



December 13, 2021

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

*Via Federal eRulemaking Portal*

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

Dear Secretary:

Betterment LLC (“Betterment”) appreciates the opportunity to respond to the Department of Labor Employee Benefits Security Administration’s proposed regulation, *Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights* RIN 1210-AC03 (the “Proposed Rule”), on the topic of environmental, social, or governance (“ESG”) considerations of investment fiduciaries of retirement plans.

### **Betterment’s Socially Responsible Investment Portfolios**

Launched in 2010, Betterment leverages technology to offer its advisory clients globally diversified portfolios constructed using low-fee exchange traded funds (“ETFs”), allocating between equity and fixed income based on each client’s personal goals. While these managed portfolios were initially available only to retail investors, Betterment for Business (“B4B”), a 401(k) offering launched in 2016, allows plan sponsors to make Betterment’s low-fee managed portfolios available to plan participants. As of the date of this submission, across all of its lines of business, Betterment manages \$33 billion on behalf of over 700,000 clients.

In 2017, Betterment first offered an ESG-informed managed portfolio option to its clients, under the moniker of Socially Responsible Investing (“SRI”). From its inception, Betterment’s approach to SRI was anchored to prioritizing clients’ long-term financial outcomes above all else. Accordingly, given our core investment philosophy, we set out to integrate an ESG mandate



only to the extent that it would not materially impact a portfolio's global diversification and low fees.

In practice, this approach necessitated only a modest departure from our core fund selection process, at least initially. Given the scope and scale of ETFs then available, Betterment's investment committee determined that incorporating ESG factors was advisable with respect to U.S. Large Cap stocks only. Our 2017 SRI portfolio therefore allocated to traditional index funds for exposure to all other asset classes. We took care to communicate the nascent state of the ESG index fund space to clients and set out a roadmap to prudently expand our SRI portfolio's ESG mandate as the market matured. Sufficiently cheap and liquid ETFs gradually materialized for other asset classes, allowing us to broaden the SRI portfolio's ESG exposure to include Developed International stocks in 2018, and Emerging Markets stocks in 2019.

In 2020, we took the step of further personalizing our methodology, to align with those clients who prioritized one of ESG's three pillars above others. Betterment's sole SRI offering became three, including both a Climate Impact and Social Impact managed portfolio—in each case governed by Betterment's core commitment to diversification and low fees. Beginning in 2017, and throughout this evolution, all of Betterment's SRI portfolios have been available not just to retail investors, but also to participants in 401(k) plans managed by B4B. In line with adoption across the entire client base, the majority of these plan participants remain invested in Betterment's traditional managed portfolios. However, SRI is growing fast, as a share of both overall participants and overall assets.

In particular, the personalized expansion of Betterment's SRI portfolios accelerated adoption substantially. In the year since October 2020, when the Climate Impact and Social Impact portfolios became available, across all Betterment 401(k) plans, the share of plan participants who have selected an SRI strategy is up 60%, while assets managed in SRI portfolios as a share of overall assets are up 70%. In July 2021, we further enhanced our SRI portfolios by including an allocation across all three portfolios to a shareholder-engagement SRI fund, \$VOTE, which is offered by the activist fund Engine No. 1.

Given our nearly 5 years of experience integrating ESG factors into 401(k) plans, we are both keenly interested and encouraged by the Department's proposals.

### **Comments and Recommendations on the Proposed Rule**

As noted above, Betterment welcomes the opportunity to engage on the important topic of ESG factors in fiduciary investment decisions. Betterment looks forward to serving as a resource, especially as the Department focuses on particular aspects of ESG investments. For purposes of



this comment, Betterment offers the following comments and recommendations that address key points raised by the Proposed Rule:

### **1. Flexible regulation should foster the inclusion of ESG investments**

Betterment commends the Department for the principles-based framework of the Proposed Rule, as compared to the prior rule, Financial Factors in Selecting Plan Investments (the “2020 ESG Rule”), which had a chilling effect on the integration of ESG factors in investment decisions. Betterment believes regulations should permit investment managers to consider a variety of factors in investment decisions, all within their overarching duties of prudence and loyalty. Within this framework, the Proposed Rule and any future regulation should promote greater leeway for fiduciaries to include ESG investments in plans.

