



July 30, 2020

Office of Exemption Determination  
Employee Benefits Security Administration  
U.S. Department of Labor  
200 Constitution Avenue NW, Suite 400  
Washington, DC 20210  
Attention: RIN 1210-AB95

Submitted online via <http://www.regulations.gov>

**RE: Financial Factors in Selecting Plan Investments; 29 CFR Part 2550; RIN 1210-AB95**

BlackRock, Inc. (together with its affiliates, “BlackRock”)<sup>1</sup> respectfully submits its comments to the Department of Labor (“DoL”) in response to the DoL’s proposed rule regarding the consideration of financial factors in selecting plan investments (the “Proposal”). We agree with the DoL’s long-standing views that ERISA fiduciaries must always put first the economic interests of the plan in providing retirement benefits and cannot sacrifice investment returns or take on additional risk to promote goals unrelated to the financial interests of the plan participants and beneficiaries. This approach is consistent with the views we have publicly outlined in [BlackRock’s ESG Integration Statement](#).<sup>2</sup>

Our investment conviction, founded on research by BlackRock, the industry, and various academics in addition to our deep experience with both investment and risk management across asset classes, is that incorporating sustainability-related factors – which are often characterized and grouped into environmental, social, and/or governance (“ESG”) categories – into investment decisions is likely to provide better risk-adjusted returns to investors over the long-term. We believe that sustainability-related factors can contribute to both value creation and value destruction. As we outline in this letter, there is a robust body of research that reinforces these views.

We appreciate the DoL’s focus on the accelerating trend in the use of the term “ESG” and the proliferation of funds that are marketed as “ESG funds”. We understand that there is a broad range of ESG-oriented products, and the rapid increase in availability

---

<sup>1</sup> BlackRock manages assets on behalf of individual and institutional clients across equity, fixed income, real assets, and other strategies. The assets we manage represent our clients’ futures and the investment outcomes they seek, and it is our responsibility to help them better prepare themselves and their families to achieve their financial goals. Two thirds of the assets we manage are retirement-related assets. BlackRock manages assets for public and private pensions, including defined benefit (“DB”) and defined contribution (“DC”) plans of varying sizes.

<sup>2</sup> BlackRock, ESG Integration Statement (revised Jul. 28, 2020), available at <https://www.blackrock.com/corporate/literature/publication/blk-esg-investment-statement-web.pdf>.

of those products could lead to confusion for investors and others. In fact, the financial services industry is similarly focused on these issues and is currently taking important steps to promote transparency and reduce confusion. In October, the Institute of International Finance (“IIF”) convened a group of financial institutions including banks, insurers, and asset managers to discuss the need for a product taxonomy. Their report, [\*The Case for Simplifying Sustainable Investment Terminology\*](#),<sup>3</sup> identified three key categories: exclusion, inclusion, and impactful. This month, the Investment Company Institute (“ICI”) published [\*Funds’ Use of ESG Integration and Sustainable Investing Strategies: An Introduction\*](#).<sup>4</sup> As with the IIF report, the ICI identified three key categories of “ESG funds”: ESG exclusionary investing, ESG inclusionary investing, and impact investing. The ICI represents the US mutual fund industry, and its board members – which represent more than 50 asset managers and directors of mutual funds<sup>5</sup> – unanimously approved this report. Both the ICI and the IIF report underscore the broad industry recognition of the need for a common language and a product taxonomy that provides transparency to help end investors differentiate among products and choose the right product for their investment needs. Endorsing a market-led product taxonomy would provide clarity and enable the DoL to identify and mitigate specific areas of concern.

We are concerned that the Proposal goes far beyond reiterating and clarifying the DoL’s long-standing and consistent position that plan fiduciaries must put first the economic interests of plan participants and beneficiaries. The Proposal creates an overly prescriptive and burdensome standard that would interfere with plan fiduciaries’ ability and willingness to consider financially material ESG factors, regardless of their potential effect on the return and risk of an investment. We encourage the DoL to address these consequences before moving forward with any final regulation.

We urge the DoL to engage with the industry to understand how investment options incorporating ESG factors are used in ERISA plans. More industry dialogue would reveal that the Proposal would impose significant costs and burdens on ERISA plans that would ultimately be detrimental to plan participants and beneficiaries. To inform a robust regulatory impact analysis, we encourage the DoL to engage with plan sponsors, investment managers, and index providers to understand how ERISA plans can and do incorporate ESG factors to drive positive economic outcomes for plan participants, and the extent to which the Proposal would create new costs and burdens for plans, including through the additional documentation requirements. To gain a holistic picture of the growing trends of ESG integration (as defined below) and investing, the DoL could issue a Request For Information (“RFI”). To help the DoL better understand the use of ESG factors, we include in this letter information on BlackRock’s approach to incorporating ESG factors, as well as data on how ESG-focused funds have performed.

---

<sup>3</sup> See IIF, Sustainable Finance Working Group Report, *The Case for Simplifying Sustainable Investment Terminology* (Oct. 2019), available at <https://www.iif.com/Portals/0/Files/content/IIF%20SFVG%20-%20Growing%20Sustainable%20Finance.pdf> (“IIF ESG Report”).

<sup>4</sup> ICI, *Funds’ Use of ESG Integration and Sustainable Investing Strategies: An Introduction* (Jul. 2020), available at [https://www.ici.org/pdf/20\\_ppr\\_esg\\_integration.pdf](https://www.ici.org/pdf/20_ppr_esg_integration.pdf) (“ICI ESG Report”).

