BMO Global Asset Management

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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
Proposed Regulation (RIN 1210-AB95)

Ladies and Gentlemen:

BMO Global Asset Management ("BMO GAM") appreciates the opportunity to comment on the Department of Labor's proposed amendments to the "Investment Duties" regulation under Title I of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), entitled "Financial Factors in Selecting Plan Investments" (the "Proposal").

We appreciate the Department's effort to bring clarity to ERISA guidance in the use of environmental, social and corporate governance ("ESG") considerations given the increasing attention paid to integrating ESG criteria into a prudent investment management process. Nonetheless, we are concerned that the Proposal is premised on the assumption that integrating ESG considerations into an investment management strategy is inherently non-pecuniary and inconsistent with the essential goal of plan fiduciaries to be focused solely on the plan's financial returns and the interests of plan participants. We are concerned that the Proposal could discourage plan fiduciaries from considering any approach to ESG investing, including those with pecuniary objectives and thereby hinder the financial goals of investors.

Overall, we agree with the comment letters submitted by our trade associations, including the Securities Industry Financial Markets Association ("SIFMA"), the Investment Company Institute ("ICI"), and the American Bankers Association ("ABA"). We appreciate the detailed thought each trade association has put into analyzing the Proposal and want to emphasize the points raised below.

Background

BMO GAM is a multi-asset management business with US$240.65 billion (as of March 2020) in AUM. Our business is characterized by specialized, regional investment teams providing a range of investment solutions, with the objective of delivering investment management expertise to clients across North America, Europe, Asia/Pacific and the Middle East ("EMEA").

At the center of our investment solutions, which span alternatives, equity, fixed income and multi-asset strategies, lies our responsible investment strategy which includes our approach to ESG integration. Our global experience with ESG considerations spans more than 35 years, successfully integrating them into our investment processes and active ownership activities. We fundamentally believe that prudent risk management and assessments of long-term pecuniary value necessitate the consideration of ESG criteria.

Discussion

ESG Considerations are integrated into prudent investment analysis.

ERISA Section 404 is clear that plan fiduciaries must ensure that professional investment principles govern a prudent process undertaken to manage their employee benefit plans. The current 404 regulation clearly and effectively outlines that mandate. Plan fiduciaries well understand their obligations under the statute and regulation. The Proposal suggests, however, that ESG considerations are seldom, if ever, pecuniary and, therefore, not part of a prudent process.

Globally and across investment styles, ESG considerations are increasingly integrated as part of prudent and long-term investing strategies. Many investors and managers, including BMO GAM, seek investment in companies that mitigate ESG risks or present sustainable growth opportunities for the long-term economic benefit to these companies. One framework, which breaks down material ESG criteria by sector, is the Sustainable Accounting Standards Board ("SASB") standards. An example of a financially material ESG issue considered in the SASB framework is harmful releases into the environment from company operations, resulting in litigation risks that may impact the company's financial condition or operating performance. Investors are increasingly referring to frameworks like SASB within the investment process, which enables both investors and companies to report and measure ESG performance within and across sectors. The increasing quantity and quality of ESG data available to investors allows ESG information to be incorporated into the investment process in a systematic and beneficial way.

There is increasing empirical evidence to support such strategies, as discussed in the comment letters submitted by SIFMA, ICI and the ABA. Fiduciaries need to consider all material criteria when making investment decisions as they evolve in response to ever-changing markets, industries and investment theories.

More research on ESG investing approaches is necessary

The Proposal imposes heightened scrutiny to any and all considerations of ESG and/or "any similarly oriented assessments or judgements." There are several different ways in which investment managers use ESG considerations, many of which are focused on risks and returns. The consequence of an approach that does not clearly acknowledge these differences is that it will likely discourage the use of ESG to improve an investment's risk and return profile and impede investors' financial objectives.

As the ESG space is evolving at a rapid pace and there is little consensus about what constitutes an "ESG investment," we agree with the Department that more rigor and precision is needed when using it and associated terms in plan fiduciary management. However, we suggest distinguishing between various ESG approaches including integration, screening, thematic and impact investing. As currently drafted, the Proposal puts them into a single category of "ESG investing." There is, for example, a significant difference in approach for investment funds that integrate material ESG criteria for risk management purposes, versus funds that are oriented towards achieving specific ESG-related impacts. Such concepts should not be equated as the same approach and thus deemed to be "non-pecuniary."

As recently as November 2019, The Investment Association published industry-wide definitions on ESG investing to create a common language for fund managers, plan sponsors, advisers and consumers. In addition to this report, BMO GAM would welcome the opportunity to comment on ESG terminology and differentiate between various ESG approaches as it relates to the investment management process.

Additional regulatory requirements and costs

The Proposal would effectively impose an unnecessary burden for plan fiduciaries when selecting ESG investments, even where they have prudently evaluated investments on pecuniary grounds. The additional record-keeping requirement under the Proposal for plan fiduciaries to document their analysis of alternative investment options to justify consideration of an ESG investment specifically is not needed and generally not required for any other investment strategy. Fiduciaries following a prudent process – as already required by the current regulation – understand their obligations.

From experience working with our clients, if they believe that ESG considerations are material to the investment management process, they will likely not seek to evaluate investment options that do not consider these criteria. As such, the Proposal would require plan fiduciaries to complete an additional record-keeping exercise with no benefit to plan participants. Resources would be expended to justify financially sound, prudent decision-making to satisfy a regulatory requirement yet adding no benefit to the process. We believe that this requirement will result in increased costs from a time and resource perspective for plan fiduciaries without advancing the plan's financial returns or interests of the participants.

Overly restrictive definition for ESG-themed funds in DC plans

The Department is proposing to prohibit defined contribution (DC) plans from using any ESG strategy as a default option for plan participants, even if selected by plan fiduciaries solely on the basis of objective risk and return criteria. As noted above, the Department does not draw distinctions between strategies that integrate ESG from a risk or growth opportunity perspective, versus those that are seeking investments within a specific ESG theme or driving for measurable environmental or social impact. In our view, the prohibition on DC plans is too restrictive and would exclude integration of financially material ESG considerations and metrics into the investment process. A plan fiduciary's selection of a fund that fails to consider material ESG criteria in its fundamental analysis could even be viewed as imprudent and likely a breach of fiduciary duty.

Conclusion

Investment professionals have been using ESG considerations for decades in their research and analysis to achieve better investment performance, particularly over long time horizons. The proposed rules of the Department would likely discourage plan fiduciaries from considering any approach to ESG investing including those with pecuniary objectives. Where ESG considerations are prohibited, the ability of plan fiduciaries to grow assets and manage risk effectively over the long-term could be significantly impaired.

As such, we urge the Department to withdraw the Proposal and schedule a public hearing or roundtable with ERISA plan fiduciaries and other experts to gather the most current research on the various ESG approaches to investment management. We appreciate the opportunity to submit this comment and are available to answer any questions.

Sincerely,

Kristi Mitchem | Chief Executive Officer
BMO Global Asset Management