Under the Proposed Rule, the Department clarifies that “climate change and other ESG factors can be financially material and when they are, considering them will inevitably lead to better long-term risk-adjusted returns, protecting the retirement savings of America’s workers.” The Proposed Rule thereby acknowledges that ESG risks *could* be important to consider when reviewing investments for strategic portfolio construction. In actuality, ESG factors have a high likelihood of impacting financial performance in the long run. For example, climate change can shift environmental conditions, force companies to transition and adapt to these shifts, lead to disruptions in business cycles and new innovations, and ultimately be a material financial risk over time when a company declines from failing to adapt.<sup>1</sup>

The Department should focus its efforts to ensure the Proposed Rule results in a regulatory regime that (i) fosters the consideration of ESG factors in investment decisions and (ii) is sufficiently flexible to incorporate additional developments in types of ESG investments. Efforts to limit or enumerate certain ESG factors that may or may not be considered by retirement plans may unintentionally hamper ESG investments relative to traditional investments, and fail to solve potential issues that present investor risks.

For example, the rise of shareholder engagement through ESG-proxy proposals presents an exciting new opportunity to enhance shareholder value and promote corporate responsibility. We’ve seen this concept in action with Engine No.1 winning three ExxonMobil board seats in a six month long proxy battle.<sup>2</sup> The change in having three new board members that are conscious

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<sup>1</sup> As noted in the Federal Reserve Bank of San Francisco’s economic letter “Climate Change Is a Source of Financial Risk” by Glenn D. Rudebusch, <https://www.frbsf.org/economic-research/publications/economic-letter/2021/february/climate-change-is-source-of-financial-risk/>

<sup>2</sup> “Exxon’s Board Defeat Signals the Rise of Social-Good Activist”, Matt Phillips, June 9, 2021. <https://www.nytimes.com/2021/06/09/business/exxon-mobil-engine-no1-activist.html>



of climate change and favor transitioning away from fossil fuels will benefit the company in the long term as renewable energy grows in prominence. After its successful proxy battle with Exxon, Engine No. 1 has also expressed support for General Motors' management actions relating to increased electric vehicle production and GM's long-term strategy.<sup>3</sup> Data shows an increasing trend of how more Fortune 100 companies are incorporating ESG initiatives into their proxy statements.<sup>4</sup> ESG-focused shareholder activism has the potential to focus corporate attention on ESG risks and help improve the long term financial health and outlook for targeted companies, thereby enhancing the retirement savings of American workers who hold securities with interests in those companies.

## **2. Qualified Default Investment Alternatives (“QDIA”) should permit ESG factors**

Subject to the overarching fiduciary duties discussed above, retirement plans should be able to utilize a QDIA that considers ESG investments, particularly if the analysis of the QDIA investment (ESG or otherwise) considers material risk-return factors and does not subordinate the interests of participants and beneficiaries to objectives unrelated to the provision of benefits under the plan.

For example, Betterment's socially responsible investing (“SRI”) portfolio strategies aim to maintain the diversified, low-fee approach of Betterment's Core portfolio while increasing investments in companies that meet socially responsible criteria without sacrificing costs or performance. In constructing and testing our SRI Portfolios, we evaluated whether the portfolio or selected investment fund is in the best interests of plan participants, analyzing all liquid ETFs available that aligned with the SRI mandate of each SRI portfolio and could replace components of the Core portfolio strategy (Betterment's current QDIA) without disrupting the diversification or cost of the overall portfolio. While funds that meet ESG criteria are often more expensive, the funds selected for Betterment's SRI portfolios remain consistent with our low-fee mandate and are not meaningfully higher than those of the Betterment Core portfolio.<sup>5</sup>

We also examined performance based on both back-tested and forward-looking returns. When adjusting for the stock allocation level and Betterment fees, we found that: there were no material performance differences, the portfolios were highly correlated overall, and over certain

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<sup>3</sup> “General Motors Stock Surges as Activist Hedge Fund Engine No. 1 Reveals Stake”, Martin Baccardax, October 4, 2021. <https://www.thestreet.com/markets/general-motors-stock-surges-as-activist-engine-no-1-reveals-stake>

<sup>4</sup> For example, Ernst & Young published data showing 91% of Fortune 100 companies disclosed they are incorporating workplace diversity into their initiatives in 2021 versus 61% in 2020. [https://www.ey.com/en\\_us/board-matters/esg-developments-in-the-2021-proxy-season](https://www.ey.com/en_us/board-matters/esg-developments-in-the-2021-proxy-season)

<sup>5</sup> Betterment Help Center, SRI. “What will these new portfolios cost me in fund level fees?” <https://www.betterment.com/help/socially-responsible-investing-fund-fees>



time horizons the SRI portfolios actually outperformed the Betterment Core portfolio. Our analysis does not provide any basis for concluding that, over the long term, there will be a meaningful difference in performance between our SRI and Betterment Core portfolios.<sup>6</sup>

Our findings are consistent with broader testing of sustainable funds by third-party sources. A white paper by the Morgan Stanley Institute for Sustainable Investing summarized the results from a study that analyzed the performance of nearly 11,000 funds from 2004 to 2018 and compared traditional funds to sustainable funds.<sup>7</sup> The primary takeaway of the study revealed that there was no trade-off in performance when comparing sustainable to traditional funds.