<sup>5</sup> Registered under the Investment Company Act of 1940.

In addition, there are several ways the Proposal could better align with its stated goal of clarifying and formalizing the DoL’s long-standing position that plan fiduciaries must put first the economic interests of plan participants and beneficiaries. Set forth below are specific recommendations to improve the Proposal and avoid unintended consequences.

In this letter, we:

- I. Define the various types of ESG factors, explain BlackRock’s approach to using ESG factors, and provide data supporting our view that ESG-focused funds can be an effective source of positive investment returns;
- II. Recommend that the DoL work with the financial services industry to conduct a comprehensive regulatory impact analysis of the Proposal and consider issuing an RFI to gather more data;
- III. Provide recommendations that would formalize the DoL’s longstanding position on fiduciary duties in the ESG context, while seeking to reduce the potential burden the Proposal places on plan fiduciaries, including suggested changes to the additional documentation obligation, the barrier to including pecuniary ESG factors in qualified default investment alternatives (“QDIAs”), and the inability to include ESG-integrated products on an investment menu of non-default options based on non-pecuniary factors; and
- IV. Articulate additional unintended consequences of the Proposal that are unrelated to the consideration of ESG factors.

## **Section I: ESG Factors**

Recognizing that the terms “sustainable investing” and “ESG” are often used to encompass a broad range of concepts, in this section, we define ESG factors, outline BlackRock’s approach to sustainable investing, and provide data on the materiality of ESG factors.

### **Types of ESG Factors**

Research by BlackRock, the industry, and academics has shown that the incorporation of material ESG factors alongside traditional financial information during the investment process contributes to long-term investment performance and mitigates risk during periods of market volatility. We define environmental, social and governance factors as follows:

- **Environmental** – covers themes such as climate risks, natural resources scarcity, pollution and waste, and environmental opportunities
- **Social** – includes labor issues and product liability, and risks such as data security and supply chain management
- **Governance** – encompasses items relating to corporate governance and behavior such as board quality and effectiveness

ESG data can be incorporated across asset classes in both active and index investment strategies to give a clearer picture of the financial risks and opportunities inherent in a portfolio.

Significant strides have been made in addressing the challenges around the uniformity of ESG-related data and metrics. Organizations like the Sustainable Accounting Standards Board (“SASB”) and Taskforce for Climate Related Financial Disclosure (“TCFD”) are driving both transparency and industry consensus around a set of well-defined metrics. The SASB and TCFD sustainability disclosure frameworks have seen significant uptake. As of February 2020, more than 1,000 companies, with a total market cap of \$12 trillion, had endorsed TCFD recommendations. These companies include more than 473 financial firms representing \$138.8 trillion of managed capital. SASB has seen a 180% increase in reporting since 2018. The widespread adoption of these frameworks is significant because both SASB and TCFD recommend a set of disclosures on issues that are likely to have an impact on a company’s long-term operational and financial performance. In addition, the Sustainable Industry Classification System (“SICS”) sits alongside the widely accepted four-tiered Global Industry Classification System (“GICS”) that uses financial metrics to determine a company’s principal business activity. Over the next few years, we believe ESG data will become even more of a common language among issuers and investors.<sup>6</sup>

To minimize confusion surrounding ESG-focused products, we believe that there should be alignment around a globally standardized naming classification for ESG-focused products that is supported by policymakers. As outlined in our *ViewPoint* titled [\*Towards a Common Language for Sustainable Investing\*](#),<sup>7</sup> BlackRock supports efforts like those of the IIF and ICI to recommend a global taxonomy classification. In Appendix A, we outline the taxonomy frameworks proposed by IIF, ICI, and BlackRock. All three frameworks are similar. For example, the ICI ESG report describes in detail how funds commonly pursue sustainable investing strategies using three approaches:

1. **ESG exclusionary investing:** Funds with this type of investment approach may exclude companies or sectors that do not meet certain sustainability criteria or do not align with investors’ objectives. They may use optimization techniques or diversification guardrails to limit large deviations from market performance.
2. **ESG inclusionary investing:** Funds with this type of investment approach generally seek positive sustainability-related outcomes by pursuing an investing thesis focusing on portfolios that fundamentally or systematically tilt a portfolio based on ESG factors alongside financial return.

---

<sup>6</sup> BlackRock, Sustainability: The tectonic shift transforming investing (Feb. 28, 2020), available at <https://www.blackrock.com/us/individual/insights/blackrock-investment-institute/sustainability-in-portfolio-construction>.

<sup>7</sup> BlackRock, ViewPoint, Towards a Common Language for Sustainable Investing (Jan 2020), available at <https://www.blackrock.com/corporate/literature/whitepaper/viewpoint-towards-a-common-language-for-sustainable-investing-january-2020.pdf>.

3. **Impact investing:** Funds with this type of investment approach seek to generate positive, measurable, reportable social and environmental impact alongside a financial return. Measurement, management, and reporting of impact is a defining feature of impact investing.

