ENVESTNET

Submitted via regulations.gov

July 30, 2020

Office of Regulations and Interpretations US Department of Labor Room N-5655 200 Constitution Avenue NW Washington, DC 20210

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

To whom it may concern:

We are writing to provide comments in response to the Department of Labor's proposed rule, "Financial Factors in Selecting Plan Investments" (RIN 1210-AB95) (the "Proposal").

Envestnet, Inc. (NYSE: ENV) is a financial services company and a wealth management platform managing over $3 trillion in AUA/AUM. Our mission is to empower advisors and financial service providers with innovative technology, solutions, and intelligence to make financial wellness a reality for everyone. Over 103,000 advisors across more than 4,900 companies (including 16 of the 20 largest U.S. banks, 46 of the 50 largest wealth management and brokerage firms, over 500 of the largest RIAs, and hundreds of FinTech companies), leverage the Envestnet platform to grow their businesses and client relationships.

The Proposal reflects a fundamental misunderstanding of how professional investment managers use environmental, social and governance ("ESG") criteria as an additional level of due diligence and analysis in the portfolio construction process. Investment managers increasingly analyze ESG factors precisely because these factors are material to financial performance and the risk-adjusted value of a particular investment or course of conduct. In the US SIF Foundation's 2018 survey of sustainable investment firms in the United States, 141 money managers with aggregate assets of more than $4 trillion responded to a question on their motivations for incorporating ESG criteria into their investment process. Three-quarters of these managers cited the desire to improve returns and to minimize risk over time. Fifty-eight percent cited their fiduciary duty obligations as a motivation.[1] And according to a recent Cerulli survey, a growing percentage of institutional investors. (50%) believe they are not meeting their fiduciary duty if they do not take long-term ESG risks into consideration.[2]

The Proposal suggests that integrating ESG into an investment decision is meant to promote environmental, social and public policy goals. This viewpoint misinterprets the objective of integrating ESG factors into portfolio management decisions. ESG integration involves incorporating additional information into the investment process in an effort to better evaluate risk and potential return and achieve a more holistic and comprehensive view of a company and its ability to create long term value.

The Proposal also suggests that ESG criteria are non-pecuniary and subsequently unrelated to risk–return characteristics. We believe that while the relevance of particular ESG issues varies by industry, and several studies

[1] 2018 Report On US Sustainable, Responsible And Impact Investing Trends
[2] https://info.cerulli.com/US-ESG-2019.html

have demonstrated that ESG issues are material to financial performance.[3] There is a direct and important link between material ESG issues and financial value drivers.

Despite the aim of providing clarity for ERISA fiduciaries, the Proposal in fact would create significant confusion for ERISA investment fiduciaries. The Proposal suggests that ESG integration may present inappropriate investment risks, and that ESG integration sacrifices returns. This appears to be, in part, because of a failure to distinguish between ESG integration and economically targeted investing ("ETI")[4]. ESG integration involves considering ESG factors as part of prudent risk management decision making by taking those risks into account. ETIs involves making investments that aim to provide financial returns as well as collateral, non-financial benefits. For example, ETIs often advertise job creation or climate impact as goals of the investment.

In our experience, incorporating ESG factors into the portfolio construction process serves as a mechanism to better evaluate risk, and as such, is prudent risk management in investment decision making. This conclusion is supported by Envestnet's recent findings. ESG has been hypothesized to protect during market downturns because of its focus on high quality companies that are more prepared for market shocks. However, in the context of an 11 year bull market, we haven't had many opportunities to see evidence of this. We therefore conducted a review of ESG focused mutual funds and ETFs available on the Envestnet platform and found that ESG focused strategies outperformed their non-ESG peers, in three major asset classes (US Equity, International Equity, and Fixed Income) over both a 4 month (1/2020 – 4/2020) and 12 month (5/2019 – 4/2020) period.[5]

This research mirrors findings by Morningstar and BlackRock, among others, that ESG focused strategies provide downside protection and can provide outperformance during periods of severe volatility.

