December 6, 2021

VIA ELECTRONIC FILING

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

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

Dear Sir/Madam:

Ceres, Inc., respectfully submits this letter in support of the Department of Labor's ("Department" or "DOL") proposed rule, *Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights* ("Proposed Rule" or "Proposal"), 86 Fed. Reg. 57272 (October 14, 2021).

We applaud the Department for issuing the Proposal. Fiduciaries must be permitted to evaluate *all* factors that impact risk and return, including climate change risk. Climate related disasters are increasingly frequent, with a record 22 events, each of which has resulted in over $1 billion in damage, in the US during 2020 alone, for a total cost of $100 billion.[1] Physical and transition risks caused by climate change are already impacting, or will impact, nearly all sectors of the economy.[2]

The Proposed Rule would make clear that a plan fiduciary may "consider *any* factor material to the risk-return analysis, including climate change and other ESG factors" (86 Fed. Reg. at 57277, emphasis in original). This is the most important aspect of the Proposed Rule. It reflects the Department's guidance prior to 2020 and the requirements of ERISA and trust law. Proper application of fiduciary principles proscribes making distinctions between investing that takes environmental, social and governance ("ESG") factors (along with other risk/return related factors) into account and investing that does not.

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[1] NOAA National Centers for Environmental Information (NCEI), "Time Series," *Billion-Dollar Weather and Climate Disasters*, 2021, https://www.ncdc.noaa.gov/billions/time-series.

[2] The Sustainability Accounting Standards Board found that climate change was reasonably likely to be material in 72 out of 77 industries, covering 93% of the U.S. equities by market capitalization.
Sustainability Accounting Standards Board (SASB), *Climate Risk Technical Bulletin*, San Francisco: SASB Foundation, 2021, https://www.sasb.org/knowledge-hub/climate-risk-technical-bulletin/.

The regulatory amendments adopted in late 2020 (*Financial Factors in Selecting Plan Investments*, 85 Fed. Reg. 72846 (Nov. 13, 2020)) ("the 2020 ESG Rule") are inconsistent with these principles. The ill-advised and legally unsupportable 2020 ESG Rule constrains plan fiduciaries from considering ESG factors in their investment decision-making. The amendments were rushed through the rulemaking process to make changes that overturned long-established Department positions, despite the overwhelming opposition of stakeholders.[3] The Department explained that it adopted the changes because of "confusion" among fiduciaries on the ESG-investment issue, but the administrative record showed almost no support for this statement. Rather, the 2020 ESG Rule has ended up causing precisely the investor confusion that the DOL said it had sought to eliminate; the result has been that many fiduciaries have stopped or scaled back their efforts to provide investment options that address ESG concerns. The upshot is that American workers are now being deprived of suitable ESG investment opportunities. The Proposed Rule would fix this.

The Proposal would also correct another misguided last-ditch rulemaking initiative relating to proxy voting (*Fiduciary Duties Regarding Proxy Voting and Shareholder Rights*, 85 Fed. Reg. 81658 (Dec. 16, 2020) ("the 2020 Proxy Rule.")). The 2020 Proxy Rule, like the 2020 ESG Rule, was a solution in search of a problem. No changes in the proxy voting requirements were needed. The end result is that the 2020 Proxy Rule "suggest[s] that plan fiduciaries should be indifferent to the exercise of their rights as shareholders" (86 Fed. Reg. at 57281), thereby also damaging the interests of workers and their families. The exercise of shareholder voting rights is an important fiduciary function.

Ceres (www.ceres.org) is a nonprofit organization working with institutional investors and companies to build sustainability leadership and drive solutions throughout the economy. We support the Investor Network on Climate Risk and Sustainability, which consists of over 200 institutional investors managing more than $47 trillion in assets who advance leading investment practices, corporate engagement strategies, and policy and regulatory solutions to address sustainability risks and opportunities. Ceres has worked closely with institutional investors since our founding in 1989, and with an expanding group of investors since the founding of our Investor Network 18 years ago. Ceres also has a Company Network, made up of 60 large companies representing millions of employees across all major sectors of the economy. We work with these companies to integrate sustainability into corporate decision-making, challenge traditional business practices, and collaborate towards systems-level change.

[3] More than 95% of the 8,737 comments submitted opposed the proposed rule. *See*, Julie Gorte, et al. "Public Comments Overwhelmingly Oppose Proposed Rule Limiting the Use of ESG in ERISA Retirement Plans," US SIF, Aug. 20, 2020, https://www.ussif.org/Files/Public_Policy/DOL_Comments_Reporting_FINAL.pdf.