We are encouraged that IIF and ICI are driving consensus in the financial services industry around a taxonomy, as we believe it is important for plan sponsors to have appropriate information to compare ESG objectives across funds. In this regard, products should be clearly marketed, and the objective(s) of ESG-focused funds should be clearly identified. We believe that marketing materials and product disclosures should clearly identify a product's objectives and clearly describe the product's strategies so that plan fiduciaries have clear information on how ESG-focused funds are constructed. A uniform global taxonomy will make identifying the investment objective(s) of a fund more straightforward and give plan sponsors the data needed to make accurate comparisons among similar types of funds. As ICI's taxonomy demonstrates, a plan fiduciary may be able to more readily satisfy its investment duties when selecting some types of ESG-focused funds as opposed to others. For example, an ESG inclusionary investing product that seeks to maximize risk-adjusted returns and does not increase risk or subordinate returns based on an ESG goal may be an appropriate investment for an ERISA plan.

### **BlackRock's Approach to Sustainable Investing**

BlackRock's sustainable investing philosophy is rooted in our clients' financial interests. We seek to integrate ESG information into our investment processes and strategies in service of improving long-term outcomes for the clients we serve. We analyze ESG information because traditional financial accounting standards such as GAAP or IFRS may not provide investors with a complete picture of the full set of risks and opportunities faced by companies. Armed with more information, investors are better positioned to evaluate risks, an advantage that is especially relevant in stressed markets when uncertainty about future outcomes is higher.

Guided by our overarching purpose of helping our clients achieve their long-term investment goals by providing resilient and well-constructed portfolios, we approach sustainable investing and the use of ESG information through:

- I. ESG integration and risk management across our investment platforms;
- II. Investment stewardship – promoting corporate practices that help create long-term shareholder value for clients, the vast majority of whom are investing for long-term goals such as retirement;
- III. Dedicated ESG-focused funds for those clients who want to align their capital with a specific ESG outcome.<sup>8</sup>

---

<sup>8</sup> BlackRock currently manages \$101 billion in assets in dedicated sustainable products and strategies and an addition \$481 billion in strategies that employ exclusionary screens. Our sustainable products are not designed to require a return tradeoff and can even provide better long-term risk-adjusted returns for investors.

## ESG Integration at BlackRock

ESG integration is a process that could be relevant for – and additive to – all active investment strategies. For our active products, we operate with a simple definition of ESG integration: incorporating material ESG information alongside traditional financial information during the investment process, with the objective of improving the long-term performance of portfolios. The goal is not to change a strategy’s underlying investment objective but to provide portfolio managers with additional tools and information to identify new risks and opportunities in their portfolios.

In our index investments business, we work with index providers to expand and improve the universe of sustainable indexes, and as part of our investment stewardship, we may engage with companies in which our clients are invested to encourage the effective management and disclosure of material ESG risks. Index fund managers engage with companies and vote proxies in order to express views as to matters that materially affect a company’s performance. These efforts seek to promote governance practices that help create long-term shareholder value for our clients, the vast majority of whom are investing for long-term goals such as retirement.<sup>9</sup>

## Performance of ESG-Focused Funds

In our research paper titled *Sustainability: The Future of Investing*, BlackRock posited that, “enhanced data and insights make it possible to create sustainable portfolios without compromising financial goals. Our research, which relies on back-tested data, shows how ESG-focused indexes have matched or exceeded returns of their standard counterparts, with comparable volatility. We find that ESG has much in common with existing quality metrics, such as strong balance sheets, suggesting that ESG-friendly portfolios could be more resilient in downturns.”<sup>10</sup>

Over the past several years, there has been a growing body of evidence and literature to support the validity of this view. For example, a 2015 study examining the effect of ESG factors on Corporate Financial Performance (“CFP”) in the *Journal on Sustainable Finance* combined more than 3,700 study results from more than 2,200 unique primary studies and found clear evidence for the business case for ESG investing.<sup>11</sup> A 2015 Harvard Business School paper found that firms with strong ratings on material sustainability issues have better future performance than firms with inferior ratings on the same issues. In contrast, firms with strong ratings on immaterial issues do not outperform

---

<sup>9</sup> BlackRock Investment Stewardship, Our approach to sustainability (Jul. 2020), available at <https://www.blackrock.com/corporate/literature/publication/our-commitment-to-sustainability-full-report.pdf>.

<sup>10</sup> BlackRock Investment Institute, *Sustainability: The Future of Investing* (Feb. 2019), available at <https://www.blackrock.com/us/individual/insights/blackrock-investment-institute/sustainability-the-future-of-investing>.

<sup>11</sup> Gunnar Friede, Timo Busch & Alexander Bassen, *Journal of Sustainable Finance & Investment*, ESG and financial performance: aggregated evidence from more than 2000 empirical studies (2015), available at [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2699610](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2699610).

firms with poor ratings on these issues.<sup>12</sup> We outline some of this research in more detail in Appendix B.

