



500 Washington Street, Suite 325, San Francisco, CA 94111

www.HIPinvestor.com

R. Paul Herman, CEO + Founder

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 of the US Dept of Labor)

Dear Director Canary:

On behalf of HIP (Human Impact + Profit) Investor Ratings + Portfolios, www.HIPinvestor.com a research partner of shareholder advocacy non-profit AsYouSow.org, we appreciate the opportunity to submit comments on the notice of proposed rulemaking entitled “Financial Factors in Selecting Plan Investments” (“Proposal” or “NPR”).

The Proposed Rule fundamentally misconstrues the importance and role of ESG integration in reducing risk and increasing returns. Further, the Proposed Rule is likely to lead to confusion and costs for retirement plan fiduciaries.

Integrating environmental, social, and governance (ESG) factors into investment activities is essential to fulfilling fiduciary obligations to engage in appropriate risk management – and can benefit portfolios via reduced risk about 90% of the time and enhanced returns about 65% of the time.

Thus, we urge you to retain existing guidance -- and not move forward with this Proposed Rule.

ESG Integration

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 body of research (assembled by AsYouSow.org, a shareholder advocacy non-profit) which makes clear that ESG factors are material investment considerations.¹ As such there exists a sound basis for integrating ESG factors into investment actions.

¹ See, e.g., Amato, J.V., and Dyott, I.S., ESG Investing: An Active Approach to Long-Term Value Creation, NEUBERGER BERMAN (2019), www.nb.com/documents/public/global/to349_0119_wp_esg_investing_an_active_approach.pdf, attached hereto as **Exhibit B** and incorporated into this comment letter in full; Ballentine, C., ESG Stock Resilience Is Paving the Way for a Surge in Popularity, BLOOMBERG (31 Mar. 2020), www.bloomberg.com/news/articles/2020-03-31/esg-stock-resilience-is-paving-the-way-for-a-surge-in-popularity, attached hereto as **Exhibit C** and incorporated into this comment letter in full; Hale, J., Sustainable Funds Weather the First Quarter Better Than Conventional Funds, MORNINGSTAR (3 Apr. 2020), www.morningstar.com/articles/976361/sustainable-funds-weather-the-first-quarter-better-than-conventional-funds, attached hereto as **Exhibit D** and incorporated into this comment letter in full; Konqui, M.H, et al. Why Using ESG Helps You Build Better Portfolios, LYXOR ASSET MANAGEMENT (July 2019), www.lyxor.com/why-using-esg-helps-you-build-better, attached hereto as **Exhibit E** and

At HIP Investor, founded in December 2006, we have comprehensively researched and analyzed the relationship among Human Impact + Profit ratings of ESG (people, planet, and trust) with higher Total Shareholder Return (TSR), showing that higher HIP sustainability ESG ratings correlate with higher TSR, while lower HIP sustainability ESG ratings correlate with lower or even negative TSR (<https://hipinvestor.com/blog/hip-ratings-and-their-correlation-to-total-shareholder-return-tsr/>).

In addition, over 7 years, AsYouSow.org with HIP Investor's analytics and data have shown that factors like overpaid CEOs contribute to under-performance. (<https://www.asyousow.org/report-page/the-100-most-overpaid-ceos-2020> ; and <https://www.asyousow.org/report-page/the-100-most-overpaid-ceos-2020-webinar>). This recurring relationship shows how ESG factors can be beneficial for both investors and society at large to ensure higher trust and accountability.

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 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.

The “all else being equal test”

We are deeply concerned that the Proposed Rule inappropriately creates new burdens for fiduciaries under the “all else being equal test” that will lead to unnecessary costs for plan participants. It also creates confusion about what activities the DOL is attempting to regulate.

Currently, under the “all else being equal test,” which has been in place since 1994, fiduciaries may select an investment that provides collateral benefits only after they have determined that the risk and return profile of that investment option is substantially similar to that of competing options that would meet the financial needs of the fund. There are many strong choices for ESG-focused funds to meet the financial criteria of future risk and future return potential.

The Proposed Rule proposes the retention of the “all things being equal” test but adds new and costly recordkeeping requirements for fiduciaries to document their conclusion that multiple options are equal and that it is, therefore, appropriate to make a decision based on collateral benefits. Below is a chart detailing three examples of traditional ETFs and their ESG counterparts. **Highlights in yellow** below indicate financial **outperformance**. As shown, funds that integrate ESG factors into their plans largely outperform their traditional counterparts over most time periods to date, indicating that ESG factors can indeed be a material rather than a non-pecuniary factor.

incorporated into this comment letter in full; Logan, L., *Commentary: Active Beats Passive in Promoting Sustainable Development*, PENSION & INVESTMENTS (23 Apr. 2020), www.pionline.com/industry-voices/commentary-active-beats-passive-promoting-sustainable-development, attached hereto as **Exhibit E** and incorporated into this comment letter in full; Wurtz, F., *ETFs for ESG: Why Passive Makes Sense for ESG*, IPE (2019), www.ipe.com/etfs-for-esg-why-passive-makes-sense-for-esg/10033627.article, attached hereto as **Exhibit F** and incorporated into this comment letter in full. See also Gary, S., *supra*, 90 U. Colo. L. Rev. 733 (2019).