Accordingly, we have a strong interest in regulatory policy regarding climate change, and we submitted comments in opposition to both 2020 Rules,[4] one of which we are pleased to see cited in the Preamble to the Proposed Rule.[5]

I. The 2020 ESG Rule was misguided, as a matter of both policy and law

A. The rushed-through rule deprives plan participants of important investment opportunities

The 2020 ESG Rule needs to be amended. The Preamble to the Proposed Rule does an excellent job in explaining why this is so, but there is more that the Department can and should say.

The Preamble to the Proposed Rule states that the Department in 2021 consulted with "a wide variety of stakeholders, including asset managers, labor organizations and other plan sponsors, consumer groups, service providers, and investment advisers," who informed the Department that the 2020 ESG Rule "has already had a chilling effect on appropriate integration of climate change and other ESG factors in investment decisions." (86 Fed. Reg. at 57275) The Department acted quickly, announcing on March 10, 2021—less than two months after the 2020 ESG Rule went into effect—that it would not enforce the rule, but concerns regarding fiduciary risk, such as the potential for private litigation, have continued to stymie appropriate ESG-related ERISA plan investments.[6] The Department noted in the Preamble that this chilling effect "… continued through the current non-enforcement period, including in circumstances that the current regulation may in fact allow." (86 Fed. Reg. at 57275)

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[4] Mindy Lubber, "Re: RIN 1210-AB95, Financial Factors in Selecting Plan Investments proposed rule," *Department of Labor*, last modified July 30, 2020, https://www.dol.gov/sites/dolgov/files/EBSA/laws-and-regulations/rules-and-regulations/public-comments/1210-AB95/00567.pdf.
Mindy Lubber, "Re: 1210-AB91, Fiduciary Duties Regarding Proxy Voting and Shareholder Rights proposed rule," *Department of Labor*, last modified October 5, 2021, https://www.dol.gov/sites/dolgov/files/EBSA/laws-and-regulations/rules-and-regulations/public-comments/1210-AB91/00217.pdf.
Brian H. Graff, Mindy Lubber, Steven M. Rothstein, Allison Wielobob, "Financial Factors in Selecting Plan Investments (The Final Rule)," *American Retirement Association*, last modified March 23, 2021, https://araadvocacy.org/wp-content/uploads/2021/05/ARA-Advocacy-2021-Comment-Letter-2021-03-23-ARA-Asks-DOL-to-Modify-ESG-Final-Rule.pdf.

[5] Proposed Rule, 86 Fed. Reg. 57275 fn.26, stating: "A number of public comment letters [citing Ceres' letter, #567] criticized the 2020 proposed regulatory text for appearing to single out ESG investing for heightened scrutiny, which they asserted was inappropriate in light of research and investment practices suggesting that climate change and other ESG factors are material economic considerations."
US Department of Labor, *Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights* (2021), 57275, https://www.federalregister.gov/d/2021-22263.

[6] *See,* "US Department of Labor Releases Statement on Enforcement of its Final Rules on ESG Investments, Proxy Voting by Employee Benefit Plans," *US Department of Labor* (Mar. 10 2021), https://www.dol.gov/newsroom/releases/ebsa/ebsa20210310.

The Preamble does not describe in detail what it heard from the stakeholders with whom it consulted, and it would be helpful if, in the adopting rulemaking release, the Department were to include this detail. What Ceres has heard in discussions with plan fiduciaries and others is concern about "the rushed nature of the rulemaking, whether the DOL considered and addressed the substantial evidence submitted by commenters on how the use of ESG considerations positively affects investment returns," and the "chilling effect" of the rule.[7] The 2020 ESG and Proxy Rules were dashed off, over the objections of many stakeholders, with a mere 30-day comment period, hardly sufficient for rules of this significance. Many parties, in their written comments on the 2020 rule proposals, asked for more time to make their submissions, but this request was denied.[8] The Department is acting appropriately in issuing the Proposed Rule in response to stakeholder concerns.

B. The DOL in 2020 gave short shrift to evidence regarding the benefits of ESG considerations in ERISA investing

In promulgating the 2020 ESG Rule, the Department gave scant regard for the overwhelming evidence of how relevant ESG-related factors considerations can be important in assessing potential investment returns and risks. Many investors look carefully at climate risk and consider it important to their investment decisions. Their numbers are growing rapidly. As of November 1, 2021, asset managers representing over $57 trillion in assets under management have made net zero commitments.[9] A 2019 analysis of 215 of the world's largest companies identified just under $1 trillion of potential risk to them from climate change – and noted that half of these losses are expected to materialize in the next five years.[10] Climate-related financial risks are especially relevant to retirement investors, who invest over decades and are generally universal owners with exposure to many at-risk sectors. Climate solutions also create significant market and investment opportunities that many fiduciaries wish to consider.[11] Accordingly, we

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[7] Patrick S. Menasco & Bibek Pandey, "U.S. Department of Labor Announces Non-Enforcement Policy on Regulation Requiring Fiduciary Investment Decisions to be Based Solely on Pecuniary Factors." *Goodwin Law* (Mar. 12 2021), https://www.goodwinlaw.com/publications/2021/03/03_12-us-department-of-labor-announces.