Furthermore, under the recent market stress, we have observed better risk-adjusted performance across sustainable products globally in the first quarter of 2020. Morningstar reported 51 out of 57 of their sustainable indices outperformed their broad market counterparts,<sup>13</sup> and MSCI reported 15 of 17 of their sustainable indices outperformed broad market counterparts in the first quarter of 2020, based on robust cross regional and index methodology.<sup>14</sup> Further, Morningstar found that 70% of sustainable mutual funds performed in the top half of their respective Morningstar categories<sup>15</sup>. While one quarter of performance is not determinative, it is instructive for a few reasons:

- I. It is consistent with the resilience in sustainable strategies that we have seen in prior market stress scenarios. BlackRock analyzed the performance of a globally representative, widely analyzed set of 32 sustainable indices against their non-sustainable benchmarks back to 2015. Our analysis found that during notable market downturns in 2015-2016 and 2018, sustainable indices tended to outperform their non-sustainable counterparts – that is, they demonstrated a smaller decrease in value during the market downturn.
- II. The recent downturn was the most significant test of this resilience, due to the severity of the market turmoil. In Q1 of 2020, 94% of sustainable indices in our analysis outperformed their parent benchmarks. We also tested whether this effect remained after the market began to recover in late March 2020 and found that the resilience was persistent. 91% of these sustainable funds outperformed their non-sustainable counterparts through June 30, 2020.<sup>16</sup>
- III. The recent evidence is consistent with prior BlackRock research and financial research across market cycles. This supports a conclusion that sustainable strategies do not require a return tradeoff and can provide better risk-adjusted returns for investors, during both normal and stressed markets.<sup>17</sup>

As the above research demonstrates, ESG factors may provide downside protection, particularly in extreme market environments, which is crucial for retirement investing.

---

<sup>12</sup> Khan, Mozaffar N., George Serafeim and Aaron Yoon, Harvard Business School Working Paper, No. 15-073, Corporate Sustainability: First Evidence on Materiality (Mar. 2015), available at <https://dash.harvard.edu/bitstream/handle/1/14369106/15-073.pdf?sequence=1>.

<sup>13</sup> Dan Lefkowitz, Morningstar, How Did ESG Indexes Fare During the First Quarter Sell-off? (Apr. 8, 2020), available at [https://www.morningstar.com/insights/2020/04/06/how-did-esg-indexes-fare?utm\\_source=eloqua&utm\\_medium=email&utm\\_campaign=&utm\\_content=0](https://www.morningstar.com/insights/2020/04/06/how-did-esg-indexes-fare?utm_source=eloqua&utm_medium=email&utm_campaign=&utm_content=0).

<sup>14</sup> Zoltán Nagy and Guido Giese, MSCI, MSCI ESG Indexes during the coronavirus crisis (Apr. 22, 2020), available at <https://www.msci.com/www/blog-posts/msci-esg-indexes-during-the/01781235361>.

<sup>15</sup> Jon Hale, Morningstar, Sustainable Funds Weather the First Quarter Better Than Conventional Funds (Apr. 3, 2020), available at <https://www.morningstar.com/articles/976361/sustainable-funds-weather-the-first-quarter-better-than-conventional-funds>.

<sup>16</sup> Source: BlackRock, as of June 30, 2020. Based on a set of 32 globally representative, widely analyzed sustainable indices and their non-sustainable counterparts.

<sup>17</sup> BlackRock, Sustainable Investing: Resilience amid uncertainty, available at <https://www.blackrock.com/corporate/about-us/sustainability-resilience-research>.

Given this research and additional research cited in Appendix B, the Proposal overlooks the fact that ESG factors can drive investment risk and return.

## **Section II: Considerations Supporting Further Industry Engagement**

### **The DoL Should Engage with Industry and Others to Identify the Full Scope of the Proposal's Impact**

We urge the DoL to engage with the asset management industry to gain a more comprehensive understanding of how sustainable investment options incorporate ESG factors. More industry dialogue would likely demonstrate that the consideration of ESG factors is generally consistent with a prudent and robust decision-making process and underscore that the Proposal would impose significant costs and burdens on ERISA plans that would ultimately be detrimental to plan participants and beneficiaries. Specifically, we are concerned that the Proposal's additional analysis and documentation burdens will discourage plan fiduciaries from considering financially material ESG factors. Additionally, we are concerned that the Proposal significantly underestimates the costs to comply with the requirements of the Proposal. The DoL believes that only plan fiduciaries who consider ESG factors or are invested in an ESG-focused investment option will be impacted.<sup>18</sup> However, we are concerned that the Proposal could be read to require an analysis of all actively-managed portfolios to determine whether each evaluation factor could be considered an ESG factor, and if so, to confirm that each such ESG factor is indeed pecuniary, as that term is defined in the Proposal. Further, as drafted (and discussed in greater detail below), Section 2550.404a-1(b)(2)(ii)(D) could be read to apply to all investments and investment courses of actions, including decisions within a plan asset vehicle. The burden associated with, and the cost of evidencing, the consideration of available alternatives for each portfolio investment decision could be prohibitive and does not appear to have been considered.

In order to gain a more complete assessment of the growing trends in ESG integration and investing, and to learn whether and to what extent these trends create any confusion or other unique challenges for plan fiduciaries, we suggest that the DoL issue an RFI to gather additional information in connection with this rulemaking effort.

In addition, below are a series of recommendations to better align the Proposal with the stated goal of clarifying and formalizing the DoL's long-standing position that ERISA fiduciaries must always put first the economic interests of the plan and cannot sacrifice investment returns or take on additional risk to promote unrelated objectives.

## **Section III: Recommendations to Clarify and Improve the Proposal**

### **The DoL Can Clarify and Formalize its Longstanding Guidance without Detering Fiduciary Consideration of ESG Factors**

*Improve the Definition of "Pecuniary"*

---

<sup>18</sup> Proposal at 39120-21.

BlackRock generally agrees with the principles of evaluating investments and investment courses of action based on pecuniary factors and that participants' and beneficiaries' financial interests must be paramount, as articulated in newly added Sections 2550.404a-1(b)(1)(ii)-(iv). However, we respectfully suggest that the definition of pecuniary is flawed and too narrow.