Share class overview	SPDR® S&P 500 Fossil Fuel Reserve Free ETF SPYX Profile	SPDR® S&P 500 ETF Trust SPY Profile	SPDR® MSCI Emerging Markets Fossil Fuel Free ETF EEMX Profile	iShares MSCI Emerging Markets ETF EEM Profile	iShares MSCI ACWI Low Carbon Target ETF CRBN Profile	iShares MSCI ACWI ETF ACWI Profile
Share class ticker	SPYX	SPY	EEMX	EEM	CRBN	ACWI
Sustainability mandate	✓	✗	✓	✗	✓	✗
Performance as of date	APRIL 29, 2020	APRIL 29, 2020	APRIL 29, 2020	APRIL 29, 2020	APRIL 29, 2020	APRIL 29, 2020
Annualized returns, 1 month	+12.44%	+12.80%	+8.38%	+8.48%	+10.66%	+10.63%
Annualized returns, 3 months	-8.83	-9.16	-10.90	-13.10	-11.89	-12.02
Annualized returns, 6 months	-2.51	-3.09	-8.79	-11.25	-7.34	-7.78
Annualized returns, 1 year	+1.99	+0.87	-10.73	-12.98	-3.93	-5.03
Annualized returns, 3 years	+9.54	+8.97	+0.53	-0.21	+4.69	+4.69
Annualized returns, year-to-date	-8.61	-9.20	-14.99	-17.21	-12.69	-13.02
Morningstar suggested benchmark	S&P 500 TR USD	S&P 500 TR USD	MSCI ACWI Ex USA NR USD	MSCI ACWI Ex USA NR USD	MSCI ACWI Ex USA NR USD	MSCI ACWI Ex USA NR USD
iShares index ETF benchmark	IVV - iShares Core S&P 500 ETF	IVV - iShares Core S&P 500 ETF	ACWX – iShares MSCI ACWI ex U.S. ETF	ACWX – iShares MSCI ACWI ex U.S. ETF	ACWX – iShares MSCI ACWI ex U.S. ETF	ACWX – iShares MSCI ACWI ex U.S. ETF
+/- compared to benchmark, 1 year	+1.16%	+0.03%	+1.33%	-0.92%	+8.13%	+7.03%
+/- compared to benchmark, 3 year	+0.53	-0.03	+0.99	+0.25	+5.15	+5.14

Of the 24 instances of comparison between traditional ETFs and their fossil-free ESG counterparts, ESG ETFs outperformed traditional ETFs 21 out of 24 times, or 88% of the time in the examples above. Not only do the ESG funds outperform their counterparts, they foster societal benefits, creating a win-win scenario for investors who are interested in building a better world for people, planet, and trust via ESG.

The Proposal’s discussion of the “all things being equal test” is cause for 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 the application of this test from the broader discussion of ESG integration, inappropriately suggesting that the documentation requirement is necessary whenever ESG factors are considered.

Defined contribution plan investment options

The Proposed Rule states that ERISA fiduciaries may select “ESG-themed funds” as an investment option for a participant-directed plan but that an “ESG-themed fund” cannot be selected as the default investment option. We strongly disagree.

All investment options should be required to integrate ESG factors as part of prudent investment decision-making.

ESG issues can have a material impact on the financial performance of securities as well as sustainability of the markets for future investors. In 2015 the Supreme Court confirmed that “a trustee has a continuing duty—separate and apart from the duty to exercise prudence in selecting investments at the outset—to monitor, and remove imprudent, trust investments.”²

Fund investors can create market volatility and undermine sustainable wealth creation when they fail to account for material ESG factors, undermining the interests of future beneficiaries.

At HIP Investor, we have seen first-hand stronger, more resilient portfolios financially and impact-wise when recommending and/or allocating portfolios to mutual funds and ETFs that are ESG focused and away from those that are ESG focused for investors, families, foundations, and endowments.

The Department’s stated rationale for prohibiting an “ESG-themed fund” from being selected as the default investment option is that it is not appropriate to select “investment funds whose objectives include non-pecuniary goals.” This statement shows a fundamental misunderstanding of the purpose of ESG integration, which is to integrate all material factors into investment decision-making. In addition, it is likely to cause confusion for fiduciaries as they attempt to rationalize the Department’s statements in the Proposed Rule that ESG factors are likely to have a material economic impact with the discussion of ESG factors in this context, in which the Department has deemed them “non-pecuniary.”

Conclusion

If the Proposal is finalized in its current form, we are concerned that fiduciaries will struggle to fulfil their obligations to integrate all financially material risk factors while also trying to respond to the language in the Proposal that appears to be aimed at preventing fiduciaries from taking account of these same risks.

Institutional investors have a duty to act in the best, long-term interests of their beneficiaries. **In this fiduciary role, we believe that ESG factors can be financially material, and integrating ESG factors is core to investment decision-making.** If the Proposed Rule goes into effect, it will undermine fiduciaries’ ability to act in the long-term best interest of their beneficiaries.

We urge you to you to allow the existing guidance to remain in effect and not move forward with this latest proposed final rule.

Thank you in advance,

R. Paul Herman
CEO and Chief Investment Officer
HIP Investor Inc., a registered investment adviser.

² *Tibble v. Edison International*, 135 S. Ct. 1823, 1828-29 (2015).