[8] Although the Administrative Procedure Act allows for a 30-day comment period, it is well-established that significant rulemakings typically allow longer periods. Agencies have been instructed to "provide the public with meaningful participation in the regulatory process," including a "meaningful opportunity to comment on any proposed regulation, which, in most cases, should include a comment period of not less than 60 days." *See,* U.S. President, Proclamation, "Regulatory Planning and Review, Executive Order 12866 of September 30 1993," *Federal Register* 58, no. 190 (Oct. 4 1993), https://www.archives.gov/files/federal-register/executive-orders/pdf/12866.pdf.

[9] "Net Zero Asset Managers Initiative," *Net Zero Asset Managers*, https://www.netzeroassetmanagers.org/.

[10] "World's Biggest Companies Face $1 Trillion in Climate Change Risks," *CDP,* June 4 2019, https://www.cdp.net/en/articles/media/worlds-biggest-companies-face-1-trillion-in-climate-change-risks.

[11] Sam Shead, "Climate Tech Start-ups have Raised a Record $32 Billion Globally so far in 2021," *CNBC*, Oct. 26, 2021, https://www.cnbc.com/2021/10/26/dealroom-climate-tech-start-ups-have-raised-32-billion-this-year.html. Melissa Karsh, "TPG Raises $5.4 Billion for Climate Fund Chaired by Hank Paulson," *Bloomberg.com,* July 27, 2021.https://www.bloomberg.com/news/articles/2021-07-27/tpg-raises-5-4-billion-for-climate-fund-chaired-by-hank-paulson.

were pleased to see the Department's recognition in the Preamble to the Proposal that "Climate change is particularly pertinent to the projected returns of pension plan portfolios that, because of the nature of their obligations to their participants and beneficiaries, typically have long-term investment horizons." (86 Fed. Reg. at 57276)

Sophisticated institutional investors recognize these risks and opportunities and are addressing climate risk as an important principle of capital preservation and growth.[12] Climate concerns and other ESG risks will be a significant driver of investment risk and return for the foreseeable future. As with any factor, performance of ESG funds will vary, but an analysis of 11,000 mutual funds over 14 years showed that ESG funds had lower downside risk and equivalent returns to the broader market.[13]

The 2020 ESG Rule discounted the large body of evidence regarding the significance of climate change as an element of financial analysis. And the Department also, quite remarkably as a matter of administrative law, failed to provide evidence of why the Rule was needed. The Preamble to the 2020 ESG Rule conceded that the Department had no evidence of any ERISA fiduciary allocating an investment based on improper ESG considerations, but brushed this defect aside: "The Department does not believe that there needs to be specific evidence of fiduciary misbehavior or demonstrated injury to plans and plan participants" in order to issue the rule. (85 Fed. Reg. at 72850) In lieu of evidence, the Department said that ESG investing raises heightened concerns under ERISA and that fiduciaries might "too hastily" be selecting ESG-oriented investment opportunities (85 Fed. Reg. at 72848) -- in other words, that ESG investing must be taking place through the hidden disloyal motives of the plan fiduciary. Such an approach to ESG, and to the rulemaking process itself, is wide of the mark.

The 2020 ESG Rule created enough uncertainty and roadblocks to ESG investing that plan fiduciaries have shied away from such investments, not wanting to risk private litigation or government enforcement actions. This was an administrative rulemaking beset by procedural and substantive shortcomings, and we commend the Department for moving quickly to initiate a procedurally sound notice-and-comment rulemaking process.

C. Not only is the 2020 ESG Rule wrong as a matter of policy, it misapplies ERISA and trust law.

The 2020 ESG Rule misapplied basic fiduciary principles of ERISA law. The Department's final rulemaking release should make this point clear.

[12] "2021 Global Investor Statement to Governments on the Climate Crisis" *The Investor Agenda,* 2021, https://theinvestoragenda.org/wp-content/uploads/2021/09/2021-Global-Investor-Statement-to-Governments-on-the-Climate-Crisis.pdf.

[13] Morgan Stanley, "Sustainable Reality: Analyzing Risk and Returns of Sustainable Funds," Morgan Stanley, last modified 2019, 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.

