

December 12, 2021

Filed Electronically

Office of Regulations and Interpretations
Employee Benefits Security Administration
Room N-5655
U.S. Department of Labor
200 Constitutional Avenue, N.W.
Washington, DC 20210

Re: *RIN 1210-AC03, Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights*

Dear Madam or Sir:

Lazard Asset Management LLC (“LAM”) submits the following comments regarding the above-referenced proposal to amend the Investment Duties regulation under Title I of the Employee Retirement Income Security Act of 1974, as amended (“ERISA”). See *Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights*, 29 CFR Part 2550, RIN 1210-AC03 (October 14, 2021), 86 Fed. Reg. 57272 (the “Proposed Rule”).

LAM is pleased that the Department recognizes that climate change and other ESG factors are often material to the assessment of investment risks and returns. We agree with the Department that the changes proposed not only would clarify the duties of plan fiduciaries when selecting investment options, but also would help individuals build retirement income security and retirement savings. In particular, we believe that the Proposed Rule, if adopted, will provide plans with the freedom to leverage the advances that active asset managers have contributed to ESG analysis and investing in recent years.

A. Background

LAM is an investment adviser registered with the Securities and Exchange Commission, with more than \$239.8 billion of assets under management as of September 30, 2021. We manage assets on a discretionary basis for a large number of global clients, including a variety of U.S. defined benefit plans, defined contribution plans, individual retirement accounts, and variable annuity portfolios.

LAM’s investment decisions are based on proprietary fundamental and quantitative research techniques that our professionals have developed over decades. Our firm seeks to manage client portfolios in a way that delivers investment performance, maximizes long-term shareholder value, and limits unwanted risks – including the risks presented by ESG factors.

B. Comments to Proposed Rule

The Proposed Rule would allow plan fiduciaries to consider a wider variety of factors when evaluating plan investment options under Section 404(a) of ERISA, which sets forth the standards of prudence that an ERISA fiduciary must satisfy when selecting investments for a qualified plan. The Proposed Rule is in response to the rule the Department adopted in 2020, *Financial Factors in Selecting Plan Investments*, 85 FR 72846 (Nov. 13, 2020) (the “2020 Rule”), which is interpreted generally to require plan fiduciaries to select investments and investment courses of action based solely on the consideration of “pecuniary factors.” The 2020 Rule also contains a prohibition against adding or retaining any investment fund, product, or model portfolio as a qualified default investment alternative (QDIA) if the fund, product, or model portfolio reflects non-pecuniary objectives in its investment objectives or principal strategies.

LAM agrees with the Department’s overall assessment of the 2020 Rule expressed in Section 3 of the preamble of the Proposed Rule - specifically, that the 2020 Rule (1) does not properly reflect the scope of fiduciaries’ duties under ERISA to act prudently and solely in the interest of participants and beneficiaries when evaluating investments and (2) creates uncertainty surrounding whether a fiduciary under ERISA may consider any ESG and other important factors in making investment decisions. A number of Department bulletins and pronouncements predating the 2020 Rule effectively guided plan fiduciaries that they could consider adding ESG investment options to their plans pursuant to Section 404(a). *See e.g.*, Interpretive Bulletin 2008-01, *Interpretative Bulletin Relating to Investing in Economically Targeted Investments*, 73 FR 61734 (Oct. 17, 2008); Interpretive Bulletin 2015-01, *Interpretive Bulletin Relating to the Fiduciary Standard Under ERISA in Considering Economically Targeted Investments*, 80 Fed. Reg. 65135 (Oct. 26, 2015); and Field Assistance Bulletin No. 2018-01 (April 23, 2018). The 2020 Rule changed the guidance and standards set forth in those precedents.

1. Investment Prudence Duties

The Proposed Rule would add language in paragraph (b)(2)(ii)(C) of the current regulation to recognize explicitly that “consideration of the projected return of the portfolio relative to the funding objectives of the plan may often require an evaluation of the economic effects of climate change and other ESG factors on the particular investment or investment course of action.”

This would allow plan fiduciaries to evaluate factors that many other investors already consider material. An analysis of over 16,000 global firms over the period of 2016 to 2020 conducted by the Lazard Climate Center found investors are actively pricing in risk from company emissions profiles.¹ The study found that with all else being equal, changes in emissions profiles can have an impact on a company’s market valuation. For example, a hypothetical 10% decrease in carbon dioxide emissions is associated with a 0.44% price-to-earnings appreciation. In addition, the Swiss Re Institute’s April 2021 report *The Economics of Climate Change: No Action Not an Option*, states that “[t]he transition towards a low carbon economy . . . has repercussions for asset valuations. It is clear that climate transition risks can have a substantial impact on equity and credit valuations.”² Their analysis concludes that “under the current trajectory, global GDP could be 11-14% less by mid-century than in a world without climate change.”

