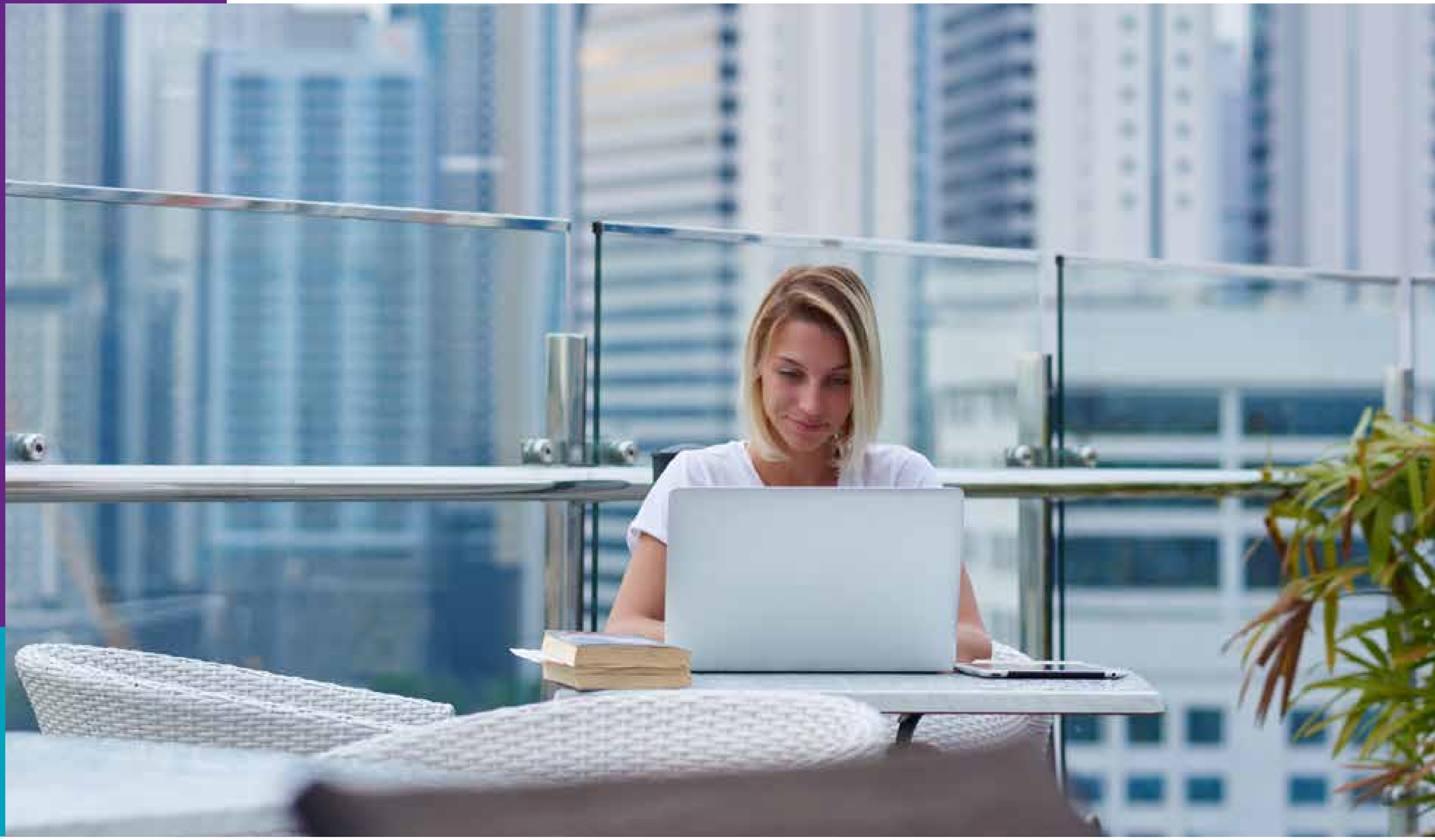
NATIXIS RETIREMENT STRATEGIES

Plan Sponsor's Guide to Sustainable Investing



Clarity on ESG investment options

Demand for sustainable investments in workplace retirement plans based on environmental, social and governance (ESG) factors is growing. Survey data from plan participants indicates that 88% of Millennials and 72% of Gen Xers would be more likely to increase contributions or begin participating if they could invest in companies with good ESG records.[1] Fortunately, these types of funds have become more widely available in the past few years – and Department of Labor (DOL) guidance on the use of ESG investment options has become clearer.

Even so, many plan sponsors may feel unprepared to adapt to these changes while also maintaining strong fiduciary best practices. The purpose of this guide is to provide clarity on the use of ESG investment options in retirement plans that complies with both the Employee Retirement Income Security Act (ERISA) and DOL requirements for investment fiduciaries.