While many commenters discussed the legal defects of the proposed 2020 ESG Rule, one of the most significant was a letter submitted by Professors Schanzenbach and Sitkoff, prominent legal scholars who in 2020 published an extraordinarily thorough legal analysis titled *Reconciling Fiduciary Duty and Social Conscience: The Law and Economics of ESG Investing by a Trustee,* 72 Stanford Law Review 2 (February 2020). The professors' analysis was not solicitous of ESG advocacy by trustees. Nonetheless, they said the DOL had gone too far in erecting climate change and ESG roadblocks.

The professors' letter stated: "[T]he [proposed 2020 ESG Rule] and accompanying commentary could be read to suggest that all manner of ESG investing is inherently suspect, presumably on fiduciary loyalty grounds, and therefore that ESG investing by an ERISA trustee or other fiduciary is always subject to enhanced scrutiny that requires extra process relative to other types of investment strategies. Such a position is inconsistent with law and sound policy." Letter dated July 30, 2020 (Comment #693). The correct view of the law, the authors stated, is that ESG investing is permissible under U.S. trust fiduciary law when the trustee reasonably concludes that ESG investing will benefit the beneficiary directly by improving risk-adjusted return and where the trustee's exclusive motive for ESG investing is to obtain this benefit. We are pleased that the Proposed ESG Rule reflects this approach.

The 2020 ESG Rule erred by placing ESG investing in a separate category from other types of investing, imposing different regulatory requirements on what should be a common set of fiduciary obligations. This approach to climate and other ESG factors is appropriately rejected by the Proposed Rule.

II. <u>The proposed changes are fully supported by applicable law and are in the best interests of plan participants</u>

We believe that in almost every respect the Department has correctly identified the primary problems with the 2020 Rule, and the Proposal would make fixes to the prior rulemaking that would align the regulations with the requirements of ERISA.

As a preliminary matter, it is essential to note that the Department did not propose any change to the basic legal principles of prudence and loyalty applicable to ERISA fiduciaries. As the Department stated in the Preamble, "a fiduciary may not subordinate the interests of the participants and beneficiaries in their retirement income or financial benefits under the plan to other objectives, and may not sacrifice investment return or take on additional investment risk to promote goals unrelated to the plan and its participants." (86 Fed. Reg at 57278). This is settled law,[14] and we agree with the Department that it is appropriate to reiterate this principle in the rule text itself in paragraph (c)(1).

[14] *Fifth Third Bancorp v. Dudenhoeffer,* 134 S. Ct. 427, 2459 and 2468 (2014).

Using fundamental ERISA law principles as the starting point, the Proposed Rule restores the regulation to ERISA's legal core. There are several aspects of the Proposed Rule that are important in this regard.

1. "**Often require" and "many instances"**: The additional language in paragraph (b)(2)(ii)(C) would state that the fiduciary's investment prudence duties require "appropriate consideration" of relevant facts and circumstances, which includes "[t]he projected return of the portfolio relative to the funding objectives of the plan, which may 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." The Preamble further explains: "[T]he Department believes that consideration of the projected return of the portfolio relative to the funding objectives of the plan not only allows but in many instances may require an evaluation of the economic effects of climate change on the particular investment or investment course of action." (86 Fed. Reg. at 57276)[15] This language – the reference to "often require" and "many instances" – makes clear that while a fiduciary's consideration of ESG factors is not mandated it may often be appropriate based on the specific facts and circumstances of the ERISA plans.

2. **"Any factor"**: We are particularly supportive of new paragraph (b)(4) which, as the Preamble states, "clarifies and confirms that a fiduciary may consider *any* factor material to the risk-return analysis, including climate change and other ESG factors." (86 Fed. Reg. at 57277; emphasis in original.) This is essential in order to fix the 2020 ESG Rule. It establishes that "under ERISA, if a fiduciary prudently concludes that a climate change or other ESG factor is material to an investment or investment course of action under consideration, the fiduciary can and should consider it and act accordingly, as would be the case with respect to any material risk-return factor." (86 Fed. Reg. at 57277)

   The examples of factors contained in paragraph (b)(4) of the Proposal are useful in this regard. The Preamble asks "whether other or fewer examples would be helpful to avoid regulatory bias." (86 Fed. Reg. at 57277) We believe that the examples are appropriate in number and detail and that these examples should be included in the rule text (or in the Preamble). We do note that two of the three examples clearly relate to the environmental (the "E") and governance (the "G") aspects of ESG while the third uses the term "workforce practices" rather than "social" (the "S"). It might be helpful if the word "social" were included in this set of examples. It also might be helpful to use the term "human capital" rather than "workforce practices" since that term is frequently used, including in a relevant disclosure requirement of the Securities and Exchange Commission. *See* Regulation S-K, Item 101(c)(2)(ii). In addition, rather than giving climate change as the sole example of an environmental issue, we suggest a rewording so

