VERT
ASSET MANAGEMENT

Submitted via regulations.gov

July 30, 2020

Office of Regulations and Interpretations
US Department of Labor
Employee Benefits Security Administration
Room N-5655
200 Constitution Avenue NW
Washington, D.C. 20210

RE: Proposed rule on Financial Factors in Selecting Plan Investments (RIN 1210-AB95)

To Whom It May Concern:

On behalf of Vert Asset Management, I respectfully submit the following comments in response to the Department of Labor's proposed rule, "Financial Factors in Selecting Plan Investments" (RIN 120-AB95).

Vert Asset Management is a dedicated ESG (environmental, social, and governance) asset manager. We work in close consultation with academic experts and experienced portfolio managers to create investment products that work for the wealth management community. Vert combines ESG research and a disciplined rules-based process to deliver funds that achieve investors' twin goals of sustainability and market rates of return. Our clients are primarily financial advisors. We currently manage one fund with $50.5 million AUM (as of June 30, 2020) that invests in publicly traded real estate investment trusts.

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 an investment portfolio construction process. The Proposal uses the acronym "ESG" as a broad catchall phrase to define various types of "sustainable or socially responsible or impact" investing.

ESG integration is the consideration of risk factors as part of prudent fiduciary management and a strategy that takes these risks into account in investment actions. ESG is shorthand for environmental, social, governance issues that could affect economic value. It is not a preferences-based strategy.

The term ESG is used throughout the Proposal as a broad statement with several consequences ascribed to it. We would argue there are differences between a portfolio construction process whose goal is to have a prescribed social outcome versus a portfolio that is constructed using financial and non-financial material metrics to evaluate risks. Environmental, social, and governance issues used in ESG integration are not "values" or preferences, they are "economic value" or business risk indicators. Value versus values. There is *economic value* in looking at risks to a business and in turn the investment portfolio. *Values* are preferences. If a portfolio is negative-screened on a client's stated preferences that is values. The following diagram illustrates how ESG integration frames non-financial material business risks:

Sample of issues and corresponding metrics that are examined under an E S G framework[1]

	ENVIRONMENT **Natural Resources** **Pollution & Waste** **Climate Change** **Environmental Opportunities**		**SOCIAL** **Human Capital** **Product Liability** **Stakeholder Opposition** **Social Opportunities**		**GOVERNANCE** **Corporate Behavior** **Corporate Governance**	
EXAMPLE ISSUES:	Greenhouse Gas Emissions	Energy Efficiency	Health & Safety	Labor Rights	Board Independence	Executive Pay
EXAMPLE METRICS:	CO_2 Emissions Per Unit Produced	Energy Use Per Square Meter	Employee Accidents Relative to Total Hours Worked	Number of Active Controversies	Independent Members Relative to Affiliated Members	Executive Pay Ratio & Disclosures

For instance in real estate, ESG issues help to identify physical risks to capital. There are real financial risks associated with the climate change. There are city regulations around the country requiring buildings to consume less energy.[2] There are physical risks to assets if a property is based in a flood risk area. Similarly, there is transitions risks if a property is located in an area with significant heat or water stress - adaptations to the property to keep it habitable are real financial risks.

The effect of sustainability issues in the capital markets and portfolio construction process cannot be disentangled from business decisions and operating choices that underlying companies are faced with. Did you know many real estate companies use an environmental impact assessment to evaluate a property before acquiring it as part of their due diligence? Did you know real estate companies conduct a life-cycle analysis as part of their investment into a property when deciding how to best retrofit a building for energy efficiency? This is because non-financial metrics are often financial indicators.

The Proposed Rule states that ERISA fiduciaries have fulfilled their obligations if they have "selected investments and/or investment courses of action based solely on pecuniary factors" and that "ESG factors and other similar factors may be economic considerations." In fact, there is now an extensive

[1] **Sustainable Investing: From Niche to Normal.** Vert Asset Management (2017) https://www.vertasset.com/position-paper/2017/position-paper-esgnichetonormal2017/

[2] **Exploring Building Performance Standards.** Institute for Market Transformation (2020) https://www.imt.org/how-we-drive-demand/building-policies-and-programs/exploring-building-performance-standards/

body of research that makes clear that ESG factors are material investment considerations. As such there exists a sound basis for our decision to integrate ESG issues and indicators into our investment actions.

Here are a couple examples of research into the validity of analysis ESG issues in real estate and investments:

The Financial Rewards of Sustainability: A Global Performance Study of Real Estate Investment Trust Franz Fuerst, (2015).
The paper analyzes the impact of sustainability initiatives measured by Global Real Estate Sustainable Benchmark (GRESB) on REITs operational performance. The author finds that REIT owners must invest in sustainability measures to remain competitive as it enhances operational performance and lowers risk exposure and volatility.

Does Increased Investment in Responsible Properties Lead to Better Corporate Performance?
McGrath, K. in The Munich Personal RePEc Archive (2014).
The paper examines the impact of eco-certified properties has on the corporate performance of REITs. The author finds ownership of LEED certified properties had a positive impact on firm's funds from operation and return on average assets.

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

The report researched the economic results of ESG practices by corporate managers and the implications for investors. The report observed three key points: 1) 90% of the cost of capital studies show that sound ESG standards lower the cost of capital of individual companies; 2) 88% of the studies show that solid ESG practices result in better corporate operational performance; and, 3) 80% of the studies show that company stock price performance is positively influenced by good sustainability practices. The study also found active ownership allows investors to influence corporate behavior and benefit from improvements in sustainable business practices. It concluded that ESG is in the best interest of investors and corporate managers to incorporate sustainability considerations into their decision-making processes. Companies that behave as better stewards of people and planet have improved corporate financials.

ESG & Corporate Financial Performance: Mapping the Global Landscape, University of Hamburg and Deutsche Bank (2015)
Deutsche Bank partnered with the University of Hamburg in 2015 to review 2,000 academic papers and found that the business case for ESG investing is empirically well-founded; they concluded that ESG indicators pay off financially and appear stable over time.i The review uncovered that 62.6% of studies examined show a positive correlation between integrating ESG factors and portfolio performance. The study corroborated work done by others on issues of materiality (the extent to which ESG considerations impact company financials). They found that environmental and social issues vary in materiality across industries, but governance issues are integral to the proper functioning of all companies. For instance, where there is a lack of oversight on governance issues there is a potential for reputational risk and financial damage. The study concluded that it is more

beneficial to apply the E, S and G independently, rather than together. The study also found similar performance links with ESG factors in bonds and real estate as well.

Corporate Sustainability: First Evidence on Materiality, Mozaffar Khan, George Serafeim and Aarn Yoon, (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 over13,397 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.

A policy by the DOL that simply clarifies that fiduciaries must integrate material factors into their investment actions, and that ESG factors may be material, would be appropriate. We are concerned, however, that the remaining components of the proposal create confusion and are likely to cause fiduciaries to believe they are not permitted to consider material ESG factors in their investment analysis.

Thank you for taking our investment management perspective into consideration. The Proposed Rule is likely to lead to confusion for retirement plan fiduciaries. We, therefore, urge you to retain existing guidance and not move forward with a final rule.

Thank you for your time and consideration.

Sincerely,

Sarah Adams
Chief Sustainability Officer
Vert Asset Management