

July 30, 2020

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**Office of Regulations and Interpretations  
Employee Benefits Security Administration  
Room N-5655  
Attn: Financial Factors in Selecting Plan Investments Proposed Regulation**

**U.S. Department of Labor  
200 Constitution Avenue NW  
Washington, DC 20210**

**Submitted via Federal eRulemaking Portal: [www.regulations.gov](http://www.regulations.gov)**

**Re: Proposed Regulation on ‘Financial Factors in Selecting Plan Investments’  
[RIN 1210-AB95]**

Dear Sir/Madam:

State Street Global Advisors, the investment management arm of State Street Corporation, appreciates the opportunity to provide comments on the Department of Labor’s (the “Department”) proposed rule entitled *Financial Factors in Selecting Plan Investments* aimed at clarifying obligations related to the consideration of environmental, social and governance (“ESG”) factors by fiduciaries of private sector employee benefit plans, including both defined contribution and defined benefit pension plans covered by the Employee Retirement Income Security Act (“ERISA”).

As a fiduciary, State Street Global Advisors has a duty to act prudently and in the best interest of our clients, which, increasingly, includes consideration of environmental, social and governance (“ESG”) factors relevant to the performance of the companies in which our clients invest. We believe that addressing material ESG issues is good business practice and essential to a company’s long-term financial performance --- a matter of value, not values --- and we seek to capture these drivers of long-term shareholder value for our clients.

While considering material ESG factors in investment strategies provides benefits for investors, the Department’s proposal unfortunately discourages such integration by U.S. private sector plan fiduciaries, potentially disadvantaging plans, participants and beneficiaries by restricting access to an entire type of long-term, value-driven investment that could help ensure future retirement security.

We believe such an outcome is clearly contrary to the purposes of ERISA. Therefore, we urge the Department to withdraw the proposed rule, and instead engage with the broad range of stakeholders --- plan sponsors, investment advisers and managers, advocates for plan participants and beneficiaries, and other groups --- to develop

forward-looking approaches to incorporating the benefits of value-driven consideration of ESG factors into U.S. pension plans' investment strategies.

Our comments cover two broad areas of concern with the proposed rule:

Part I --- The proposed rule denies ERISA plans the financial benefits of ESG integration; and

Part II --- The proposed rule is inconsistent with ERISA and creates legal uncertainty.

### **Part I --- The Proposed Rule denies ERISA plans the financial benefits of ESG integration**

State Street Global Advisors agrees with the Department's statements in the preamble to the proposed rule describing the obligations imposed by ERISA: plan fiduciaries are required to "act prudently and diversify plan investments," and to "act solely in the interest of the plan's participants and beneficiaries."<sup>1</sup> As discussed more fully below, these are fundamental principles of ERISA, and of fiduciary duty more generally.

We disagree, however, with the Department's proposed new interpretation of these fiduciary duties with respect to the use of material, value-driving ESG factors into the selection of investments by ERISA fiduciaries. The role of ESG factors in today's investing approaches broadly falls into three categories:

- Those that are designed to make an impact and capitalize on a particular set of ESG goals first and foremost above other investment considerations (so-called "impact investing"), often accomplished by including or excluding certain assets;
- Those that explicitly capture the financial risks and opportunities presented by the emerging evidence of ESG materiality to the risk and return profile of an investment; and
- Those that deliberately ignore any ESG considerations and exclude consideration of such factors in the investment process.

We suspect the Department's skeptical view of ESG investing relates primarily to the first of these categories, "impact investing," which may seek financial and non-financial benefits, such as advancing social goals. We do not believe the Department has given sufficient consideration to the second category, ESG integration, and, as a result, the Department has placed an unduly high bar to the adoption of such

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<sup>1</sup> 85 Fed. Reg. 39113 at 39114 (June 30, 2020) ("Section 404 of ERISA, in part, requires that plan fiduciaries act prudently and diversify plan investments so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so. Sections 403(c) and 404(a) also require fiduciaries to act solely in the interest of the plan's participants and beneficiaries, and for the exclusive purpose of providing benefits to their participants and beneficiaries and defraying reasonable expenses of administering the plan.").

approaches by ERISA plans. Thus, under the proposed rule, ERISA plans will be left with solely the third option, strategies that deliberately ignore ESG considerations, which we believe will be to the detriment of plans, participants and beneficiaries.

With respect to “impact investing” and similar strategies, we agree such strategies, like all strategies, must result in investments that are prudent and in the best financial interest of plan participants and beneficiaries. Plan fiduciaries, including investment advisors, are well acquainted with ERISA requirements with respect to “impact investing,” and we see no pressing need for amended rules in this area. The Department, in the preamble to the proposed rule, concedes that fiduciary mismanagement in connection with ESG investments does not currently exist.<sup>2</sup> We believe the current legal framework is working; changing that framework and imposing substantial new compliance burdens and costs on plans and plan fiduciaries is unwarranted, unneeded and not in the best interest of plan participants and beneficiaries.