### **BlackRock Recommendations:**

1. The definition of the term "pecuniary factor" in Section 2550.404a-1(f)(3) should be modified to read: "The term "pecuniary factor" means a factor *that could reasonably be expected to have* a material effect on the risk and/or return of an investment based on appropriate investment horizons consistent with the plan's investment objectives and the funding policy established pursuant to section 402(b)(1) of ERISA."<sup>19</sup>
2. Section 2550.404a-1(b)(1)(ii) should be modified to read: "Has evaluated investments and investment courses of action based solely on pecuniary factors."<sup>20</sup>

These edits create a clearer, more workable standard that is also more consistent with the fiduciary requirements of sections 403 and 404 of ERISA and the existing regulations thereunder.<sup>21</sup>

### *Clarify Section 2550.404a-1(c)*

The addition of Section 2550.404a-1(c) unnecessarily creates a new fiduciary review requirement targeted at a specific type of investment risk that is confusing, complicated, and costly to satisfy. While we believe that the DoL's apparent presumption that the use of ESG factors is inherently non-pecuniary is not supported by the evidence, we acknowledge that there may be certain investments that are designed to further non-financial goals. In those limited cases, we understand the DoL's concern that an investment in such a product could be motivated, in part, by non-financial reasons and, therefore, a plan fiduciary should undertake additional analysis to determine whether such an investment would be appropriate for the plan consistent with her fiduciary duties. As written, the Proposal casts far too wide a net by overly burdening plan fiduciaries in all

---

<sup>19</sup> For ease of reference, the following is a comparison of our suggested language with the original: "The term 'pecuniary factor' means a factor that ~~has~~ could reasonably be expected to have a material effect on the risk and/or return of an investment based on appropriate investment horizons consistent with the plan's investment objectives and the funding policy established pursuant to section 402(a)(1) of ERISA."

<sup>20</sup> For ease of reference, the following is a comparison of our suggested language with the original: "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.~~"

<sup>21</sup> See e.g., DoL Regulation Section 2550.404a-1(b)(2)(i): "A determination by the fiduciary that the particular investment or investment course of action is *reasonably designed*...to further the purposes of the plan" (emphasis added); Under DoL Regulation Section 2550.404c-5(e) a qualified default investment alternative may constitute an investment fund "that is *designed* to provide varying degrees of long-term appreciation and capital preservation through a mix of equity and fixed income exposures." (emphasis added).

instances where ESG factors may be taken into consideration. Specifically, the problematic aspects of the Section 2550.404a-1(c) are as follows:

I. Section (c)(1) – Consideration of Pecuniary vs. Non-Pecuniary Factors.

The following sentence creates a new standard that relates uniquely to ESG factors, which is inconsistent with over forty years of the DoL’s principles-based interpretation of fiduciary investment duties, and is difficult to apply: “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.”

To satisfy this requirement, it appears that a fiduciary would need to determine which evaluation consideration(s) could be viewed as an ESG factor. That may be difficult. For example, would a pecuniary vs. non-pecuniary assessment be required under the Proposal if an investment policy statement (“IPS”) includes as an evaluation factor the consideration of a prospective investment manager’s human capital or talent management? This could reasonably be considered a social or corporate governance factor that would be subject to a pecuniary vs. non-pecuniary assessment. Assuming this is considered an ESG factor, then it remains unclear whether the factor would be pecuniary if only *some* qualified investment professionals would treat this factor as a material economic consideration under generally accepted investment theories, or if a consensus of investment professionals is required. One would expect that a consensus would not be required, because such a requirement may not be dynamic enough to allow for industry evolution beneficial to plan participants and beneficiaries.<sup>22</sup> Even if the Proposal as written does not require a consensus, the required multi-step analysis and the concomitant documentation is time-consuming and costly in a way that seems disproportional to the concern that it is designed to address.

The following sentence from (c)(1) also creates significant additional challenges: “Fiduciaries considering environmental, social, corporate governance, or other similarly oriented factors as pecuniary factors are also required to examine the level or diversification, degree of liquidity, and potential risk-return in comparison with other available alternative investments that would play a similar role in the plans’ portfolio.” Going back to the example of a fund manager’s talent management practices, how would a prudent fiduciary satisfy this requirement? Presumably the fiduciary would compare each of the investment options against similar options offered by different fund managers. However, it would certainly be easier and subject to less scrutiny to simply remove that evaluation factor from the IPS. There are likely a number of common and useful evaluation factors that raise similar questions, which may be easier to eliminate. It is difficult to imagine that the DoL intended to create conditions that would discourage fiduciaries from even considering the relevance of common, longstanding evaluation factors because of the cost and potential regulatory and/or litigation risk, but that may very well be the result.

---

<sup>22</sup> For an example of beneficial evolution, consider the use of indexing, which was not commonplace in the 1970s. Plan participants would not have been served well if ERISA prohibited the use of index funds until it later became accepted by a consensus of investment professionals.