In sum, Betterment supports the Department's efforts in the Proposed Rule to remove the prohibition on ESG factors in a plan's QDIA. The Proposed Rule's flexible approach, which applies the same fiduciary standards to the selection and monitoring of a QDIA as other designated investment alternatives, will result in increased QDIAs that consider ESG factors. Because (i) ESG factors have a high likelihood of impacting financial performance in the long run and (ii) participants often allocate (by default or affirmative selection) funds to QDIA investments, Betterment believes allowing QDIAs to consider ESG factors will enhance the long-run retirement savings for American workers.

### **3. Regulation should avoid unequal disclosure requirements on collateral benefits**

As the Department considers how fiduciaries approach investment decisions, it is important to avoid imposing unequal or greater disclosure requirements on ESG investments that would discourage beneficial practices. Betterment supports the Proposed Rule's removal of the heightened documentation requirements for a tie-breaker set forth the 2020 ESG Rule, and encourages the Department to build in additional leeway for fiduciaries to determine what factors are material when selecting plan investments.

For example, the Proposed Rule acknowledges that the Department has long recognized that ESG issues may present material business risk or opportunities that rise beyond 'collateral' considerations. In particular, prior interpretive guidance highlights "environmental, social, and governance issues may have a direct relationship to the economic value of the plan's investment. In these instances, such issues are not merely collateral considerations or tie-breakers, but rather are proper components of the fiduciary's primary analysis of the economic merits of competing

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<sup>6</sup> Betterment Help Center, SRI. "Will the performance of my SRI portfolio deviate from my Betterment portfolio?" <https://www.betterment.com/help/performance-socially-responsible-vs-market-cap-core>

<sup>7</sup> "Sustainable Reality: Analyzing Risks and Returns of Sustainable Funds", Morgan Stanley Institute for Sustainable Investing. [https://www.morganstanley.com/content/dam/msdotcom/ideas/sustainable-investing-offers-financial-performance-lowered-risk/Sustainable\\_Reality\\_Analyzing\\_Risk\\_and\\_Returns\\_of\\_Sustainable\\_Funds.pdf](https://www.morganstanley.com/content/dam/msdotcom/ideas/sustainable-investing-offers-financial-performance-lowered-risk/Sustainable_Reality_Analyzing_Risk_and_Returns_of_Sustainable_Funds.pdf)



investment choices.”<sup>8</sup> However, though the Proposed Rule would permit a broader consideration of collateral benefits in choosing investment options for individual account plans, in situations where collateral benefits form the basis of an investment choice, the Proposed Rule notes that fiduciaries must disclose the specific collateral benefits they considered. The Proposed Rule is not clear on whether those specific collateral benefits must be identified as a tie-breaker in disclosures. The dividing line between when an ESG factor is considered a core factor or a collateral factor is opaque, and imposing additional specific disclosure on collateral factors may make it difficult for fiduciaries to know which factors should be disclosed.

Betterment agrees with the Department that a fiduciary’s duty of prudence may often require an evaluation of the effect of climate change and/or government policies changes to address climate change on investments’ risks and returns. In the context of collateral benefits, Betterment respectfully recommends the Department clarify that disclosure of a fiduciary’s investment considerations, including any collateral benefits, is subject to the overarching principles-based framework rather than specific disclosure requirements.

## **Conclusion**

Betterment applauds the Department for its efforts to recognize that climate change and ESG factors can be financially material to an investment decision. What is clear from the breadth and complexity of ESG factors is the importance of pursuing a flexible regulatory regime that builds on long-standing fiduciary principles, allowing investment managers to engage in a careful and deliberative process when making investment decisions. ESG factors are often material to an investment’s risk-return analysis and rulemaking should foster further consideration of such factors, including climate change-related, governance, and social factors. To this end, Betterment welcomes the Department’s efforts to solicit feedback and additional information from stakeholders and looks forward to working with the Department on ESG issues.

Sincerely,

/s/ Boris Khentov  
Head of Sustainable Investing

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<sup>8</sup> Interpretive Bulletin 2015-01, 80 FR 65135 (October 26, 2015).