The impacts of the proposed rule extend far beyond “impact investing” and similar investment approaches and would negatively affect ERISA plans’ use of ESG-related investments that are aimed at providing increased financial benefits to plan participants and beneficiaries. Specifically, the proposed rule does not seem to recognize the growing prevalence of ESG integration as a value-driving factor for traditional investment analysis and decision-making. Under such strategies, the thoughtful assessment of material ESG factors, used, for example, as a complement to traditional research such as analyzing financial statements, industry trends and company growth strategies, is integral to identifying opportunities, mitigating risks and creating long-term shareholder value for investors. As the quality and consistency of ESG data and analytics increase, we expect such ESG integration to increasingly become a mainstream, if not standard, element of long-term, value-driven investing. We believe plans and their participants and beneficiaries will be disadvantaged if fiduciaries are prohibited by the Department from taking advantage of ESG integration or are discouraged from accessing new, innovative investment products into the marketplace when prudent and in their plans’ best interest.

Under an ESG integration strategy, value-driving ESG factors are incorporated into the investment analysis and investment decisions, alongside traditional financial factors. The evidence supporting the value of ESG integration in investment strategies is substantial and continues to grow.

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<sup>2</sup> 85 Fed. Reg. at 39120 (“While the Department does not have sufficient data to estimate the number of such fiduciaries [who are currently not following or misinterpreting the Department’s existing sub-regulatory guidance], the Department believes it is small, because most fiduciaries are operating in compliance with the Department’s sub-regulatory guidance.”).

Stronger cash flows, lower borrowing costs and higher valuations are common features of companies focused on managing material sustainability risks.<sup>3</sup> Moreover, an analysis of over 2000 studies shows a compelling correlation between strong corporate sustainability and economic performance, with 90% of those studies ultimately rebutting claims that investments through an environmental, social or corporate governance lens necessarily means diminished financial returns<sup>4</sup>. Similar data can be found both in the 2018 U.S. Government Accountability Office (GAO) report<sup>5</sup> and a study commissioned by the Department itself in 2017<sup>6</sup>, where results show a positive correlation between ESG investing and financial returns.

A recent McKinsey paper found a strong correlation between paying attention to ESG concerns and company performance, and links strong ESG considerations to value creation in five ways, including by:

- Facilitating top-line growth;
- Reducing costs;
- Minimizing regulatory and legal interventions;
- Increasing employee productivity; and
- Optimizing investment and capital expenditures.<sup>7</sup>

Investment approaches that integrate value-driven ESG factors offer risk/reward characteristics different from those that do not. We believe investment strategies that integrate material ESG metrics into the investment analysis and decision-making process are clearly seeking to maximize long-term investor returns and, therefore, consistent with the goals of ERISA. Denying ERISA plan sponsors and beneficiaries the financial benefits of such ESG integration therefore will, contrary to the clear intent of ERISA and the Department's stated goal to protect the interests of plan participants and beneficiaries, reduce the long-term financial returns that are essential to Americans' retirement security.

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<sup>3</sup> Gunnar Friede, Timo Busch, & Alexander Bassen, 'Journal of Sustainable Finance & Investment', ESG and financial performance: Aggregated evidence from more than 2000 empirical studies, 5:4, 210–233, 2015.

<sup>4</sup> Oxford University, Arabesque Asset Management, From the Stockholder to the Stakeholder: How Sustainability Can Drive Financial Outperformance, [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2508281](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2508281), 2014.

<sup>5</sup> GAO report on ESG investing, available at <https://www.gao.gov/products/GAO-18-398>.

<sup>6</sup> "Environmental, Social, and Governance (ESG) Investment Tools: A Review of the Current Field" (Washington, D.C., Dec. 2017), prepared by Ogechukwu Ezeokoli et. al., available at <https://www.dol.gov/sites/dolgov/files/OASP/legacy/files/ESG-Investment-Tools-Review-of-the-Current-Field.pdf>.

<sup>7</sup> See <https://www.mckinsey.com/business-functions/strategy-and-corporate-finance/our-insights/five-ways-that-esg-creates-value#>

## **Part II --- The Proposed Rule Is Inconsistent With ERISA And Creates Legal Uncertainty**

In addition to opposing the proposed rule due to its potential to severely impact value-driven investing on behalf of plans, we are concerned that, from a legal perspective, the proposal does not appear to “build” or “elaborate” upon existing law so much as supplant existing law. We believe the terms of the proposal to be generally unworkable, leaving asset managers and other plan fiduciaries with substantial legal uncertainty around the way in which they must perform their duties.

