, ESG assessment is a means to an end—allowing for a better overall picture of the risks and opportunities associated with a given investment in an effort to achieve superior risk-adjusted performance—and is part of the mosaic of decision-useful information considered by analysts and portfolio managers on a daily basis. The majority of our managers' products would not be considered "ESG-themed." Where our managers do offer "ESG-themed" funds, the investment objectives remain solely pecuniary

in nature, with a majority of these funds achieving these pecuniary objectives since their respective inception dates. A product being "ESG-themed" does not preclude it from having pecuniary investment objectives, such as to maximize total return, to outperform broad market indices, to provide attractive capital appreciation and income, and so on.

The Department notes the "increase in asset flows into ESG funds," stating "the amount of assets invested in so-called sustainable funds in 2019 was nearly four times larger than in 2018", citing Morningstar data. What the Department overlooks is that the bulk of this asset growth is not explained by new money flowing into "so-called sustainable funds" or "ESG-themed" funds. Rather, much of this asset growth can be attributed to a wide array of asset managers increasingly formalizing the incorporation of ESG considerations in decision-making processes and doing so across larger portions of assets under management. Morningstar categorizes funds as "sustainable" if investment strategy language in regulatory filings (e.g., prospectus documents) includes mention of ESG-related considerations. However, this categorization is not a label nor is it an indication that a fund has non-pecuniary objectives. A 2018 survey of money managers conducted by the US Forum for Sustainable and Responsible Investment (USSIF) revealed that risk, return and fiduciary duty were top reasons those managers incorporated ESG considerations in decision-making.

Many scholarly and industry studies (including, but not limited to, those listed below) similarly show that ESG considerations can reduce risk and increase risk-adjusted returns. When used in this way, these ESG factors serve the economic interests of participants and can offer significant value to ERISA plans, including when used as QDIAs:

- In 2015, the Journal of Sustainable Finance and Investment reviewed the primary and secondary data of previous academic review studies, combining the findings of roughly 2,200 individual studies. The results show that "…the business case for ESG investing is empirically very well founded. Roughly 90% of studies find a nonnegative ESG–[Corporate Financial Performance] relation."[6]
- Based on a detailed analysis of thousands of publicly traded companies, a Bank of America study found that companies with better ESG characteristics performed better financially within the time frames studied, while those with poor records posed higher risks for themselves and for investors. For example, S&P 500 companies in the top 25% by ESG ratings experienced lower future earnings-per-share volatility than those in the bottom 25% from 2005-2015. 90% of S&P 500 bankruptcies were by companies that had below average ESG rating in the prior five years.[7]

[6] "ESG and Financial Performance: Aggregated Evidence from More than 2000 Empirical Studies," Journal of Sustainable Finance and Investment, 2015.

[7] "*ESG from A to Z: A Global Primer,*" Bank of America, November 25, 2019.

- Another study found that the top quintile of companies rated on ESG factors outperformed the bottom quintile by 3 percentage points.[8]
- A Morgan Stanley survey of nearly 11,000 funds from 2004-2018 compared sustainable funds to traditional funds. It found that sustainable fund returns were comparable to traditional funds, but reduced downside risk and lowered volatility.[9]
- A McKinsey & Company survey of business leaders and investment professionals found that 83% expect that ESG programs will contribute more shareholder value in five years than today.[10]

The Proposal misconstrues the valuable role that properly utilized ESG factors play in reducing risk and increasing returns for ERISA plan participants under generally accepted investment theories and treats all uses of ESG factors as if they present the same risks as non-pecuniary factors. This approach simply is not justified by the literature, and therefore it risks being arbitrary and capricious.

What's more, because the Proposal focuses on ESG status rather than pecuniary status, the prohibition on ESG factors in QDIAs likely applies to virtually any investment, not just to those that are intended to incorporate ESG factors. In our experience, corporate governance is an issue considered by every investment manager to one degree or another. Similarly, any investment manager will take into account whether a company that pollutes faces regulatory and litigation risk. Are these analyses involving ESG factors triggering additional fiduciary duties and exclusion from QDIAs?

The Proposal suggests that they are, as the Preamble notes that:

> "…factors that <u>sometimes are considered without regard to their pecuniary import</u>—such as environmental considerations—will present an economic business risk or opportunity that corporate officers, directors, and qualified investment professionals <u>would appropriately treat as material economic considerations under generally accepted investment theories</u>. For example, a company's improper disposal of hazardous waste would likely implicate business risks and opportunities, litigation exposure, and regulatory obligations…Dysfunctional corporate governance can likewise present pecuniary risk that a qualified investment professional would appropriately consider on a fact-specific basis."[11] [emphasis added]

Thus, "dysfunctional corporate governance" is an ESG factor that is also pecuniary. What is the result of this dual status when this factor is considered by an investment manager? The

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[8] MSCI ESG Research LLC, FactSet, Refinitiv, Sustainalytics, BofA Global Research U.S. Equity & Quant Strategy.

[9] "Sustainable Reality: Analyzing Risk and Returns of Sustainable Funds," Morgan Stanley report, 2019.

[10] "'The ESG Premium,' New Perspectives on Value and Performance," McKinsey, Feb. 2020.

[11] 85 Fed. Reg. 39,116 (June 30, 2020).