LAM’s research recognizes that there will be economic winners and losers from the low carbon transition, and that economically material factors should not be ignored in investment analysis simply because they

¹ <https://www.lazard.com/media/451920/lazard-climate-center-presentation-december-2021.pdf>

² <https://www.swissre.com/institute/research/topics-and-risk-dialogues/climate-and-natural-catastrophe-risk/expertise-publication-economics-of-climate-change.html>

are of an environmental, social, or governance nature. The Proposed Rule properly grants fiduciaries the express permission to consider material ESG factors in their investment analysis, which we believe should result in promoting retirement income security and more secure retirement savings.

The Proposed Rule “confirms that a fiduciary may consider *any* factor material to the risk-return analysis, including climate change and other ESG factors” (emphasis added). It goes on to list numerous non-exclusive examples:

- (i) Climate change-related factors, such as a corporation's exposure to the real and potential economic effects of climate change, including its exposure to the physical and transitional risks of climate change and the positive or negative effect of Government regulations and policies to mitigate climate change;
- (ii) governance factors, such as those involving board composition, executive compensation, and transparency and accountability in corporate decision-making, as well as a corporation's avoidance of criminal liability and compliance with labor, employment, environmental, tax, and other applicable laws and regulations; and
- (iii) workforce practices, including the corporation's progress on workforce diversity, inclusion, and other drivers of employee hiring, promotion, and retention; its investment in training to develop its workforce's skill; equal employment opportunity; and labor relations.

We believe that the examples given in the Proposed Rule, while necessarily incomplete, do serve the purpose of providing adequate guidance to plan fiduciaries. We also believe the Department’s examples focus fiduciaries on economically material considerations.

At LAM, we have embedded ESG insights into our relevant investment research and portfolio construction functions. We have developed a proprietary ESG integration framework using (among other things) materiality mapping, which is being implemented across relevant investment platforms. As an active asset manager that has incorporated ESG considerations into its proprietary research, LAM is able to regularly provide our clients with examples of how such considerations have positively influenced investment outcomes. We have made these investments into our platform because we believe that investors – including plan fiduciaries – need to understand how ESG factors impact the financial productivity, operational risks, and valuations of the companies whose shares and bonds are in their portfolios.

2. Investment Loyalty Duties

Paragraph (c)(3) of the Proposed Rule amends the “tie breaker” standard in the 2020 Rule to allow fiduciaries to use broader discretion when comparing investment options. Under the proposal, a fiduciary evaluating two suitable investment options may select the ESG option over the non-ESG option where both would “equally serve the financial interests of the plan over the appropriate time horizon,” instead of limiting the use of the “tie-breaker” standard to situations in which both are “economically indistinguishable.” LAM agrees with this more comprehensive approach as it recognizes that fiduciaries should have the freedom to choose an investment for the purposes of diversification or to hedge against broad categories of risk, both of which can lead to better financial performance for a portfolio.

The Proposed Rule rescinds paragraph (d)(2)(ii) of the current regulation which prevents an investment option to serve as a qualified default investment alternative (QDIA) if it includes the use of non-pecuniary factors in its investment objectives even if the option is prudent from a risk and return perspective. LAM believes the 2020 Rule in this regard is contrary to goals of ERISA as it could potentially exclude financially prudent investment options on the simple basis that they consider economically material ESG factors. As previously stated, LAM believes that consideration of economically material factors should not be prohibited on the sole basis that they are of an environmental, social, or governance nature.

C. Conclusion

We believe that plan fiduciaries should include assessments of material ESG issues when evaluating retirement plan investments. The risks identified by an ESG-integrated assessment are often ultimately detrimental, and the opportunities identified can be quite additive, to the financial performance and value of assets in an investment portfolio. Importantly, the Proposed Rule greatly reduces the current uncertainty surrounding a fiduciary's consideration of material ESG factors. It restores trust in fiduciaries by allowing them to use their professional judgement to evaluate all material factors when selecting investment options for plan participants and beneficiaries.

In light of the foregoing, we recommend that the Department adopt and implement the Proposed Rule as written. We would be happy to provide the Department with additional information concerning our comments. Any requests should please be directed to our General Counsel, Mark Anderson, who may be reached at (212) 632-1890 or mark.anderson@lazard.com.

Respectfully submitted,

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