By broadly prejudging ESG integration as harmful and subjecting it to special scrutiny, the proposal will have the effect, perhaps unintended, of rendering ESG integration presumptively imprudent. This presumption will pressure fiduciaries to categorically avoid investment approaches that expressly, or perhaps even implicitly, integrate ESG considerations, even when such investments are otherwise prudent choices.

By its terms, the proposal conflates the legally separate duties of procedural prudence and subjective loyalty and imposes a checklist of objective preconditions for satisfying both. This will effectively eliminate the subjective test of loyalty that has stood for almost fifty years.

Lastly, the proposal requires fiduciaries to consider a potentially unlimited universe of alternatives in making investment decisions. This is not only impractical and unduly costly, but also conflicts with the current statutory prescription, which requires managers and other fiduciaries to consider alternatives only to the extent prudent.

We discuss each of these three broad concerns in detail immediately below.

### ***The Proposal Inappropriately Renders ESG Integration Presumptively Imprudent.***

As the Department has long recognized, ERISA itself provides comprehensive fiduciary standards.<sup>8</sup> One of these standards is the duty of prudence, which requires fiduciaries to act—

with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims.

Since 1974, both the courts and the Department have consistently viewed the duty of prudence as a circumstantial standard, such that investment decisions are not to

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<sup>8</sup> Letter from Olena Berg, Assistant Sec’y of Labor, to Comptroller of the Currency (March 21, 1996).

be viewed in isolation from the relevant facts then existing.<sup>9</sup> This view flows from the statutory command that fiduciary decisions be judged under the “circumstances then prevailing.” Consistent with this view, the Department’s 1979 regulation expressly provides that investment fiduciaries must give—

appropriate consideration to those facts and circumstances that, given the scope of such fiduciary’s investment duties, the fiduciary knows or should know are relevant to the particular investment or investment course of action involved, including the role the investment or investment course of action plays in that portion of the plan’s investment portfolio with respect to which the fiduciary has investment duties.<sup>10</sup>

Until now, the Department has never deviated from this basic view of the duty of prudence. Indeed, the Department has long opined that, regardless of the unique risk/reward or other characteristics involved, all investments are subject to the same prudential standard of care. In 1996, for example, the Comptroller of the Currency asked the Department for its views on the use of derivatives. Notwithstanding that derivatives may “include [characteristics of] extreme price volatility, a high degree of leverage, limited testing by markets, and difficulty in determining the market value of the derivative due to illiquid market conditions” and “require a higher degree of sophistication and understanding on the part of fiduciaries than other investments”, the Department stated that derivatives are subject to the same fiduciary standards as any other investment:

Investments in derivatives are subject to the fiduciary responsibility rules in the same manner as are any other plan investments. Thus, plan fiduciaries must determine that an investment in derivatives is, among other things, prudent and made solely in the interest of the plan’s participants and beneficiaries. In determining whether to invest in a particular derivative, plan fiduciaries are required to engage in the same general procedures and undertake the same type of analysis that they would in making any other investment decision. This would include, but not be limited to, a consideration of how the investment fits within the plan’s investment policy, what role the particular derivative plays in the plan’s portfolio, and the plan’s potential exposure to losses.

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<sup>9</sup> See, e.g., 29 C.F.R. §2550.404 a-1; *Donovan v. Bierwirth*, 680 F.2d 263, 271 (2d Cir. 1982); *United States v. Mason Tenders District Council of Greater New York*, 19 EBC 1467 (S.D.N.Y. 1995); *Marshall v. Glass/Metal Ass’n & Glaziers & Glassworkers Pension Plan*, 507 F. Supp. 378, 384 (D. Haw. 1980); *Donovan v. Walton*, 609 F. Supp. 1221, 1240 (S.D. Fla. 1985), *aff’d sub. nom Brock v. Walton*, 794 F.2d 586 (11th Cir. 1986); *Donovan v. Cunningham*, 716 F.2d 1455, 1467 (5th Cir. 1983); *Laborers National Pension Fund v. Northern Trust Quantitative Advisors, Inc.*, 173 F.3d 313 (5th Cir. 1999).

<sup>10</sup> 29 C.F.R. §2550.404 a-1(b)(1)(i).

In 2015, the Department reiterated this view in connection with ESG investing (then called “economically targeted investments” or “ETI”), stating: “The fiduciary standards applicable to ETIs are no different than the standards applicable to plan investments generally.”<sup>11</sup> Finally, in June 2020, the Department again took a circumstantial view of the duty of prudence in addressing the inclusion of private equity components in individual account plan investment options. The fact that such components “tend to involve more complex organizational structures and investment strategies, longer time horizons, and more complex, and typically, higher fees” did not, in the Department’s view, render such components suspect. The Department stated:

In evaluating a particular investment alternative for consideration as a designated investment alternative, the fiduciary must engage in an objective, thorough, and analytical process that considers all relevant facts and circumstances and then act accordingly.