[15] The Preamble asks (86 Fed. Reg. at 57277) whether proposed additional language in paragraph (b)(2)(i), requiring consideration of how an investment or investment course of action compares to reasonably available alternatives, is a necessary addition. We believe it is useful to include this language.

that the example would read: "(i) environmental factors such as climate change-related factors, including a corporation's exposure . . ."

One final point about subparagraph (b)(4) is the use of the word "material." The subparagraph reads: "A prudent fiduciary may consider any factor in the evaluation of an investment or investment course of action that, depending on the facts and circumstances, is material to the risk-return analysis . . ." For more than 40 years, since the Department adopted the original investment duties regulation in 1979, the standard for ERISA fiduciary duty has been to take into account all "relevant" factors.[16] This standard was restated in Interpretive Bulletin 94-1, Interpretive Bulletin 2008-01, and Interpretive Bulletin 2015-01, all of which required that the fiduciary making the investment decision "give appropriate consideration to those facts and circumstances that, given the scope of the fiduciary's investment duties, the fiduciary knows or should know are relevant." (See 59 Fed. Reg. 32606 (June 23, 1994), 73 Fed. Reg. 61734 (October 17, 2008), and 80 Fed. Reg. 65135 (October 26, 2015). The word "material" was never part of the ERISA fiduciary analysis until it was inserted in the 2020 Rule.

There is a huge body of decisional and regulatory law underpinning the word "material" in the context of the federal securities laws, and the subparagraph might be read as importing that law. There is no reason to introduce a new term, inviting new interpretations of well-settled fiduciary concepts in ERISA. The word "relevant" in this context is preferable to "material."

3. **"Pecuniary" and "Non-pecuniary":** The Proposal appropriately eliminates the terms "pecuniary" and "non-pecuniary" with respect to plan investments, terms that were first introduced to the ERISA lexicon by the 2020 ESG Rule. These terms suggest that fiduciaries must apply a new test for ESG investing, thereby causing considerable confusion. Many relevant financial factors that have "pecuniary" significance also often have "non-pecuniary" aspects. For example, climate risk affects the bottom line of many investments, but also has a moral component that could be viewed as "non-pecuniary." The "pecuniary" terminology is confusing and unnecessary.

4. **"Tie-breakers":** The Department proposes to rescind paragraph (c)(2) of the 2020 ESG Rule, which deals with "tie-breakers" and provides that competing investments are only tied when they are "indistinguishable" based on consideration of risk and return. This standard effectively prohibits the use of collateral benefits altogether, a stark departure from the Department's longstanding and consistent guidance across four Presidential Administrations.

   As we and many other commenters noted in connection with the promulgation of the 2020 ESG Rule, investment decision-making rarely leads to one clear answer. ERISA fiduciaries typically employ a prudent investment process that results in multiple investments meeting the plan's criteria, and thus any one of those investments is

[16] *See* Investment Duty Regulation, 29 CFR 2550.404a-1(b)(1)(i), 44 Fed. Reg. 37221-37225 (June 26, 1979).

"prudent." When this is the case, the plan fiduciary should be able to select any of them without further justification or the need to provide special documentation.

The 2020 ESG Rule set these basic understandings aside. Paragraph (c)(3) of the Proposed Rule offers a remedy by allowing the fiduciary to choose between competing investments or courses of action where the alternatives "equally serve the financial interests of the plan." (86 Fed. Reg. at 57278)

While the proposed "equally serve" language is certainly an improvement over the word "indistinguishable," more precise language is needed to fulfill the ERISA principle of giving deference to the fiduciary to choose among investment alternatives that are the output of a prudent process. The Preamble gives two examples of how the "equally serve" language would work. In one, two investments "may differ on a wide range of attributes" but considered in "totality" they serve the financial interests of the plan "equally well"; the investments are "not indistinguishable" but are "equally appropriate." In the other example, the fiduciary chooses a "hedge against a specific risk to the portfolio, even though the investment, when considered in isolation from the portfolio as a whole, is riskier or less likely to generate a significant positive return than other investments that do not serve the same hedging function." (86 Fed. Reg. at 57278)

Our concern is that the phrase "equally serve the financial interests of the plan" does not capture these examples and may unduly constrain the fiduciary in choosing among investment options. In the hedging example, the alternative investments "do not serve the same hedging function" and present materially different risk and return profiles. Because one could conclude that the hedging option does not "equally" serve the financial interests of the plan, the rule might be read as barring this option. Likewise, in the first example, small deviations in the financial effects of two investments could lead to a conclusion that they are not "equally serving" the interests of plan beneficiaries and that the fiduciary cannot choose among them.