## **BlackRock Recommendations:**

1. Without the two sentences referenced above, section (c)(1) effectively restates the requirements in (b)(1)(ii)-(iv) and is therefore unnecessary. We recommend eliminating this section.
2. Alternatively, if the DoL believes it is imperative to include additional criteria to determine that an ESG factor is pecuniary, we urge the DoL to revise (c)(1) to read as follows: “A fiduciary’s evaluation of an investment must be focused only on pecuniary factors. Plan fiduciaries are not permitted to sacrifice investment return or take on additional investment risk to promote non-pecuniary benefits or any other non-pecuniary goals. Environmental, social, corporate governance, or other similarly oriented considerations are pecuniary factors only if they present, *or are intended to assess*, economic risks or opportunities that *could reasonably be treated* as material economic considerations under generally accepted investment theories. Fiduciaries considering environmental, social, corporate governance, or other similarly oriented factors as pecuniary factors *should not select investments or an investment course of action solely on the basis of such factors.*”

### II. Section (c)(2) – Economically Indistinguishable Alternative Investments

Section (c)(2) of the Proposal imposes a significant burden on plan fiduciaries who consider ESG factors during investment selection. The DoL states in the preamble that it believes economically indistinguishable alternatives are rare, and as such this requirement will not result in a substantial cost burden.<sup>23</sup> However, economic indistinguishability is not an objective fact. As a result, fiduciaries may regularly decide to document the basis for concluding a distinguishing factor cannot be found and why the investment was chosen based on the relevant factors in (c)(2) each time they select an investment using ESG factors even when the ESG investment wins on an assessment of pecuniary factors, as a prudent and protective measure. While it is likely true that fiduciaries generally keep some record of their decision-making process, at a minimum each fiduciary will have to review and revisit their documentation process to confirm compliance with the requirements of the Proposal. These costs were not accounted for in the regulatory impact analysis.

## **BlackRock Recommendations:**

1. Assuming a fiduciary complies with the general requirements of Sections (b)(1) and (2) regarding the appropriate considerations for investment decisions, it is unclear why the additional costs and burdens created by Section (c)(2) are necessary. The DoL should consider eliminating the documentation requirements of this section.

### III. Section (c)(3) – Investment Alternatives for Individual Account Plans

In line with the consistent position of the DoL on ESG matters, the preamble to the Proposal states that a “prudently selected, well managed, and properly diversified fund with ESG investment mandates could be added to the available investment options on a

---

<sup>23</sup> Proposal at 39122.

401(k) plan platform without requiring the plan to forgo adding other non-ESG focused investment options to the platform, consistent with the standards in ERISA sections 403 and 404.” If the intent was to refer to investment mandates looking at pecuniary ESG factors, those funds could presumably be added to a 401(k) platform even if they replace other non-ESG focused options. As a result, it would seem to follow that a plan fiduciary could select a fund for an investment lineup, in part, for the collateral benefits that may be attractive to plan participants. Plan fiduciaries may wish to do so consistent with their fiduciary duties because they may determine that many employees would be more enthusiastic about these investment options and more likely to focus on their retirement savings, which could lead them to save more for retirement, without sacrificing investment performance. Section (c)(3)(i) of the proposal clouds the issue by saying all funds on the lineup must be selected based only on the specified economic considerations.

### **BlackRock Recommendations:**

1. The DoL should clarify that the requirements of section (c)(3) are (a) not intended to preclude consideration of collateral benefits when the fund is selected through a prudent process that is otherwise focused on economic factors, and (b) not applicable if the fund and the selection process are compliant with Section (c)(1).
2. Similarly, the DoL should clarify that a fund’s inclusion of ESG considerations as pecuniary factors in compliance with Sections (b) and (c)(1) should not preclude the fund from being selected as a QDIA. Depending on how the rules in Section (c)(3)(i) are interpreted, the Proposal as written could be interpreted to preclude selection of a fund that incorporates ESG factors as a QDIA even when the ESG factors are pecuniary factors compliant with Section (c)(1). Such a rule would seem inconsistent with the general approach of the Proposal. Even the DoL’s explanation of the QDIA rule in the preamble pointed to the inclusion of “non-Pecuniary goals” as the basis for the rule.<sup>24</sup>

### **Section IV: Unintended Consequences of the Proposal Unrelated to ESG Factors**

The breadth of the language in the Proposal creates unintended consequences unrelated to the consideration of ESG factors. For example, Section 2550.404a-1(b)(2)(ii)(D) could be read to require a broad and costly new documentation burden on plan fiduciaries that relates to all investments and investment courses of action. The DoL explains that this requirement was added as a reminder that fiduciaries must not let non-pecuniary factors divert them from an alternative option that would provide better financial results.<sup>25</sup> However, this section appears to apply regardless of whether or not a plan fiduciary is considering ESG factors.

Further, a literal reading of this new subsection appears to require a full review by plan fiduciaries of prior investment decisions and could require additional, unplanned analysis and evaluation. The DoL’s regulatory impact analysis assumes that additional costs would only be incurred by fiduciaries who consider ESG factors, which suggests this language was intended to be narrower in application.

---

<sup>24</sup> Proposal at 39119.

<sup>25</sup> Proposal at 39117.

Importantly, as currently drafted, the Proposal seemingly applies not only to plan fiduciary selection and monitoring of an investment fund, but also to fiduciaries' management of plan asset vehicles (e.g., bank collective trusts and insurance company separate accounts considered to hold "plan assets" subject to ERISA). For example, in the context of a plan asset fund manager investing in publicly traded equity securities that are part of a large index, the manager generally seeks to replicate the index. The Proposal would seem to require the manager to examine the level of diversification and degree of liquidity of each equity security. We do not believe this is the intended result, since it would not be appropriate to evaluate each individual security in an index fund. Given the objective of replicating or closely replicating an index by investing in certain specific securities, it is neither necessary nor appropriate to evaluate each individual security in an index fund.