The Department’s current proposal departs from this history by prejudging ESG integration as presumptively imprudent. In doing so, the proposal puts fiduciaries and plans in a “lose-lose” position of either foregoing ESG investments altogether, even when they are prudent (or even more favorable than alternatives), or running the risk of special scrutiny and enforcement activity by second-guessing the policy views underlying the proposal, in addition to private litigation. Respectfully, the Department’s prejudgment and the practical effect it will have on fiduciaries and plans is not consistent with their statutory duties to act prudently and in the interests of the plans and their participants and beneficiaries.

In the preamble, the Department indicates its belief that the proposal will not impact fiduciaries who integrate only financial ESG factors into their decisions:

This proposal would not impair fiduciaries’ appropriate consideration of ESG factors in circumstances where such consideration is material to the risk-return analysis and advances participants’ interests in their retirement benefits. The Department does not intend to increase fiduciaries’ burden of care attendant to such consideration; therefore, and no additional costs are estimated for this requirement.

Respectfully, given the proposal’s special scrutiny of all ESG considerations, including financial ones, we do not see how this will be the case.

The proposal establishes a new, generally applicable “pecuniary factors” test for all investment considerations, including ESG factors. The test requires that a fiduciary—

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<sup>11</sup> Interpretative Bulletin 2015-01, 80 Fed. Reg. 65135 (Oct. 26, 2016). Revisiting ESG investing just three years later in 2018, in Field Assistance Bulletin 2018-01, the Department emphasized that fiduciaries must be cautious in considering ESG factors, but did not purport to change the basic prudence analysis.



Has evaluated investments and investment courses of action based solely on pecuniary factors that have a material effect on the return and risk of an investment based on appropriate investment horizons and the plan's articulated funding and investment objectives insofar as such objectives are consistent with the provisions of Title I of ERISA.

The proposal also establishes a second, heightened standard of care solely for ESG factors, including factors that are otherwise financial. Under that heightened standard of care—

Environmental, social, corporate governance, or other similarly oriented considerations are pecuniary factors only if they present economic risks or opportunities that qualified investment professionals would treat as material economic considerations under generally accepted investment theories. The weight given to those factors should appropriately reflect a prudent assessment of their impact on risk and return. Fiduciaries considering environmental, social, corporate governance, or other similarly oriented factors as pecuniary factors are also required to examine the level of diversification, degree of liquidity, and the potential risk-return in comparison with other available alternative investments that would play a similar role in their plans' portfolios.

This standard of care does not define “qualified investment professionals” or quantify the degree to which they must concur in the treatment of given ESG factors (nor does the statute or any other authority), leaving such issues open to interpretation and, along with the heightened standard more generally, increasing the risk of enforcement activity or private litigation.

By focusing solely on traditional economic metrics, these tests require managers to ignore other material factors that may impact the value of an investment, such as a corporate issuer's reputation, the experience of its management or its compliance history and transparency. These considerations would be relevant under ERISA's duty of prudence, however.<sup>12</sup>

The Department states in the preamble that this special scrutiny of ESG investing is appropriate because of potential confusion in the marketing of ESG investments and the potential for higher costs. This treatment appears to conflict with the

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<sup>12</sup> See, e.g., 29 C.F.R. §2550.404a-1(b)(1) (requiring “appropriate consideration to those facts and circumstances that, given the scope of such fiduciary's investment duties, the fiduciary knows or should know are relevant to the particular investment or investment course of action involved . . .”); *Donovan v. Mazzola*, 716 F.2d 1226, 1232 (9th Cir. 1983) (examining “whether the individual trustees, at the time they engaged in the challenged transactions, employed the appropriate methods to investigate the merits of the investment and to structure the investment.”); *In re Unisys Savings Plan Litigation*, 173 F.3d 145, 153-154 (3d Cir. 1999) (in addition to examining process leading to investment, court asked whether a “hypothetical prudent investor” would have made the same investment.); *Laborers National Pension Fund v. Northern Trust Quantitative Advisors, Inc.*, 173 F.3d 313 (5th Cir. 1999) (prudence not to be measured in isolation); *Braden v. Wal-Mart Stores, Inc.*, 588 F.3d 585, 595 (8th Cir. 2009) (“In evaluating whether a fiduciary has acted prudently, [courts] therefore focus on the process by which it makes its decisions.”).