Reviewing ESG factors in the investment menu design offers three key benefits for plan sponsors

1. Opportunity to build a better plan investment menu
2. Satisfy participant demand for responsible investments
3. Confidently meet fiduciary obligations

Key benefits for plan sponsors

1. Build a better plan investment menu with ESG factors

ESG has become an increasingly integral part of the investment process. While consideration of ESG factors may have once been seen as a distinct analysis for a specific type of investment, the application is demonstrating broader value. In fact, seven in ten institutional investors say ESG analysis is integral to sound investing.[2] This analysis is not limited to identifying risks and screening out exposures to certain companies and industries. More than six out of ten institutional investors (62%) go so far as to say there is alpha to be found in ESG investing.[2]

This more holistic view of analysis and alpha-seeking mindset shows up clearly in the wide range of ways institutions say they implement ESG across their portfolios. Almost half (49%) of those surveyed rely on an integration strategy that allows them to include nonfinancial factors alongside their fundamental analysis for a more comprehensive consideration of investments.[2]

2. Satisfy participant demand for sustainable investments

Survey data also shows that although all respondents register positive sentiment on sustainable investments, Millennials and Generation X participants show clear preferences for including sustainable investments in their company's retirement plan. Bottom line: This preference could help drive participation and contribution rates.[3]

3. Confidently meet fiduciary obligations required by regulators

The overarching responsibility of plan fiduciaries is to serve the best interests of plan participants and beneficiaries. To this end, the fiduciary duties of loyalty and care under ERISA require using relevant information in a sound due diligence process. The DOL recognizes that relevant ESG factors may impact the risk and return characteristics of investments held as plan assets. This means it is entirely consistent with fiduciary obligations and investment best practices to apply ESG factors in a sound, consistent due diligence process for your plan.

	Millennials	Gen X	Boomers
ESG factors can affect investment performance	94%	86%	87%
I would like to see more sustainable investments in my retirement plan	92%	81%	65%
I would be more likely to increase my contributions or begin participating if I could invest in companies with good ESG records	88%	72%	45%

How can plan sponsors incorporate ESG factors into the investment menu?

Implementing ESG factors has three components, which we'll explore in more detail:

1. **Understanding fiduciary obligations**
2. **Identifying and applying ESG factors**
3. **Determining roles and responsibilities**

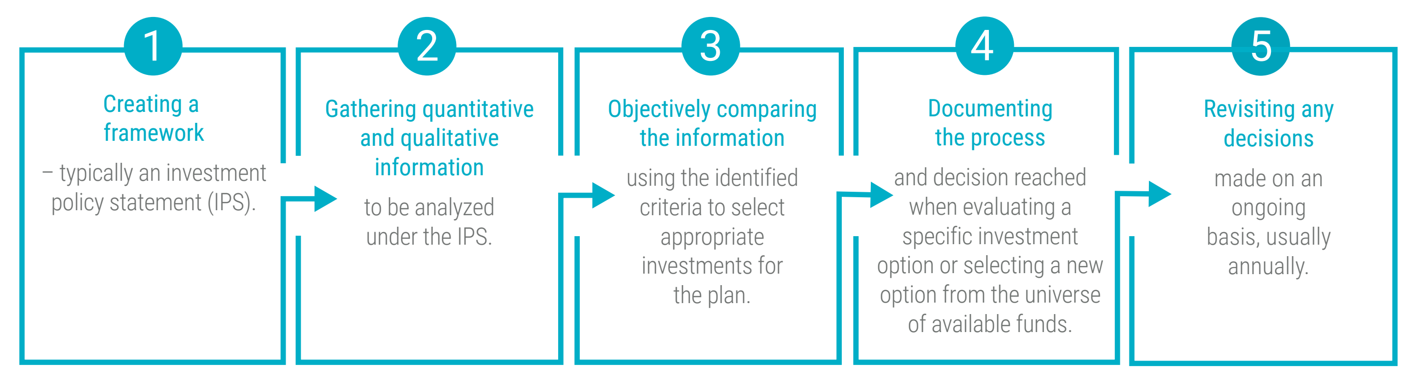
1. Understanding fiduciary obligations

Plan sponsors must meet specific investment duties under ERISA Section 404 unless they have outsourced the function to a third party, such as an investment advisor or consultant. Even so, to the extent that an investment duty is outsourced, plan sponsors still have a responsibility to monitor the third party.

The primary investment duty under ERISA requires that fiduciaries act in the best interest of plan participants and beneficiaries. It is the long-held view of the DOL that this duty means a fiduciary may not put the financial interests or retirement savings of participants and beneficiaries second to other objectives. Fiduciaries must base their evaluation of an investment on risk and return factors that they determine are relevant to investment value, on a case-by-case basis.

Fiduciaries must also carry out investment decisions using a prudent process and with the skill of an investment professional. Fiduciaries are expected to be prudent experts and not laypeople, which is why most plan sponsors use an advisor or consultant to assist with investment selection and monitoring. A prudent process involves a series of steps to select an investment.