Proposal's operative text at 404a-1(c)(1) and (c)(3) explains in some detail what considering a factor that is both pecuniary and ESG triggers:

> 404a-1(c)(1): "…Fiduciaries considering environmental, social, corporate governance, or other similarly oriented factors as pecuniary factors are also required to examine the level of diversification, degree of liquidity, and the potential risk-return in comparison with other available alternative investments that would play a similar role in their plans' portfolios." [emphasis added]
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> 404a-1(c)(3)(i): "…a fiduciary's addition (for the platform) of one or more prudently selected, well managed, and properly diversified investment alternatives that include one or more environmental, social, corporate governance, or similarly oriented assessments or judgments in their investment mandates, or that include these parameters in the fund name…[does not violate the rules provided] (i) the fiduciary uses only objective risk-return criteria, such as benchmarks, expense ratios, fund size, long-term investment returns, volatility measures, investment manager investment philosophy and experience, and mix of asset types…in selecting and monitoring all investment alternatives…[and] (iii) the environmental, social, corporate governance, or similarly oriented investment mandate alternative is not added as, or as a component of, a qualified default investment alternative…" [emphasis added]

The Proposal should be amended to treat all pecuniary factors alike and to remove the QDIA exclusion. This would address the issue the Department is primarily concerned about and avoid definitional entanglements about what ESG means. If a factor (of whatever type) is non-pecuniary, it cannot be considered.[12] If a factor (of whatever type) is pecuniary, it is an objective risk/return criteria like any other relevant factor, and should be eligible to be part of any prudent investment offered by a plan.

Legislative and Regulatory History Direct the Department to Let Generally Accepted Investment Theories Dictate Prudence, Not Static, Regulatory Edicts

In adopting the "Prudent Man" standard in ERISA Sec. 404(a)(1)(B), Congress expressly rejected the notion of having the government dictate which investments and investment strategies ERISA plans must adopt or must avoid. The Department has consistently recognized this in prior rulemakings. Citing the legislative intent of Congress that "…the 'prudence' rule in [ERISA] sets forth a standard built upon, but that should and does depart from, traditional trust law in certain respects…,"[13] the Department concluded when adopting the rule the Proposal now

[12] We agree with the Department's decision to continue to permit the use of non-pecuniary factors to select among "indistinguishable" investments. However, we believe the Department is incorrect in suggesting this would arise only rarely. A prudent ERISA fiduciary investment process typically results in multiple investments that meet the plan's investment criteria—any of these investments are "indistinguishable" from a fiduciary perspective as they are all equally prudent. ERISA does not require selecting the "best" of these—indeed, there typically is no way to make such a determination, and we do not believe the Department intends to suggest that there is.

[13] 44 Fed. Reg. 37,222 (June 26, 1979), citing H.R. Rep. No. 1280, 93d Cong., 2d Sees. 302 (1974).

seeks to amend that it was not "…appropriate to include in the regulation any list of investments, classes of investments, or investment techniques…no such list could be complete; moreover, the Department does not intend to create or suggest a 'legal list' of investments for plan fiduciaries."[14]

In promulgating the QDIA regulation in 2007, the Department resisted calls to identify specific investment products as QDIAs because doing so would cause them to be fixed at a certain point in time rather than "…accommodate future innovations and developments in retirement products."[15] In 2011, the Department even more clearly articulated this principle when it declined to define the statutory term "generally accepted investment theories," writing, "…attempting to provide additional specificity in this area, such as by prescribing an acceptable list of theories and practices, may result in significant unintended consequences. Specific requirements might limit advisers' ability to select or apply the most current or effective investment theories, and thereby impede beneficial innovations in investment advice and reduce the economic benefits of the statutory exemption."[16]

Unfortunately, this is exactly where the Proposal departs from ERISA's requirements and 40 years of regulatory precedent. Rather than relying on generally accepted investment theories to guide fiduciaries in discerning when ESG factors are used to promote the pecuniary interests of participants, the Proposal arbitrarily would substitute the Department's judgement.

The Regulatory Process Employed Does Not Provide a Meaningful Opportunity for Public Comments and is Based on Inadequate Data

The semiannual Unified Agenda of Federal Regulatory and Deregulatory Actions requires each agency to list all of the proposed rules it expects to publish in the next 12 months.[17] There was no mention of the Proposal in the Fall 2019 Unified Agenda released on November 20, 2019. The Department subsequently issued the Proposal but provided an unusually short comment period of only 30 days.

We believe a public hearing is necessary for the Department to receive testimony regarding the academic and professional consensus regarding the role of ESG factors in investing. Given that this information is central to the Department's policy decisions (especially that pecuniary ESG factors cannot be part of a QDIA despite being prudent as a designated investment alternative), proceeding without conducting such a hearing supports a conclusion that the decision was arbitrary.

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[14] 44 Fed. Reg. 37,225 (June 26, 1979).

[15] 72 Fed. Reg. 60,460 (October 24, 2007).

[16] 76 Fed. Reg. 66,157 (October 25, 2011).

[17] "About the Unified Agenda" on the website of the Office of Regulations and Information at https://www.reginfo.gov/public/jsp/eAgenda/UA_About.myjsp last accessed on July 23, 2020.

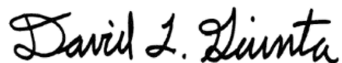
Conclusion

Natixis Investment Managers agrees that ERISA imposes fiduciary obligations of prudence and loyalty on fiduciaries that prevent them from subordinating the economic interests of participants to collateral goals. However, the Proposal is in need of fundamental modification to protect the interests of participants and beneficiaries. As written, the Proposal is inconsistent with ERISA's historical reliance on generally accepted investment theories, and the Department should not substitute its judgement for financial professionals regarding investments or investment strategies and analytics.

The Proposal should be modified in any final rule to treat pecuniary ESG factors like any other pecuniary factor, removing any additional requirements and making investments utilizing such ESG factors eligible for use in QDIAs.

We would be happy to meet with you at your convenience to discuss these or any other issues related to the Proposal, and we thank you for everything you do to protect American workers.

Sincerely,



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