This type of comparison is similarly inappropriate in a fixed income portfolio. Individual bonds are selected that provide relative value, fundamental momentum, and cross-asset momentum relative to the transaction costs, market impact, and risk. The contribution to risk, diversification, and liquidity can only be determined relative to a proposed portfolio. Because these considerations only matter relative to the other bonds in the portfolio, it would be onerous, and incorrect, to examine the level of diversification and the degree of liquidity of each security.

**BlackRock Recommendation:**

1. Absent a better articulation of the need for this section and consideration of the actual costs to comply, we recommend that this section be deleted.

\*\*\*\*\*

We thank the DoL for providing the opportunity to comment on the Proposal, and we welcome the opportunity to further discuss any of the information or recommendations we have provided.

Sincerely,

Barbara Novick  
Vice Chairman

Anne Ackerley  
Head of the Retirement Group

Brian Deese  
Global Head of Sustainable Investing

Nicole Rosser  
Director, Legal & Compliance

## **Appendix A: ESG Taxonomy Frameworks**

### **IIF taxonomy, published in [The Case for Simplifying Sustainable Investment Terminology](#):**

1. **Exclusion investments:** Those actively avoiding investing in unsustainable corporates or countries based on screens or other ways to identify particular issues or outcomes of concern.
2. **Inclusion investments:** Those actively investing in sustainable corporates and countries based on consideration of underlying data about issues or outcomes.
3. **Impactful investments:** Those seeking to have a direct, positive measurable impact on society and/or the environment while targeting market, or better, financial returns.

### **ICI taxonomy, published in [Funds' Use of ESG Integration and Sustainable Investing Strategies: An Introduction](#):**

1. **ESG exclusionary investing:** Funds with this type of investment approach may exclude companies or sectors that do not meet certain sustainability criteria or do not align with investors' objectives. They may use optimization techniques or diversification guardrails to limit large deviations from market performance.
2. **ESG inclusionary investing:** Funds with this type of investment approach generally seek positive sustainability-related outcomes by pursuing an investing thesis focusing on portfolios that fundamentally or systematically tilt a portfolio based on ESG factors alongside financial return.
3. **Impact investing:** Funds with this type of investment approach seek to generate positive, measurable, reportable social and environmental impact alongside a financial return. Measurement, management, and reporting of impact is a defining feature of impact investing.

### **BlackRock taxonomy, published in [Towards a Common Language for Sustainable Investing](#):**

1. **Screened:** Exclude specific companies / sectors associated with objectionable activities or specific sustainability risks.
2. **ESG:** Invest in securities based on overall ESG performance, or pursue specific environmental, social, governance, or SDG issues.
3. **Impact:** Intent to contribute to measurable positive environmental, social or SDG outcomes, alongside financial returns.

## **Appendix B: Independent academic and practitioner research**

In addition to the BlackRock proprietary research cited throughout this letter, there exists a large and growing body of academic and practitioner literature covering the empirical and qualitative implications of ESG considerations for investment risk and return, asset pricing and corporate behavior. Below is a list of such research. This list is not all-inclusive.

### **Research on the financial materiality of environmental, social and governance factors**

Acemoglu, D., Carvalho, V.M., Ozdaglar, A., and Tahbaz-Salehi, A. (2012). *The Network Origins of Aggregate Fluctuations*, *Econometrica* 80. 1977–2016.

Albuquerque, R., Koskinen, Y., Zhang, C. 2019. *Corporate Social Responsibility and Firm Risk: Theory and Empirical Evidence*.

DellaVigna, S., and Pollet, J. (2007). *Demographics and Industry Returns*. *American Economic Review* 97 (5): 1667–1702.

Di Giovanni, J., Levchenko, A.A., and Medjean, I. (2014). *Firms, Destinations, and Aggregate Fluctuations*. *Econometrica* 82. 1303–40.

Du, H., Dong, L., Polk, C., and Zhang, J. (2019). *Trade Networks and Asset Prices: Evidence from the Sovereign CDS Market*. London School of Economics working paper.

Duffie, D. (2010). *Presidential Address: Asset Price Dynamics with Slow-Moving Capital*. *Journal of Finance* 65. 1237–1267.

Dunn, Jeff, Shaun Fitzgibbons and Lukasz Pomorski, AQR Capital Management, LLC (2017). "Assessing Risk Through Environmental, Social and Governance Exposures."

Fama, E. F. (1970). "Efficient Capital Markets: A Review of Theory and Empirical Work." *Journal of Finance*, American Finance Association, vol. 25(2). 383–417

Fama, E.F. and French, K. (2007). *Disagreement, Tastes, and Asset Prices*. *Journal of Financial Economics* 83. 667–689.

Friedman, H. L., and Heinle, M. S. (2016). *Taste, Information, and Asset Prices: Implications for the Valuation of CSR*. *Review of Accounting Studies*, 21 (3). 740–767.

Gabaix, X. 2011. *The Granular Origins of Aggregate Fluctuations*. *Econometrica* 79. 733–72.

Greenwood, R., and Vayanos, D. (2010). *Price Pressure in the Government Bond Market*. *American Economic Review Papers and Proceedings* 100. 585–590.

