Council of Institutional Investors®
The voice of corporate governance

Submitted Electronically

December 2, 2021

Mr. Ali Khawar
Acting Assistant Secretary
Employee Benefits Security Administration
U.S. Department of Labor
200 Constitution Avenue NW
Washington, DC 20210

Re: Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights (RIN 1210–AC03)

Dear Acting Assistant Secretary Khawar:

I write on behalf of the Council of Institutional Investors (CII) to provide our perspectives on the rule proposed by the Department of Labor (DOL) regarding "Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights" (Proposed Rule) under Title I of the Employee Retirement Income Security Act of 1974, as amended (ERISA).[1] CII generally supports the Proposed Rule and believes it is an important step to correcting the issues created by the final rule regarding "Financial Factors in Selecting Plan Investments" (Financial Factors Rule) and the final rule regarding "Fiduciary Duties Regarding Proxy Voting and Shareholder Rights" (Proxy Rule).[2] Below, we offer a number of comments aimed at improving the Proposed Rule.

CII is a nonprofit, nonpartisan association of U.S. public, corporate and union employee benefit funds, other employee benefit plans, state and local entities charged with investing public assets, and foundations and endowments with combined assets under management of approximately $4 trillion. Our member funds include major long-term shareowners with a duty to protect the retirement savings of millions of workers and their families, including public pension funds and defined contribution plans with more than 15 million participants – true "Main Street" investors through their funds. Our associate members include non-U.S. asset

[1] Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights, RIN 1210–AC03, 86 Fed. Reg. 52,272 (Dep't of Labor Oct. 13, 2021), https://www.govinfo.gov/content/pkg/FR-2021-10-14/pdf/2021-22263.pdf.
[2] Financial Factors in Selecting Plan Investments, RIN 1210–AB95, 85 Fed. Reg. 72,846 (Dep't of Labor Nov. 12, 2020), https://www.govinfo.gov/content/pkg/FR-2020-11-13/pdf/2020-24515.pdf; Fiduciary Duties Regarding Proxy Voting and Shareholder Rights, RIN 1210–AB91, 85 Fed. Reg. 81,658 (Dep't of Labor Dec. 15, 2020), https://www.govinfo.gov/content/pkg/FR-2020-12-16/pdf/2020-27465.pdf.

owners with about $4 trillion in assets, and a range of asset managers with more than $40 trillion in assets under management.[3]

I. Rules Related to ESG and Other Investment Considerations

A. CII supports DOL's position with respect to ESG investing.

CII supports DOL's efforts to correct for issues created by the Financial Factors Rule by removing actual or perceived legal barriers to prudent environmental, social and governance ("ESG") investing. CII is a "broad tent" organization, and our membership is comprised of sophisticated institutional investors with a variety of views on ESG. We have consistently taken the position that fiduciaries should be afforded the flexibility to consider ESG factors, where appropriate, as part of a prudent process.

We agree with DOL that "there could be instances when ESG issues present material business risk or opportunities to companies."[4] We believe there is an emerging consensus, based on a growing body of research, that ESG factors can be economically material investment factors. A majority of institutional investors now report using ESG data as part of their decision-making process.[5] For example, the CEO of the largest asset manager in the world wrote the following in an open letter to investors:

> "[I[*nvestors cannot prepare their portfolios for this transition [climate change] unless they understand how each and every company is prepared both for the physical threats of climate change and the global economy's transition to net zero [carbon emissions]*."[6]

We believe this sentiment is shared by many institutional investors, asset owners, assets managers, other investment professionals, researchers and academics.

Our July 28, 2020, comment letter (attached) included references to some of the evidence and research supporting our views of the economic relevance of corporate governance factors.[7]

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[3] For more information about the Council of Institutional Investors ("CII"), including its board and members, please visit CII's website at http://www.cii.org.
[4] 86 Fed. Reg. at 57,276.
[5] *See, e.g.*, David Freiberg et al., *How ESG Issues Become Financially Material to Corporations and Their Investors* 5 (Harv. Bus. Sch. Working Paper 20-056 (2019), *available at* https://www.hbs.edu/ris/Publication%20Files/20-056_1c21f28a-12c1-4be6-94eb-020f0bc32971.pdf ("Most institutional investors now report that the primary reason why they use ESG data is because these issues are or will become financially material (Amel-Zadeh and Serafeim 2018).")
[6] Larry Fink's 2021 Letter to CEO's, BlackRock, *available at* www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter (last visited Dec. 2, 2021) (emphasis added).
[7] Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors to Office of Regulations and Interpretations, Employee Benefits Security Administration 4-5 (July 28, 2020), https://www.cii.org/files/issues_and_advocacy/correspondence/2020/July%2028%202020%20DOL%20letter.pdf (citing empirical research that "DOL should have evaluated . . . before incorporating corporate governance into the provisions of the Proposed Rule") (Attachment 2).