Regardless of whether a plan sponsor goes it alone or hires an advisor or consultant, an important part of a fiduciary's duty of prudence under ERISA may include evaluation of the economic effects of climate change and other ESG factors on investment performance, as long as these factors are considered material. This is consistent with the DOL's requirement that the financial interests of participants and beneficiaries cannot be secondary to other objectives, such as social causes. So plan sponsors need to do their homework. including:



2. Identifying and applying ESG factors

The first step in understanding the DOL's stance on ESG investment options is to be aware of ESG factors. The DOL does not provide specific risk and return factors, but it requires that any ESG factors considered be relevant. Relevancy is similar to the concept of materiality and is an assessment of the long-term financial outcome of an investment, either by reducing its potential risk or increasing its potential return.

This means that some ESG factors may be relevant in certain instances and not in others. Some examples are provided in Figure 1, although this is not an exhaustive list. It is not the role of the plan sponsor to make this assessment – that is the responsibility of a fund's portfolio manager. But plan sponsors have an opportunity to weigh in when they create or adjust the plan's investment policy statement.

Beyond relevancy, portfolio managers can use ESG factors in different ways, not all of which may be available to retirement plan investors. The fund sponsor's responsibility is to consider whether the investment will create financial value and whether it puts the financial interests of participants and beneficiaries first.

Reviewing a fund's investment objective is a good place to start. The objective should provide a clear statement of what the fund seeks to achieve for investors.

Focusing on the objective can also help cut through some of the confusing terminology often associated with ESG-oriented investment philosophies (Figure 2). Specific details about a fund's investment philosophy can usually be found in the Principal Investment Strategies section of the fund prospectus.

FIGURE 1: DOL ESG Factors and Examples

ESG Factors	Explanation	Material Risk Examples	Material Opportunity Examples
Environmental or climate change–related factors	A corporation's exposure to: • Real and potential economic effects of climate change • Physical and transitional risks of climate change • Positive or negative effect of government regulations and policies to mitigate climate change	Increasingly extreme weather events can cause business disruption and facilities damage, increasing claims and costs for property and casualty insurers.	• Companies that proactively locate and harden facilities to make them safer reduce risks and improve their competitive standing. • Insurers that understand environmental risks can price coverages more accurately.
Social factors or workforce practices	Impact on a corporation from factors such as: • Progress on workforce diversity, inclusion, and other drivers of employee hiring, promotion, and retention • Investment in training to develop workforce skill sets • Equal employment opportunity • Labor relations	Companies with low wages, poor benefits, and unpleasant working conditions can suffer high turnover, absenteeism, and health and safety issues.	Positive working conditions and labor relations can produce high worker retention, productivity, and satisfaction – big competitive advantages in a tight labor market.
Governance factors	Impact on a corporation from factors such as: • Board composition and executive compensation • Transparency and accountability in corporate decision making • Avoidance of criminal liability • Compliance with labor, employment, environmental, tax, and other applicable laws and regulations	Poorly constructed executive compensation can misalign leadership and ownership interests, creating business risks.	Companies with well-crafted compensation systems can more effectively attract and retain talent and promote value creation.

FIGURE 2: ESG-Oriented Investment Philosophies

	Description	ESG Value Created?	Financial Value Created?
Negative Screening	Exclusion of sectors or companies considered unsustainable or controversial	Avoids "disagreeable" businesses or industries	• Not primary goal • May avoid asset-specific risks • May underperform broader market
ESG Integration	• Actively factors ESG risks and opportunities into financial analysis. • Can include adjusting estimated future cash flows based on evaluation of ESG-related risks/opportunities • Identifying/measuring impact of off-balance-sheet ESG-related assets/liabilities	Typically not primary goal	• Primary goal • Generally related to valuation of assets, risk management and/or idea generation
Positive/Best in Class Screening	• Invests in sectors, companies, or projects with positive ESG performance • May be measured relative to peers • May avoid companies that do not meet certain ESG performance thresholds	May produce stronger ESG profile overall and on individual dimensions than the broad market	• Primary goal • May underweight companies facing material ESG-related risks/headwinds • May overweight companies better at managing ESG-related risks and opportunities
Sustainability Themed Investing	Thematic investment selection and portfolio construction around ESG themes such as gender-lens investing, low carbon, sustainable food and agriculture or renewable energy.	Based on selected themes and the level of exposure to those themes	• Typically a primary goal • May relate to prospects for themes
Impact Investing	Invests in companies with explicit intent to generate positive social or environmental impact along with financial return, which can range from below market to market rate.	Primary goal and related to the selected investment	• Secondary consideration but sometimes aims for market rate returns

3. Determining roles and responsibilities

The process for selecting and monitoring ESG investment options should be no different than for any other plan investment. This applies both to the designated investment alternatives (fund lineup) and the qualified default investment alternatives (default funds). That's why it is especially important to be clear about the specific roles and responsibilities of the plan sponsor, the advisor or consultant, and a fund's portfolio manager.