Under the core principles of ERISA, the issue is not how closely two or more investments resemble one another, but whether they are each the product of a prudent process and analysis. Fiduciaries should receive deference if their investment choice is the product of such a process. We believe it is more appropriate for the collateral benefit provision in the final rule to focus on whether investments are the output of a prudent fiduciary process rather than on an analysis of the equivalence of their financial characteristics.

5. **Documentation:** The Proposal would rescind the 2020 ESG Rule's requirement for documentation when "non-pecuniary" factors, such as ESG factors, are used to make a final selection from among equivalent investments. We agree with the Preamble's statement that "singling out this one category of investment actions for a special documentation requirement may, in practice, chill investments based on climate change or other ESG factors." (86 Fed. Reg. at 572790) Further, we agree that a special documentation requirement is unnecessary given that fiduciaries maintain records about

their fiduciary obligations. Moreover, the documentation requirement exposes fiduciaries to risk and uncertainty, suggesting they must explain why one particular investment that is deemed prudent is "better" than another investment that is also deemed prudent. We therefore support the proposed rescission of this requirement.

6. **Disclosure**: Paragraph (c)(3) would add a new disclosure requirement providing that where a collateral-benefit characteristic is used to select from among investments that equally serve the financial interests of the plan, then that characteristic (such as ESG or some other factor) of the fund, product or model portfolio must be prominently displayed in disclosure materials provided to participants and beneficiaries in an individual account plan. We of course are in favor of efforts to provide good disclosure to participants, but we question whether this aspect of the Proposal is the best approach. It may chill appropriate use of ESG as a collateral benefit in much the same way as the documentation requirement of the 2020 Rule, which (as discussed above) the Department is proposing to jettison. This is particularly the case because the proposal is vague and could lead to allegations against plan sponsors for failure to make adequate disclosures. Moreover, we do not believe a special disclosure requirement is necessary here, given that the Department's regulation at 29 CFR §2550-404a-5 already ensures participants receive the information they need to evaluate their plan investment alternatives. In any event, if the Department goes forward with this requirement it should provide sufficient guidance to facilitate compliance efforts.

7. **QDIA**: We fully endorse the Department's rescission of the prohibition on certain investment alternatives being used as a Qualified Default Investment Alternative (QDIA). We have heard the same thing from stakeholders as has the Department – as described in the Preamble, the "concern that funds could be excluded from treatment as QDIAs solely because they expressly considered climate change or other ESG factors, even though the funds were prudent based on a consideration of their financial attributes alone." (86 Fed. Reg. at 57279) The Department's rationale in 2020 for the disparate treatment of ESG-oriented funds is that participants do not affirmatively select the QDIA and in such a circumstance the fiduciary should not be permitted to impose its values on participants. But a fiduciary's responsibilities of prudence and loyalty are no different for a QDIA than for other plan investments. As the Department observes in the Preamble, the 2020 rule "only serve[s] to harm participants by depriving them of otherwise financially prudent options as QDIAs." (86 Fed. Reg. at 57280)[17]

8. **Assessment:** The Preamble asks for comments on whether the rule should "require that any collateral benefit relied upon as a tie-breaker be based upon an assessment of the

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[17] This aspect of the Proposal has already been criticized because it would purportedly "coerce workers and business into supporting progressive policies." The Editorial Board, "Your New Woke 401(k)," *Wall Street Journal*, October 20, 2021, https://www.wsj.com/articles/your-new-woke-401-k-retirement-savings-esg-erisa-biden-administration-department-of-labor-proposal-11634753095. This criticism lacks merit. There is no coercion. Plan participants will continue to have completely free choice in making their plan selections even when a plan has adopted automatic enrollment.

shared interests or views of the participants." (86 Fed. Reg. at 57279) We do not believe such a requirement is needed.

As the Department notes, its guidance dating back to 1994 consistently defined what are now termed collateral benefits as benefits of the investment apart from the participants' interest in their retirement income. This has been understood to include not only ESG factors, but also a variety of considerations such as job opportunities, community development and similar issues. This broad definition is appropriate as the investments must be found to be prudent for the plan prior to the consideration of any collateral benefits. Based on our discussions with experienced ERISA counsel, nearly 30 years of experience with this standard has not demonstrated any concerns or abuse justifying a change.[18]

We agree that the interests of participants can be a relevant factor for a fiduciary to consider in making investment decisions. Indeed, participant demand for sustainable and climate-friendly investments has been important in the growing adoption of ESG investments in ERISA-covered retirement plans. However, an assessment of participant views on different types of collateral benefit issues should not be a prerequisite for using any particular collateral benefit. It is not clear how this information would be utilized by plan fiduciaries, how it could be collected, or what collateral issues should be included in such an assessment.