Since the submission of that letter, we have published and have recently updated a report entitled "Empirical Research on ESG Factors and Engaged Ownership."[8]

B. CII Encourages DOL to clarify language that could be read to suggest fiduciary must always consider ESG factors.

Although CII's membership is generally supportive of the prudent consideration of ESG factors, we also believe that fiduciaries are in the best position to determine what factors are economically material to any particular investment. This fundamental principle is at the core of the fiduciary provisions of Title I of ERISA. We, therefore, encourage DOL to ensure that the final rule is clear that the agency does not intend to substitute its own judgment for that of fiduciaries.

In this regard, we note that the Proposed Rules state that an evaluation of the projected return of an investment "may often require" consideration of the effects of climate change and other ESG factors.[9] Some have interpreted this language as going further than merely suggesting that such factors could, in some cases, be economically material but that it is up to the fiduciary to ultimately make that determination. It is our understanding this was not DOL's intent, so it would be useful to revise the rule to dispel any misconception. For example, DOL could make the following modification:

> *(C) The projected return of the portfolio relative to the funding objectives of the plan, which may involve ~~often require~~ an evaluation of the economic effects of climate change and other environmental, social, or governance factors on the particular investment or investment course of action.*[10]

C. CII supports revision to the "Governance Factors" to recognize the core governance principle of one share, one vote.[11]

Although CII's membership is generally supportive of the three examples of prudent consideration of ESG factors, we also believe the "Governance factors"[12] example should be revised to reflect a core principle of corporate governance—the principle of one share, one vote.[13] When a company taps the capital markets to raise money from public investors, we

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[8] Lucy Nussbaum & Glenn Davis, EMPIRICAL RESEARCH ON ESG FACTORS AND ENGAGED OWNERSHIP, A Bibliography, CII (updated Aug. 2021), https://www.cii.org/files/publications/July%202021%20update%20bibliography%20final%20(3).pdf.
[9] *See* 86 Fed. Reg. at 57,302 (Proposed Rule § 2550.404a-1(b)(4)(ii)(C)).
[10] *Id.* (emphasis added).
[11] *Id.* (Proposed Rule § 2550.404a-1(b)(4)(ii)).
[12] *Id.*
[13] *See, e.g.,* Council of Institutional Investors, Corporate Governance Policies, § 3.3 Voting Rights (updated Sept. 22, 2021), https://www.cii.org/files/09_22_21_corp_gov_policies.pdf (Each share of common stock should have one vote [and] [c]orporations should not have classes of common stock with disparate voting rights.).

believe those investors should have a right to vote in proportion to the size of their holdings. A single class of common stock with equal voting rights also ensures that the board of directors is accountable to all of the shareholders. Empirical evidence indicates that this bedrock principle of good corporate governance is economically significant.[14] We, therefore, believe it should be explicitly included in the Proposed Rules' example of governance factors. And we respectfully recommend that the DOL make the following modification:

> *"(ii) Governance factors, such as those involving board composition, executive compensation, and transparency and accountability in corporate decision-making, including the core corporate governance principle of one share, one vote, as well as a corporation's avoidance of criminal liability and compliance with labor, employment, environmental, tax, and other applicable laws and regulations; and"*[15]

D. CII supports changes to the tie-breaker rule.

CII supports DOL's amendment to the "tie-breaker" or "all things being equal" test to eliminate burdensome documentation requirements when collateral considerations are used to decide between two equally appropriate investments.[16] There is nothing in ERISA that indicates particular investment decisions should be subject to unique documentation requirements, and it