It is generally not the role of the plan sponsor to choose social causes or ESG factors to guide plan investments. The plan sponsor's primary responsibility is to follow a prudent process to make sure the right information is properly reviewed and that a well-reasoned outcome is met in selecting investment options for the plan (Figure 3).

FIGURE 3: Who Does What

Role	Responsibilities
Plan Sponsor	• Evaluate current and potential plan options based on the expertise provided by an investment advisor or consultant. • Review reports and analysis provided by the advisor/consultant to determine how well the process outlined in the IPS was followed. • Determine how well the process being used arrives at an outcome that will increase participant returns, reduce risk, and meet other required ERISA criteria, including reasonable fees.
Advisor/Consultant	• Evaluate how the fund portfolio manager analyzes companies, including the use of ESG factors. • Examine a fund's investment philosophy to determine if it meets the spirit of ERISA and the plan's sponsor's IPS. • Review benchmarks, ratings and other metrics to determine a "score" for a particular investment option to present to plan sponsors.
Portfolio Manager	• Manage the fund to pursue the stated investment objective, including analysis of companies based on criteria that will result in financial benefit to participants, which can include review of relevant ESG factors. • Adhere to a stated investment philosophy to pursue the best outcome for plan participants. • Meet with advisors and consultants (and sometimes plan sponsors) as needed to convey information about their process and the qualitative and quantitative factors they review, including relevant ESG factors.

Action Steps

Investing based on ESG factors is in demand by plan participants, and the marketplace has evolved to meet these needs. Here are three steps to help you get started:

1. **Take an inventory of the existing framework for investment selection** in your plan's IPS, and determine whether updates are needed to account for ESG investing.
   - Keep in mind that a separate investment policy statement for ESG investing is not required. The IPS just needs to align with the process that is followed.
   - Inventory the existing fund lineup to determine if there are ESG investments or criteria you are including that aren't reflected in your existing documentation.
2. **Evaluate your IPS**, advisor or consultant, reports, and any tools and data presented for monitoring investments, including ESG, to determine if updates are required.
3. **Work with your advisor or consultant** to make any necessary updates based on the prior two steps.
   - When updating investment-related documents, be consistent across all tools and resources.
   - If you do update the IPS, make sure to adjust your monitoring program accordingly.

While the DOL has continued to provide guidance related to ESG over time, the two core duties mandated by ERISA – acting in the best interest of participants and following a prudent process – have not changed. Contact a retirement plan advisor or consultant today to get started with ESG investing considerations for your plan.

To learn more, please contact your Natixis Retirement Specialist.

Call: 800-862-4863

Visit: im.natixis.com

Key takeaways

Investing based on ESG factors is in demand by plan participants, and the marketplace has evolved to meet these needs. Here are three steps to help you get started:

1. Take an inventory of the existing framework for investment selection
2. Evaluate your IPS, advisor or consultant, reports, and any tools and data
3. Work with your advisor or consultant

To learn more, please contact your Natixis Retirement Specialist.

Call: 800-862-4863

Visit: im.natixis.com

1 Natixis Investment Managers, Survey of US Defined Contribution Plan Participants conducted by CoreData Research, January and February 2023. Survey included 736 US workers, 587 being plan participants and 149 being nonparticipants. Of the 736 respondents, 362 were Millennials (age 27–42), 166 were Gen Xers (age 43–58) and 208 were Baby Boomers (age 59 and above).

2 Natixis Investment Managers, Global Survey of Institutional Investors conducted by CoreData Research in October and November 2022. Survey included 500 institutional investors in 30 countries throughout North America, Latin America, the United Kingdom, Continental Europe, Asia and the Middle East..

3 Natixis Investment Managers, Survey of US Defined Contribution Plan Participants conducted by CoreData Research, January and February 2023. Survey included 736 US workers, 587 being plan participants and 149 being non-participants. Of the 736 respondents, 362 were Millennials (age 27–42), 166 were Gen X (age 43–58) and 208 were Baby Boomers (age 59 and above).

Alpha: A measure of the performance of an investment relative to a market index or benchmark. A positive alpha indicates outperformance and negative alpha indicates underperformance.

Sustainable investing focuses on investments in companies that relate to certain sustainable development themes and demonstrate adherence to environmental, social and governance (ESG) practices; therefore the universe of investments may be limited and investors may not be able to take advantage of the same opportunities or market trends as investors that do not use such criteria. This could have a negative impact on an investor's overall performance depending on whether such investments are in or out of favor.

4459057.4.1
Exp. 7/31/2025
RP04-0424