Department's treatment of private equity just last month, however. In June 2020, the Department concluded that "a plan fiduciary of an individual account plan may offer an asset allocation fund with a private equity component". Consistent with its long-standing treatment of investment decision-making, the Department's letter neither cites nor attempts to impose any special scrutiny or heightened standard of care on the selection of such funds. This is true notwithstanding the Department's explicit acknowledgement that private equity, when compared to public market alternatives, comes with "different regulatory disclosure requirements, oversight, and controls", complex and subjective valuations, "more complex organizational structures and investment strategies, longer time horizons, and more complex, and typically, higher fees." Instead, the Department concluded – and properly so – that the selection of such a fund is entrusted to the same statutory duties, including the duty of prudence, as any other investment decision. For reasons not articulated in the proposed rule, however, the Department fails to apply the same logic to potential ESG investments.

Even if ESG investments were significantly more confusing or difficult to understand than private equity or any other type of investment (which they are not), we do not believe they necessitate the special scrutiny and the accompanying burdens and costs imposed by the proposal. ERISA already requires fiduciaries to possess (or hire) the sophistication necessary to prudently consider an investment or strategy – derivatives, private equity, ESG or otherwise – regardless of how they are marketed and, to the extent they fail to do so, ERISA provides for liability and other remedies to protect participants and beneficiaries. This is the view that the Department took in addressing ESG investments just five years ago, stating: "The fiduciary standards applicable to ETIs are no different than the standards applicable to plan investments generally."<sup>13</sup> We respectfully submit that this is the view that should continue to prevail.

***The Proposal Effectively Eliminates the Subjective Test of Loyalty That Has Stood For Almost Fifty Years.***

Separate and apart from the duty of prudence, the statute requires that fiduciaries act "solely in the interest of" plan participants and beneficiaries. This standard looks to a fiduciary's subjective intent (*i.e.*, its state of mind), requiring fiduciaries to act with an "eye single to the interests of the participants and beneficiaries."<sup>14</sup> It requires that fiduciaries not subordinate the interests of the participants and beneficiaries to

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<sup>13</sup> Interpretative Bulletin 2015-01.

<sup>14</sup> See *Donovan v. Bierwirth*, 680 F.2d 263, 271 (2d Cir. 1982); *Davidson v. Cook*, 567 F. Supp. 225, 236 (E.D. Va. 1983), *aff'd mem.*, 734 F.2d 10 (4th Cir. 1984); *Brotherston v. Putnam*, 907 F.3d 17, 40 (1st Cir. 2018); *In re Wells Fargo ERISA 401(k) Litig.*, 331 F. Supp. 3d 868, 875 (D. Minn. 2018), appeal docketed, No. 18-2781 (8th Cir. Aug. 20, 2018); *Wildman v. American Century Services, LLC*, 362 F. Supp. 3d 685, 700-701; *Perez v. First Bankers Tr. Servs. Inc.*, 210 F. Supp. 3d 518, 534 (S.D.N.Y. 2016).

unrelated objectives.<sup>15</sup> It does not require fiduciaries to avoid investments merely because they provide incidental benefits to others, including plan sponsors, third parties or even the fiduciaries themselves, however.<sup>16</sup>

The Department's proposal conflates the statute's separate, subjective loyalty standard and its procedural duty of prudence and imposes several objective conditions that fiduciaries must satisfy, in addition to anything else the statute may require. Among other things, the proposal makes anti-subordination of participant interests an objective standard (in place of the current subjective standard), severely inhibiting fiduciaries from selecting any investment with incidental benefits, whether to ESG interests or otherwise.

This formula disregards the physical separation of the two duties in the statute. Consistent with cardinal rules of statutory interpretation, ERISA's fiduciary duties of loyalty and prudence, which are contained in separate provisions of ERISA § 404(a)(1), should be interpreted as having separate meanings to avoid rendering either superfluous.<sup>17</sup>

In addition, this formula is unworkable because every investment necessarily affords incidental benefits to other interests. For example, investing in corporate equities incidentally benefits issuers, broker-dealers and market participants as a whole. Investing in employer stock may incidentally benefit a sponsoring employer (benefits which Congress acknowledged in providing an exemption for such investments<sup>18</sup>). Nothing in ERISA's duty of loyalty prohibits such incidental benefits as long as participants' interests come first.

The Department acknowledges as much in its recently proposed fiduciary rule package.<sup>19</sup> The package includes an exemption for principal transactions with a fiduciary adviser, notwithstanding that the transactions will necessarily benefit the adviser. The exemption is expressly conditioned on the adviser satisfying its duty of

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<sup>15</sup> 29 C.F.R. § 2509.94-1.