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[14] *See* Lindsay Baran et al, *Dual Class Share Structure and Innovation* (Dec. 8, 2019), *available at* https://ssrn.com/abstract=3183517 (Financially constrained companies with multi-class stock may be more innovative in the early years, but these benefits were shown to disappear within 10 years after the IPO); Martijn Cremers et al., *The Life-Cycle of Dual-Class Firm Valuation* (ECGI, Fin. Working Paper No. 550, 2018), *available at* https://ssrn.com/abstract=3062895 (Any valuation premiums that multi-class firms had over single-class firms at IPO were found to dissipate over time and turn into discounts six to nine years after the IPO); Paul A. Gompers et al., *Extreme Governance: An Analysis of Dual Class Firms in the United States* (AFA 2005 Philadelphia Meetings, Rodney L. White Center for Fin. Res. Working Paper No. 12-04, Rock Center for Corp. Governance Working Paper No. 39, 2008), *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=562511 (To the extent that insiders' voting rights exceed their equity stake (i.e. "cash flowrights") due to dual-class structures, firms were shown to underperform.); Lucian A. Bebchuk & Kobi Kastiel, *The Untenable Case for Perpetual Dual Class Stock*, 103 VIRGINIA L. REV. 585 (2017) (on file with CII) (finding that even those who believe that dual-class structures are in many cases efficient at the time of the IPO should recognize the substantial risk that their efficiency may decline and disappear over time: *see also* Rick Fleming, Investor Advocate, Dual-Class Shares: A Recipe for Disaster, Speech, ICGN Miami Conf., Miami, Fla. (Oct. 15, 2019), https://www.sec.gov/news/speech/fleming-dual-class-shares-recipe-disaster ("companies with dual-class structures tend to underperform companies with dispersed voting power"); Commissioner Robert J. Jackson Jr., Perpetual Dual-Class Stock: The Case Against Corporate Royalty, Speech, S.F., Cal. (Feb. 15, 2018), https://www.sec.gov/news/speech/perpetual-dual-class-stock-case-against-corporate-royalty ("Seven or more years out from their IPOs, firms with perpetual dual-class stock trade at a significant discount[to those with sunset provisions.").

[15] *See* 86 Fed. Reg. at 57,302 (Proposed Rule § 2550.404a-1(b)(4)(ii)) (emphasis added).

[16] *Id.* at 57,273.

was inappropriate to create such requirements as the benefit – if any – was greatly outweighed by the cost imposed on plan fiduciaries.[17]

We also welcome DOL's clarification that the tie-breaker test may be applied when two investments are "equally appropriate" rather than reserving the test for when the two investments are "indistinguishable."[18] We believe that this language better recognizes the complexities of comparing investment options and affords fiduciaries an appropriate amount of flexibility and deference in their decision-making.

That said, we recommend that DOL eliminate the requirement that a fiduciary disclose the specific collateral benefits it considered making an investment. The dividing line between economic and collateral factors is not always clear or easy to identify, making it difficult for fiduciaries to know which factors should be disclosed. Additionally, there could be any number of collateral factors considered, leading to a complex and confusing disclosure.

E. CII supports changes to the treatment of QDIAs.

CII believes the Financial Factors Rule included unnecessary and unreasonable requirements related to the use of ESG factors in the selection of Qualified Default Investment Alternatives (QDIAs). Specifically, the Financial Factors Rule prohibited an investment alternative from being used as a QDIA "if it, or any of its components, has investment objectives or goals or principal investment strategies that include, consider, or indicate the use of one or more non-pecuniary factors."[19] DOL went so far as to suggest that investment funds that utilize '"screening strategies"' or other exclusionary strategies may not serve as QDIAs if those stategies involve non-pecuniary factors.[20]

There is simply no justification for this disparate treatment of QDIAs. An investment – and the process used to make the investment – is either a prudent offering or not. DOL justified this restrictive approach by stating a "heightened prophylactic approach for QDIAs is the best course of action" and noting that, in light of the fact that participants are often defaulted into QDIAs, "it is inappropriate for participants to be defaulted into a retirement savings fund that may have other objectives absent their affirmative decision."[21] However, virtually all participants in a plan are invested in an option selected by the plan's fiduciary, regardless of