Regardless of whether a collateral benefit is used, the investment must be prudent and serve the best interests of participants and beneficiaries. Requiring further surveys or assessments of participants would serve to increase costs and complexity.

III. We support the proposed changes to the proxy rules

A. Proxy voting is an important shareholder right that should be taken seriously by fiduciaries.

On December 16, 2020, the Department published the 2020 Proxy Rule. Ceres filed a letter in opposition[19] to that proposed rule during the comment process, but the final rule did not make the changes we suggested. The Department now proposes to make those changes, and we endorse this effort.

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[18] As noted above (page 5), the Department itself in 2020 recognized that it could not find any evidence of fiduciary "misbehavior." We discussed this issue with Bradford P. Campbell, former Assistant Secretary of Labor for Employee Benefits and head of the Employee Benefits Security Administration from 2006 to 2009. Mr. Campbell informed us that his office reviewed these issues in developing the guidance in IB 2008-01 and did not find any specific cases of fiduciary misconduct at that time.

[19] Mindy Lubber, "Re: 1210-AB91, Fiduciary Duties Regarding Proxy Voting and Shareholder Rights proposed rule," *Department of Labor*, last modified October 5, 2021, https://www.dol.gov/sites/dolgov/files/EBSA/laws-and-regulations/rules-and-regulations/public-comments/1210-AB91/00217.pdf.

The 2020 Proxy Rule altered well-established understandings of the fiduciary requirements for those who manage ERISA covered pension plans. ERISA's fiduciary duties include active ownership, including informed proxy voting on shareholder proposals affecting companies owned by the plan. Shareholder proposals often address issues that can pose significant financial risks to companies, such as climate change, governance, human capital, and other ESG issues not being addressed adequately by management.[20]

Shareholder proposals are a valuable tool for shareholder input into corporate policies and business strategies that affect shareholder value over the long term. Members of our Investor Network have repeatedly emphasized the value of active ownership, including proxy voting on ESG and other issues, and corporate engagement, to protect and enhance the value of their investments. And shareholders increasingly are using their power to build strong support for proposals and to lead companies to take action on climate change.[21] A recent high-profile example is the Exxon shareholder vote on May 26, 2021 that elected three new board members with expertise in climate and clean energy.[22] Exxon had failed to acknowledge the extent to which its assets were impaired by climate change, although other oil majors such as Chevron and BP had done so. Exxon acknowledged the potential for impairment on November 3, 2021.[23]

Investors are also playing an essential stewardship role in connection with the financial risks posed by hazardous chemicals and pesticides in products and supply chains.[24] Over the last ten years, investors have engaged over 100 companies on this issue, filing 165 chemicals-related

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[20] We note in this regard that the Division of Corporation Finance at the Securities and Exchange Commission recently issued a staff legal bulletin relating to shareholder proposals, and that staff bulletin is consistent with the Department's approach to shareholder proposals addressing ESG issues such as climate change. The bulletin stated that the staff may no longer agree with companies that certain proposals are excludable from proxy statements under SEC Rule 14a-8, including proposals that "request[] companies adopt timeframes or targets to address climate change." Staff Legal Bulletin 14L (Nov. 3, 2021).

[21] *See generally,* Mindy Lubber, "Why This Proxy Season is a Record Breaker for Climate Proposals," *Forbes*, last modified May 14, 2021, https://www.forbes.com/sites/mindylubber/2021/05/14/why-this-proxy-season-is-a-record-breaker-for-climate-proposals/?sh=1fb3437a54d4.

[22] Jennifer Hiller and Svea Herbst-Bayliss, "Exxon loses board seats to activist hedge fund in landmark climate vote," *Reuters*, last modified May 26, 2021, https://www.reuters.com/business/sustainable-business/shareholder-activism-reaches-milestone-exxon-board-vote-nears-end-2021-05-26/.

[23] Reuters, "Exxon Warns Some Assets May Be at Risk for Impairment Due to Climate Change," *U.S. News*, last modified November 3, 2021, https://money.usnews.com/investing/news/articles/2021-11-03/exxon-warns-some-assets-may-be-at-risk-for-impairment-due-to-climate-change.