<sup>16</sup> *Donovan v. Bierwirth*, 680 F.2d 263, 271 (2d Cir. 1982); *Vander Luitgaren v. Sun Life Assurance Co. of Canada*, 765 F.3d 59 (1st Cir. 2014) ("an accompanying benefit to the fiduciary is not impermissible", "the fiduciary [simply must] not place its own interests ahead of those of the Plan beneficiary."); *Trenton v. Scott Paper Co.*, 832 F.2d 806, 809 (3d Cir. 1987); *Donovan v. Walton*, 609 F. Supp. 1221, 1245-46 (S.D. Fla. 1985), *aff'd sub. nom Brock v. Walton*, 794 F.2d 586 (11th Cir. 1986).

<sup>17</sup> See *Hibbs v. Winn*, 542 U.S. 88, 101 (2004).

<sup>18</sup> See ERISA Section 408(e) (providing relief from the restrictions of Sections 406 and 407 of ERISA for the acquisition or sale by a plan of certain qualifying employer securities).

<sup>19</sup> See Conflict of Interest Rule – Retirement Investment Advice: Notice of Court Vacatur, 85 Fed. Reg. 40589 (July 7, 2020) and Improving Investment Advice for Workers & Retirees, 85 Fed. Reg. 40834 (July 7, 2020).

loyalty.<sup>20</sup> Thus, it cannot be the Department's view that the duty of loyalty flatly prohibits a fiduciary (or anyone else) from receiving incidental benefits. Rather, as it has long been interpreted, the duty of loyalty must require only that the interests of the plan and its participants and beneficiaries come ahead of the interests of others.

The proposal attempts to preserve the statute's incidental benefits principle by permitting a fiduciary to consider incidental benefits in choosing among investment alternatives that are "economically indistinguishable". Taking advantage of this exception would require the fiduciary to undertake additional compliance burdens, including creating and maintain supporting documentation demonstrating, among other things, the economic equivalence. We do not think this exception saves the proposal from a fundamental conflict with the statute because, like the Department, we think that proper investment alternatives will rarely, if ever, be "economically indistinguishable". Each, instead, will merely be prudent.

We are also concerned that, as a practical matter, this exception will require fiduciaries integrating ESG factors into their investment decisions to undertake the impossible burden of proving that investments were not just prudently selected, as the statute requires, but that they were also superior to all other alternatives.

***The Proposal Inappropriately Requires Fiduciaries to Consider All Available Alternatives When Making Investment Decisions.***

As explained above, the statute requires fiduciaries to act prudently in making investment decisions. Whether and to what extent fiduciaries must consider alternatives in any given case turns on all relevant facts and circumstances, including, among others, governing guidelines, the role of the investment in the account or portfolio and the costs and benefits to the plan. For example, prudence would not require an investment manager to consider every security in the world (on top of mutual funds, collective trusts and all other potential options) before constructing a portfolio.<sup>21</sup>

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<sup>20</sup> Section II(a)(1) of the proposed exemption requires compliance with the Impartial Conduct Standards, which in part requires the financial institution and adviser to not "place the financial or other interests of the Investment Professional, Financial Institution or any affiliate, related entity, or other party ahead of the interests of the Retirement Investor, or subordinate the Retirement Investor's interests to their own." 85 Fed. Reg. at 40863. See also 85 Fed. Reg. at 40842 ("This proposed best interest standard is based on longstanding concepts derived from ERISA and the high fiduciary standards developed under the common law of trusts, and is intended to comprise objective standards of care and undivided loyalty, consistent with the requirements of ERISA section 404.").

<sup>21</sup> See *Hecker v. Deere & Co.*, 556 F.3d 575, 586 (7th Cir. 2009) ("nothing in [ERISA] requires plan fiduciaries to include any particular mix of investment vehicles in their plan" or "to scour the market to find and offer the cheapest possible fund (which might, of course, be plagued by other problems)."); *Larson*, 350 F. Supp at 796; *White*, 2016 U.S. Dist. LEXIS 115875, at \*25-37; *Dorman v. Charles Schwab Corp.*, No. 17-00285-CW, 2018 U.S. Dist. LEXIS 218049, at \*10-12 (N.D. Cal. Sept. 20, 2018).

The Department's proposal would fundamentally change the current statutory approach to seemingly require the consideration of all available alternatives (as opposed to a prudent consideration of alternatives). The proposal does not define or qualify the term "available" but indicates that it should be broadly construed. For example, the preamble broadly compares negatively all ESG investments (regardless of management style, asset class, cost or other risk/reward characteristics) to low cost and passively-managed index funds.

Respectfully, such a broad interpretation of the term "available" is inconsistent with the statute's duty of circumstantial prudence and the Department's historic position.<sup>22</sup> It is also potentially harmful to the interests of plan investors and their participants and beneficiaries. Potential investments should be compared, as prudent, to others offering a similar mix of risk/reward characteristics. Index funds may form appropriate comparators in some cases (e.g., to other passive investment funds), but not all (e.g., where a manager's mandate is to seek opportunities for returns in excess of market, access to varying risk/reward profiles for hedging and other diversification purposes and flexibility in altering asset allocations and other tactics in response to market conditions).