[17] *See* Warren Rojas, Legal Battles Likely Over Trump's ESG Crackdown, Advisors Say, Bloomberg L. (June 24, 2020) (on file with CII) ("Documentation requirements on social investing called burdensome"); Martin Lipton et al., DOL Proposes New Rules Regulating ESG Investments, Harv. L. Sch. F. Corp. Gov. (July 7, 2020), https://corpgov.law.harvard.edu/2020/07/07/dol-proposes-new-rules-regulating-esg-investments/ ("The extensive scope of criteria that the DOL considers problematic will also likely result in increased costs and fees as plan fiduciaries seek to filter for these criteria.").
[18] 86 Fed. Reg. at 57,278.
[19] Investment Duties, 29 CFR § 2550.404a-1(d)(2)(ii) (Dec. 16, 2020), *available at* https://www.law.cornell.edu/cfr/text/29/2550.404a-1.
[20] 85 Fed Reg. at 72,866.
[21] *Id.* at 72,865, 72,866.

whether they made an affirmative investment election or not, and DOL presented no evidence that fiduciaries are more likely to imprudently consider non-economic factors when selecting a QDIA as opposed to other plan investments. Moreover, even if DOL believes special, QDIA-specific rules are necessary, those rules should be considered in the context of amendments to DOL's QDIA regulation.

II. Rules Related to Proxy Voting and Shareholder Engagement

A. CII generally supports a rule that is more permissive of shareholder engagement.

CII views the voting of proxies as an economically important mechanism for shareholders to monitor and hold corporate management accountable and to create and protect long-term value.[22] We agree with DOL that "proxies should be voted as part of the process of managing the plan's investment in company stock unless a responsible plan fiduciary determines voting proxies may not be in the plan's best interest (*e.g.*, if there are significant costs or efforts associated with voting)."[23] Therefore, CII supports efforts to modify the Proxy Rule to eliminate barriers to shareholder engagement.

For example, we agree with DOL's decision to amend the Proxy Rule to eliminate the statement in the Proxy Rule that "the fiduciary duty to manage shareholder rights appurtenant to shares of stock does not require the voting of every proxy or the exercise of every shareholder right."[24] Although we agree with the sentiment of that statement, we also agree with DOL that the statement could be misinterpreted as stating that fiduciaries should be indifferent to the exercise of their rights. We believe the elimination of this statement, together with DOL's statements in the preamble of the Proposed Rule, will help clarify the issue.

B. CII supports eliminating certain documentation and monitoring obligations.

CII supports the elimination of enhanced proxy vote monitoring and recordkeeping requirements. We agree with DOL that fiduciaries have no more of an obligation to monitor voting proxies or keep records of their activities than other plan fiduciary activities. Our members are familiar with the monitoring and recordkeeping obligations under ERISA and believe that the legal framework predating the Proxy Rule was sufficiently protective of plans, participants, and beneficiaries. Moreover, we are concerned that, by codifying the proxy-specific

[22] *See, e.g.*, Letter from Jeffrey P. Mahoney, General Counsel. Council of Institutional Investors to Jeanne Klinefelter Wilson, Acting Assistant Secretary, Employee Benefits Security Administration, U.S. Department of Labor 2 (Sept. 24, 2020), https://www.cii.org/files/issues_and_advocacy/correspondence/2020/September%2024%202020%20letter%20to%20DOL.pdf ("CII views the voting of proxies as an economically important mechanism for shareholders to monitor and hold corporate managements accountable and to create and protect long-term value.") (Attachment 1).
[23] 86 Fed. Reg. at 57,281.
[24] *Id.*

obligations, the Proxy Rule created the erroneous impression that proxy voting is subject to heightened obligations.

C. CII urges DOL to retain the provision of the Proxy Rule allowing for standing policies.

CII appreciates that the Proposed Rule retains the portion of the Proxy Rule that explicitly permits fiduciaries to establish standing proxy voting policies. Many of our members utilize such policies as a way to prudently manage investments while controlling costs. We are unconcerned with the elimination of the two existing safe harbors. Neither safe harbor was particularly helpful, and there is little evidence that a material number of fiduciaries are currently relying on them.

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We appreciate the opportunity to provide DOL with our views on the Proposed Rule. Thank you for considering our comments. Please do not hesitate to contact me if you need additional information.

Sincerely,

Jeff Mahoney

Jeffrey P. Mahoney
General Counsel

Attachment 1: Letter from Jeffrey P. Mahoney, General Counsel. Council of Institutional Investors to Jeanne Klinefelter Wilson, Acting Assistant Secretary, Employee Benefits Security Administration, U.S. Department of Labor (Sept. 24, 2020).
Attachment 2: Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors to Office of Regulations and Interpretations, Employee Benefits Security Administration (July 28, 2020).