- Morningstar found that in the first quarter of 2020, seven out of 10 sustainable equity funds finished in the top halves of their Morningstar Categories, and 24 of 26 ESG-tilted index funds outperformed their closest conventional counterparts. Morningstar notes that a lower exposure to energy and higher exposure to technology in these funds contributed to outperformance, but the primary driver was that "sustainable funds appear to have benefited from selecting stocks with better ESG credentials".[6]
- Morningstar also tracked performance of ESG and non-ESG ETFs, comparing rolling monthly returns up to March 20 in four Morningstar categories. The results show that ESG ETFs outperformed non-ESG ETFs in three of the four categories examined: Global, Europe, and US Large-Cap.[7]
- Analysis from MSCI found positive results for its US ESG indexes; the MSCI ACWI ESG Leaders Index outperformed the MSCI ACWI by 1.1% from January 31-March 12.[8]
- S&P findings also show ESG indices holding up better than non-ESG counterparts.[9]

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[3] Mozaffar Khan, George Serafeim and Aaron Yoon, "Corporate Sustainability: First Evidence of Materiality," Harvard Business School, November 2016; Jody Grewal, George Serafeim and Aaron Yoon, "Shareholder Activism on Sustainability Issues," Harvard Business School, August 2016; https://corpgov.law.harvard.edu/2018/05/10/materiality-matters-targeting-the-esg-issues-that-impact-performance/

[4] ETI refers to any investment or investment course of action that is selected, in part, for its expected non-pecuniary benefits, apart from the investment return to the employee benefit plan investor.

[5] Envestnet PMC 2020

[6] https://www.morningstar.com/articles/976361/sustainable-funds-endure-the-first-quarter-better-than-conventional-funds

[7] https://www.morningstar.co.uk/uk/news/201154/how-esg-etfs-have-performed-in-the-sell-off.aspx

[8] https://www.linkedin.com/posts/msci-inc_factor-covid19-msciresearch-activity-6645732006598705152-hNQ1/

[9] https://www.spglobal.com/en/research-insights/articles/through-the-turbulence-a-new-breed-of-esg-indices-delivers

These are encouraging findings that strengthen the case for ESG integration by demonstrating the value of this additional risk lens in the investment process. Mitigating downside risk is important to retirement savers who are investing for the long term.

More broadly and beyond the recent market volatility, it is now widely accepted that integrating environmental, social and governance insights into investment decision making at a minimum does not sacrifice performance. Analysis and studies from Morgan Stanley, Bank of America, Deutsche Bank, Nuveen, Harvard Business School, Oxford, MSCI, TIAA-CREF, and UBS, among others, point to this conclusion.[10] The most extensive review of academic research concluded that 90% of 2,200 individual studies found a non-negative relationship between ESG and corporate financial performance, and 63% showed positive findings.[11] In 2019, Bank of America published a report indicating that ESG is an effective signal of future quality, or earnings stability.[12] It also found that an investor holding stocks with above average overall environmental and social scores would have avoided more than 90% of the S&P 500 bankruptcies that have occurred since 2005. BlackRock found that sustainable portfolios tend to have a quality bias, providing greater downside protection in 'risk-off' periods.[13] There are also several studies that demonstrate that better management of ESG issues corresponds with a reduction in downside risk, lower cost of capital, lower loan and credit default swap spreads, and higher credit ratings.[14] It is therefore not a surprise that credit ratings firms are now incorporating ESG factors into their analysis of the credit risks presented by companies due to the importance and relevance of these factors.[15] All of this evidence supports the notion that ESG factors are economically relevant to determining the risk-adjusted economic value of an investment or investment course of action, and that, at a minimum, ESG analysis doesn't sacrifice returns.

We are concerned that the Proposal creates new burdens for fiduciaries using the "all else being equal test" that would lead to unnecessary costs for plan participants. The Proposal's discussion of the all things being equal test will cause confusion because, while the test was originally developed to guide the consideration of ETIs and the discussion in the Proposal appears to envision the selection of an ETI investment, the language of the Proposal does not distinguish between the application of this test in selecting an ETI from the discussion of integrating ESG factors in the context of analyzing the risks presented by a potential investment in a company.