Such a broad interpretation of the term "available" could also increase potential litigation risks for plan fiduciaries and fiduciary service providers, with respect to every investment, regardless of its purpose or relative position in the portfolio or fund. The added time and expense spent in defending investment decisions may dissuade plan fiduciaries and managers from making prudent choices solely because of the availability of cheaper investments and could put upward pressure on fees and expenses born by the plans.

### **Part III --- Other Technical Concerns**

In addition to the concerns discussed above, we have identified the following additional technical and legal issues presented by the proposed rule:

#### ***The Rule Risks Capturing Plan Asset Vehicles***

The proposal's operative terms refer to investment decisions by a "fiduciary of an employee benefit plan." The extensive discussion in the preamble, as well as the terms themselves, address the consideration of plan-level issues, such as plan liquidity and the role that selected investments will play in the plan's portfolio. The terms do not expressly refer to asset management fiduciaries to investment vehicles

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<sup>22</sup> The Department's current regulations provide that "fees and expenses are only one of several factors" in making investment decisions. 29 C.F.R. § 2550.404a-5(d)(1)(iv)(A)(4) (2015). A Department handbook for plan fiduciaries takes a similar position, stating: "Fees are just one of several factors fiduciaries need to consider in deciding on service providers and plan investments." Meeting Your Fiduciary Responsibilities, September 2017, available at <http://www.dol.gov/ebsa/pdf/meetingyourfiduciaryresponsibilities.pdf>. In 2007 Congress declined to amend ERISA to require plans to offer at least one index fund. See H.R. 3185, 110th Cong. (2007). The Assistant Secretary of Labor at the time expressed in written testimony the Department's concern that mandating specific investment options would "limit[] the ability of employers and workers together to design plans that best serve their mutual needs . . . ." The Appropriateness of Retirement Plan Fees, Hr'g. Before the H. Comm. on Ways and Means, 110th Cong. 19 (2007) (statement of Bradford P. Campbell, Assistant Sec'y of Labor).

or accounts that hold plan assets. It is generally not the duty of asset managers, for example, to question their plan clients' asset allocations, guidelines or other product choices. Consistent with this approach, the proposal's cost-benefit analysis does not refer to, or attempt to quantify, the costs that the proposal will impose on asset managers. If the Department intended to cover asset managers, it presumably would have made that clear and examined those costs that it would impose. The proposal's terms may nevertheless be subject to a broad reading that would, in our view, inappropriately extend to asset managers of a fund or account in which a plan participates or owns an interest.

***ESG Investments Should not be Precluded from Consideration as QDIAs***

As discussed above, ERISA's statutory duties provide comprehensive rules for determining the propriety of a given investment or investment option. An entire class of prudent and otherwise compliant fund options should not be prejudged and precluded from consideration as "qualified default investment alternatives" or "QDIAs" simply because they integrate ESG considerations, in whole or part. Indeed, we believe doing so will only disadvantage the many participants and beneficiaries who do not make their own investment choices by depriving them of the above-described financial benefits arising from ESG integration.

Permitting the selection of an otherwise prudent and compliant ESG fund as a QDIA is consistent with the position taken by the Department in its recent Information Letter on private equity. In that letter, the Department indicated that asset allocation funds with a private equity component could be included not only as designated investment alternatives, but also as QDIAs. In discussing the prudential process that a fiduciary selecting such a fund must undertake, the Department expressly referenced QDIAs:

The fiduciary must also determine whether plan participants will be furnished adequate information regarding the character and risks of the investment alternative to enable them to make an informed assessment regarding making or continuing an investment in the fund. This factor would be especially important in the case of a plan or responsible plan fiduciary claiming limited fiduciary liability under ERISA section 404(c) for participants exercising control over their accounts (see 29 CFR 2550.404c-1) *and/or deciding that a particular investment alternative would be prudent to use as a qualified default investment alternative (QDIA) for the plan under 29 CFR 2550.404c-5.*

Permitting the use of a prudently selected ESG fund as a QDIA is also consistent with the Department's QDIA regulation, which "does not identify specific investment

products - rather, it describes mechanisms for investing participant contributions.”<sup>23</sup> Respectfully, we believe the same analysis should apply to ESG funds.

The Department’s comparison of ESG funds to employer stock funds, which the Department’s regulations prohibit from serving as a QDIA, does not seem apt. Unlike many ESG funds that could serve as appropriate QDIAs, employer stock funds are not diversified investment options and, thus, would not be appropriate as the sole investment in a participant’s account.