Gollier, C., and Pouget, S. (2014). *The "Washing Machine": Investment Strategies and Corporate Behavior with Socially Responsible Investors*. Toulouse School of Economics Working Papers 457.

Hoepner, Andreas G. F., Ioannis Oikonomou, Zacharias Sautner, Laura T. Starks and Xiaoyan Zhou (Aug. 10, 2018). “ESG Shareholder Engagement and Downside Risk.” AFA 2018 paper. Available at SSRN: <https://ssrn.com/abstract=2874252> or <http://dx.doi.org/10.2139/ssrn.2874252>

Khan, Mozaffar N., George Serafeim and Aaron Yoon (March 2015). “*Corporate Sustainability: First Evidence on Materiality.*” Harvard Business School Working Paper, No. 15-073.

Lucas, R. (1977). *Understanding Business Cycles*. Carnegie-Rochester Conference Series on Public Policy 5, issue 1. 7-29.

Luo, H.A., and Balvers, R. (2017). *Social Screens and Systematic Investor Boycott Risk*. Journal of Financial and Quantitative Analysis, 52, issue 1. 365-399.

Malmendier, U., and Nagel, S. (2011). *Depression Babies: Do Macroeconomic Experiences Affect Risk Taking?* Quarterly Journal of Economics 126. 373-416.

Malmendier, U., and Nagel, S. (2015). *Learning from Inflation Experiences*. Quarterly Journal of Economics 131. 53-87.

Morningstar Research (January 2018). *Sustainable Funds U.S. Landscape Report*.

Pástor, L., Stambaugh, R.F, and Taylor, L. (2019). *Sustainable Investing in Equilibrium*. University of Chicago Booth School of Business working paper.

Pedersen, L.H., Fitzgibbons, S. and Pomorski, L. 2019. *Responsible Investing: The ESG-Efficient Frontier*. AQR.

State Street Global Advisors (2018). *ESG Institutional Investor Survey*, “Performing for the Future: ESG’s place in investment portfolios. Today and tomorrow.”

### **Research on climate risk and investment risk**

Auffhammer, Maximilian and Anin Aroonruengsawat. “*Simulating the impacts of climate change, prices and population on California’s residential electricity consumption.*” Climate change, December 2011.

Baker, M.P., Bergstresser, D.B., Serafeim, G., and Wurgler, J.A. (2018). *Financing the Response to Climate Change: The Pricing and Ownership of U.S. Green Bonds*.

Barber, B.M., Morse, A. and Yasuda, A. (2019). *Impact Investing*.

Bertolotti, Andre, Debarshi Basu, Kenza Akallal and Brian Deese. “Climate Risk in the US Electric Utility Sector: A case study.” Available at SSRN: [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=3347746](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3347746)

Bolton, P., Despres, M., da Silva, L.A.P., Samana, F., and Svartzman, R. (2020). *The green swan: Central banking and financial stability in the age of climate change*, Bank for International Settlements.

Deschênes, Olivier and Michael Greenstone. “*Climate Change, Mortality, and Adaptation: Evidence from Annual Fluctuations in Weather in the US.*” *American Economic Journal: Applied Economics*, Vol. 3, No. 4, October 2011

Heinkel, R., Kraus, A., and Zechner, J. (2001). *The Effect of Green Investment on Corporate Behavior*. *Journal of Financial and Quantitative Analysis*, 36 issue 4. 431-449.

Hsiang, Solomon and Amir Jina. “*The Causal Effect of Environmental Catastrophe on Long-Run Economic Growth: Evidence From 6,700 Cyclones.*” *The National Bureau of Economic Research Working Paper No. 20352*.

Hsiang, Solomon, Robert Kopp, Amir Jina, James Rising, Michael Delgado, Shashank Mohan, D. J. Rasmussen, Robert Muir-Wood, Paul Wilson, Michael Oppenheimer, Kate Larsen and Trevor Houser. “*Estimating economic damage from climate change in the United States.*” *Science*, June 2017.

Nachmany, Michal, Sam Fankhauser, Jana Davidová, Nick Kingsmill, Tucker Landesman, Hitomi Roppongi, Philip Schleifer, Joana Setzer, Amelia Sharman, C. Stolle Singleton, Jayaraj Sundaresan and Terry Townshend (2015). “*The 2015 Global Climate Legislation Study, A Review of Climate Change Legislation in 99 Countries, Summary for Policy-makers.*” Grantham Research Institute on Climate Change and the Environment, GLOBE – The Global Legislators Organisation, and the Inter-Parliamentary Union.

Rhodium Group (March 2019). “*Clear, Present and Underpriced: The Physical Risks of Climate Change.*”

Schlenker, Wolfram and Michael J. Roberts. “*Nonlinear temperature effects indicate severe damages to U.S. crop yields under climate change.*” *Proceedings of the National Academy of Sciences of the United States of America*, Sept. 15, 2009

The Economist Intelligence Unit (2015), “*The cost of inaction: Recognising the value at risk from climate change.*”

Weitzmann, M.L. (2012). *GHG Targets as Insurance Against Catastrophe Climate Damages*. *Journal of Public Economic Theory* 14. 221-244.

Weitzman, M. L. (2011). *Fat-Tailed Uncertainty in the Economics of Catastrophic Climate Change*. *Review of Environmental Economics and Policy* 5. 275-292.

World Economic Forum (2018). *The Global Risks Report 2018, 13th Edition*.