Finally, the Proposal suggests that ESG funds are categorized as an alternative asset class. We would like to clarify that ESG is not an asset class, but rather that ESG factor consideration is integrated into the portfolio construction

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[10] https://arabesque.com/research/From_the_stockholder_to_the_stakeholder_web.pdf; http://www.hbs.edu/faculty/publication%20files/ssrn-id1964011_6791edac-7daa-4603-a220-4a0c6c7a3f7a.pdf; https://www.nuveen.com/en-us/thinking/responsible-investing/responsible-investing-delivering-competitive-performance; https://www.morganstanley.com/content/dam/msdotcom/ideas/sustainable-investing-offers-financial-performance-lowered-risk/Sustainable_Reality_Analyzing_Risk_and_Returns_of_Sustainable_Funds.pdf; https://www.bofaml.com/en-us/content/esg-investing-research-report.html; https://cornerstonecapinc.com/wp-content/uploads/Sacrifice-Nothing_A-Fresh-Look-at-Performance.pdf; https://www.db.com/newsroom_news/2016/ghp/esg-and-financial-performance-aggregated-evidence-from-more-than-200-empirical-studies-en-11363.htm

[11] Gunnar Friede et al., "ESG and financial performance: Aggregated evidence from more than 2000 empirical studies," Journal of Sustainable Finance & Investment, October 2015, Volume 5, Number 4, pp 210-33; Deutsche Asset Wealth Management Investment; McKinsey analysis

[12] https://newsroom.bankofamerica.com/system/files/2019_Environmental_Social_Governance.pdf

[13] https://www.blackrock.com/institutions/en-us/insights/investment-actions/global-insurance-report-2019/portfolio-resilience-through-sustainability

[14] Witold J. Henisz and James McGlinch, "ESG, material credit events, and credit risk," *Journal of Applied Corporate Finance*, July 2019, Volume 31, pp. 105–17, onlinelibrary.wiley.com; Erik Landry, Mariana Lazaro, and Anna Lee, "Connecting ESG and corporate bond performance," MIT Management Sloan School and Breckinridge Capital Advisors, 2017, mitsloan.mit.edu; and Mitch Reznick and Michael Viehs, "Pricing ESG risk in credit markets," Hermes Credit and Hermes EOS, 2017, hermes-investment.com. Allen Goss and Gordon S. Roberts, "The impact of corporate social responsibility on the cost of bank loans," *Journal of Banking and Finance*, July 2011, Volume 35, Number 7, pp. 1794–810, sciencedirect.com; Sudheer Chava, "Environmental externalities and cost of capital," *Management Science*, September 2014, Volume 60, Number 9, pp. 2111–380, pubsonline.informs.org;

[15] https://www.spglobal.com/ratings/en/products-benefits/products/esg-evaluation; https://esg.moodys.io/; https://www.pionline.com/esg/fitch-ratings-esg-heat-map-shows-relevance-credit-ratings

of investment products across asset classes and product structure (mutual funds, ETF, separate accounts, private placement strategies). Today, Envestnet has nearly 600 products on its platform that integrate ESG into the portfolio construction and risk management process, but each of these products is classified by its asset class and not by its inclusion (or exclusion) of ESG factors. Advisors who build "ESG portfolios" follow the same process as with non-ESG portfolios whereby they construct a strategic asset allocation based on the client's risk tolerance before selecting the investment products for each asset sleeve.

We submit that by discouraging the use of ESG factors in constructing portfolios or otherwise providing advice to plans subject to ERISA, the Proposal will have the unintended effect of increasing financial risk to plan participants and their beneficiaries. By increasing the risk that investment fiduciaries will be held to breach their fiduciary duties under ERISA if they take ESG factors into account, the Proposal will discourage asset managers from analyzing and taking into account ESG risks presented by different investments; this increased risk of enforcement action will cause asset managers to ignore or inappropriately consider material financial risks presented by potential investments. In turn, this will have the effect of hurting the retirement security of American workers. We believe it is imprudent to ignore the types of financial risks that are revealed and analyzed in the course of evaluating ESG factors. American workers will be harmed if such financial risks are not appropriately considered because their retirement plan assets will be subject to greater risk of loss. In this respect, the past few years and more recent events suggest that the risks to companies presented by ESG factors are only increasing. Accordingly, we believe the Proposal will fail to achieve its objectives and will unfortunately undermine the retirement security of American workers and increase their financial risks.

For the foregoing reasons, we believe that ESG-focused investment strategies should not be singled out to require additional justification and that Proposal limiting the use of ESG factors should be withdrawn.

Thank you for your consideration of these comments.

Sincerely,

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