***The Department’s Cost-Benefit Analysis Omits the Vast Majority of Costs That the Rule Will Impose on Plans, Plan Fiduciaries and Other Affected Parties***

With limited exception, the Department’s cost-benefit analysis concludes that the proposal will impose virtually no costs on the thousands of fiduciary service and investment product providers to the over 700,000 ERISA-governed defined benefit and defined contribution plans that the proposal may affect.<sup>24</sup> Respectfully, we do not see how this can be accurate. Each of the providers will expend time and incur varying legal and other costs in connection with the proposal. This will include time and expenses to, among other things: (i) read the rule and digest its potential interpretations and determine how those interpretations may affect their particular plans or businesses (which may include multiple products within multiple business lines), (ii) review their investment policies, strategies, procedures, management agreements, marketing materials and related documentation in light of the rule, (iii) make any necessary changes, and (iv) provide notice of such changes to plan clients.

The amount of time and money necessary for fiduciary service providers and others to undertake the relevant foregoing tasks will be significant. Indeed, if one were to assume for the sake of argument that only half of the roughly 13,000<sup>25</sup> registered investment advisers provide services and products to ERISA-governed plans and each spends only a modest \$10,000 in legal and other costs in addressing the rule, that would add \$65,000,000 to the rule’s costs just for registered advisers. Ongoing compliance costs in monitoring existing investments and selecting new investments would be additional, as would the costs to address the heightened potential litigation risks raised by the proposal. Similar costs could be incurred in connection with the proposed rule by banks and insurers.

As mentioned above, the Department may have intended the proposal to cover only fiduciary decision-making at the plan level, and not asset managers of a fund or

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<sup>23</sup> DOL Fact Sheet, 10/24/2007— Regulation Relating To Qualified Default Investment Alternatives In Participant-Directed Individual Account Plans.

<sup>24</sup> The Department states that the sole cost of the rule will be 600 hours of total time (or \$56,818) annually for defined benefit and defined contribution plans with ESG investments that are not participant directed to maintain new documentation.

<sup>25</sup> “Information about Registered Investment Advisers and Exempt Reporting Advisers: July 2006 – July 2020”, available at <https://www.sec.gov/help/foiadocsinvafoiahtm.html>.



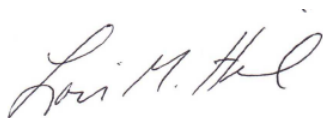
account in which a plan participates or owns an interest. The text of the proposal does not reflect such a limitation, however. Further, even if the proposal were so limited, it would still require managers and other product level fiduciaries to collectively incur significant costs in examining how the proposal affects their clients' choices and, thus, the products they offer. Costs to change those products would be additional.

The Department's proposal does not consider any of the foregoing costs.<sup>26</sup> As a result, we respectfully submit that without first determining and considering the actual costs of its proposal in order to make a reasoned determination that adopting the rule would be in the public interest, the Department appears not to have a sufficient basis to proceed with finalizing the rule.<sup>27</sup> Therefore, we respectfully request that the Department withdraw the proposal and fully determine and consider such costs in an open dialogue with relevant stakeholders before taking further regulatory or sub-regulatory action.

In summary, we oppose the proposed rule in its current form, due to what we anticipate would be a negative financial impact on ERISA plans, participants and beneficiaries and to its inconsistencies with well-established ERISA interpretations. As a result, we urge the Department to withdraw the proposed rule and instead engage with a broad range of stakeholders --- including plan sponsors, investment advisers and managers, plan participants and beneficiaries, and other groups --- to develop forward-looking approaches to incorporating the benefits of value-driven consideration of ESG factors into U.S. pension plans' investment strategies.

Once again, State Street Global Advisors appreciates the opportunity to comment on the proposed rule. Please do not hesitate to contact us with any questions, or if we can be of further assistance in any way.

Sincerely,



Lori Heinel

Executive Vice President and Deputy  
Global Chief Investment Officer  
State Street Global Advisors



Katherine S. McKinley

Senior Vice President and General  
Counsel  
State Street Global Advisors

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<sup>26</sup> Plans will bear even greater costs. If one were to assume for the sake of argument that each ERISA plan spends an average of only \$1,000 in legal fees or other costs just to determine whether and how the rule affects it, the initial cost to all plans would total over \$700 million. Ongoing compliance costs in monitoring existing investments or options and selecting new investments or options would be additional.

<sup>27</sup> See, e.g., *Business Roundtable v Securities and Exchange Commission*, 647 F.3d 1144 (DC Cir 2011) (striking down SEC's proxy access rule due to defective cost-benefit analysis; *Corrosion Proof Fittings v Environmental Protection Agency*, 947 F.2d 1201 (5th Cir 1991) (striking down EPA regulation of asbestos products for defective cost-benefit analysis).