[24] *See* Investor Environmental Health Network, "Impact" *Investor Environmental Health Network*, accessed September 15, 2020, https://iehn.org/membership/impact.

shareholder resolutions.[25] This is because of the slow pace of corporate responses to reduce this risk:

> Many chemicals of serious public health concern to the scientific community have not yet been restricted by regulatory bodies. . . . Despite the lack of restrictions on various chemicals of concern to public health experts and consumers, many companies exercise a compliance mentality when it comes to chemical management, i.e. if government regulations do not prohibit inclusion of a chemical in a product, then it is considered acceptable for inclusion. This often places companies at risk of market lockouts, consumer exodus and liability.[26]

Shareholder resolutions about these issues benefit company managers and directors by making them aware of emerging risks that could materially affect the company's performance over the short, medium or long term. Encouragingly, some corporations have begun responding. A 2019 report provided examples of corporations reducing their chemical footprint, making significant improvements in their chemical management policies and practices, and disclosing this information publicly.[27]

B. The Proposed Rule Contains Appropriate and Necessary Changes to the 2020 Proxy Rule.

The 2020 Proxy Rule harms fiduciaries by discouraging fiduciaries from voting on proxy proposals and by significantly raising the cost of voting. We endorse the Department's proposal to make the following specific changes:

1. **Encouraging proxy voting:** The Proposal would eliminate the statement in paragraph (e)(2)(ii) 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." No previous iteration of the rule required fiduciaries to vote every proxy, so this statement is unnecessary. Fiduciaries should be encouraged to exercise their shareholder rights unless the fiduciary reasonably determines that voting proxies may not be in the plan's best interest. The Proposed Rule takes this approach.

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[25] Examples of resolutions are available at Investor Environmental Health Network, "Shareholder Resolutions," *Investor Environmental Health Network*, accessed November 16, 2021, https://iehn.org/resources/resolutions.

[26] Sanford Lewis, "re: File Number S7-06-16 - Regulation S-K Concept Release on Business and Financial Disclosure Required by Regulation S-K," *Investor Environmental Health Network*, last modified July 15, 2016 https://www.sec.gov/comments/s7-06-16/s70616-133.pdf.

[27] The Chemical Footprint Project, "CFP 2019 Annual Report Press Release," *The Chemical Footprint Project*, last modified November 14, 2019, https://www.chemicalfootprint.org/news/article/2019-chemical-footprint-project-press-release. *See also*, Meg Wilcox, "Chemical footprinting comes of age," *Greenbiz*, last modified July 13, 2020, https://www.greenbiz.com/article/chemical-footprinting-comes-age.

2. **Monitoring third parties:** The Proposal correctly recognizes that a trustee's duties of prudence and loyalty already impose a requirement that a fiduciary monitor the activities of an investment manager or proxy advisory firm in connection with proxy voting. Hence, we agree that some enhanced monitoring obligation is unnecessary.

3. **Safe harbors:** The Proposal would revise the current regulation's provision on proxy voting policies (paragraph (e)(3)(i)) by removing the two safe harbor examples for proxy voting policies. These so-called safe harbors disincentivize fiduciaries from properly representing the participants' interests. For the reasons stated in the Preamble we believe that these safe harbors are both unnecessary and unhelpful.

4. **Maintenance of records:** The Proposal would eliminate the requirement in paragraph (e)(2)(ii)(E) that, when deciding to exercise shareholder rights and when exercising those rights, plan fiduciaries must maintain records on proxy voting activities and other exercises of shareholder rights. As stated in the Preamble, this regulation "appears to treat proxy voting and other exercises of shareholder rights differently from other fiduciary activities and may create a misperception that proxy voting and other exercises of shareholder rights are disfavored or carry greater fiduciary obligations, and therefore greater potential liability, than other fiduciary activities." (86 Fed. Reg. at 57281) For the reasons noted above, we disagree with the overall attempt by the Department in 2020 to impose costs on and raise impediments to proxy voting. Hence, we support the Proposal in this regard.

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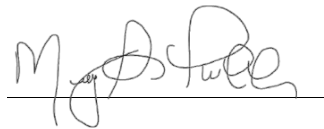
Again, we appreciate the Department's efforts to restore ERISA rules to comply with the legal requirements of ERISA and trust law and to rescind the regrettable late-2020 efforts to constrain ESG investing and proxy voting. We would be pleased to discuss or provide additional information on any of the points raised above. If there are questions, please reach out to Steven Rothstein (srothstein@ceres.org).

Respectfully submitted,



Mindy S. Lubber
CEO and President

cc: Honorable Martin J. Walsh, Secretary of Labor