CFA Institute

1401 New York Ave. NW
Suite 330
Washington, DC
20005-2269 USA

+1 (202) 908 4520 tel
+1 (202) 908 4538 fax
info@cfainstitute.org
www.cfainstitute.org

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

Attention:
Edwin Nieves
Phone Number 202-693-4655
Email nieves.edwin@dol.gov
Victoria Godinez
Phone Number 202-693-4667
Email godinez.victoria.c@dol.gov

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

CFA Institute, the world's largest association of investment professionals, respectfully submits this comment letter to the U.S. Department of Labor (the "Department" or "DOL") in response to its recently published notice of proposed rulemaking: Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights (the "Proposal").[1]

CFA Institute[2] is a global, not-for-profit professional association with more than 80,000 U.S.-based members who function variously as chief investment officers, investment advisers, and portfolio managers on the buy side of the market; as brokers, investment bankers, and financial analysts on the sell side; and as consultants, chief financial officers, regulators, and academics elsewhere in the financial world. Our membership is bound by a common commitment to the CFA Institute Code of Ethics and Standards of Professional Conduct ("Code and Standards") that requires all members and candidates to "place their clients' interests before their employer's or their own interests."[3] CFA Institute speaks on behalf of its members and advocates for investor protection and market integrity before standard setters, regulatory authorities, and legislative bodies worldwide.

---

[1] DOL, "Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights," 86 FR 52,272 (Oct. 13, 2021), https://www.govinfo.gov/content/pkg/FR-2021-10-14/pdf/2021- 22263.pdf"

[2] CFA Institute membership includes more than 185,000 investment analysts, advisers, portfolio managers, and other investment professionals in 163 countries, of whom more than 178,500 hold the Chartered Financial Analyst® (CFA®) designation. CFA Institute membership also includes 160 member societies in 77 countries and territories.

[3] CFA Institute Code of Ethics and Standards of Professional Conduct: https://www.cfainstitute.org/en/ethicsstandards/ethics/code-of-ethics-standards-of-conduct-guidance

Summary

CFA Institute supports the Department's reexamination of current regulations regarding "Financial Factors in Selecting Plan Investments" ("Financial Factors Rule")[4] and "Fiduciary Duties Regarding Proxy Voting and Shareholder Rights" ("Proxy Voting Rule").[5] In short, the 2020 Rules were rushed and were based on a mischaracterization of market practices.[6] Rather than reiterate and clarify ERISA fiduciary responsibilities, as was the stated goal, the 2020 Rules are fraught with ambiguities and inconsistencies. Worse yet, contrary to ERISA principles and congressional intent, the Rules impose special scrutiny of ESG factors and proxy voting, placing an unwarranted regulatory burden on Plan fiduciaries. If allowed to stand as is, the Rules risk limiting investment options, constraining investment professionals from performing their duties and, in the long run, may preclude ERISA fiduciaries from fulfilling their responsibilities to Plan beneficiaries.

For these and other reasons explained more fully below, we agree it is necessary for the Department to amend the Financial Factors and Proxy Voting Rules to clarify and, where appropriate, eliminate flawed language and erroneous assumptions. Specifically, we support the Department's overarching emphasis on the well-developed ERISA framework to empower fiduciaries to consider *all* relevant factors and courses of action as part of their investment analysis, provided they meet their ERISA obligations. In so doing, we believe the Proposal helps to restore the balance Congress intended in ERISA when it placed Plan investment decisions with the Plan fiduciaries, not with the Department.

In general, CFA Institute is concerned with the regulatory seesaw from administration to administration. We strongly believe that investment decisions and policy governing the markets should primarily reflect and be driven by market dynamics.[7] To that end, we provide comments

---

[4] DOL, "Financial Factors in Selecting Plan Investments," 85 FR 72,846 (Nov. 12, 2020), https://www.govinfo.gov/content/pkg/FR-2020-11-13/pdf/2020-24515.pdf

[5] DOL, "Fiduciary Duties Regarding Proxy Voting and Shareholder Rights," 85 FR 81,658 (Dec. 15, 2020), https://www.govinfo.gov/content/pkg/FR-2020-12-16/pdf/2020-27465.pdf

[6] *See, e.g.*, ABA, DCIIA, IRI, IAA, ICI, SIFMA, Spark Institute letter to DOL on the Financial Factors proposal (Jul. 20, 2020), https://www.dol.gov/sites/dolgov/files/EBSA/laws-and-regulations/rules-and-regulations/public-comments/1210-AB95/00123.pdf (requesting 30-day extension of the comment period). *See also* Impax, Morningstar, US SIF, Ceres, AFL-CIO, ICCR analysis of the Financial Factors proposal comment file, "Public Comments Overwhelmingly Oppose Proposed Rule Limiting the Use of ESG in ERISA Retirement Plans" (Aug. 20, 2020), https://www.ussif.org/Files/Public_Policy/DOL_Comments_Reporting_FINAL.pdf (finding that the NPRM is not based on evidence that a problem actually exists, the proposed rule is based on a flawed and unsupported assumption that ESG funds give up financial returns in favor of "non-pecuniary" rewards and largely dismisses the financial materiality of ESG issues); Impax, Morningstar, US SIF, Ceres analysis of the Proxy Voting comment file, "Majority of Public Comments Oppose DOL Proposal Curtailing Shareholder Voting Rights in ERISA Retirement Plans" (Nov. 20, 2020), https://www.ussif.org/Files/Public_Policy/DOL_Proxy%20voting%20proposal_analysis%20FINAL.pdf (finding that the NPRM misrepresents existing market practices and value of shareholder engagement, proxy voting, and lacks evidentiary basis).

[7] *See also* Survey of CFA Institute Members on Latest ESG Matters (November 2021), https://www.cfainstitute.org/-/media/documents/survey/cfa-esg-survey-web.pdf (finding that 47% believe regulators should not mandate ESG integration by regulated investment managers and 31% believe ESG integration should be decided by the client in consultation with the investment manager).

below that aim to support the Proposal, if finalized, in establishing a sustainable ERISA framework for the benefit of Plan fiduciaries, their beneficiaries and the market.

I. Consideration of ESG Factors and ESG Investing

A. Clarifying the ESG investment "thesis"

In our view, the investment profession has long come to the understanding that certain ESG factors are material and an integral consideration in proper financial analysis. That is, ESG is not a Trojan horse for a social agenda, as was implicitly assumed in the Financial Factors proposal and final rule. In our comment letter on the Financial Factors proposal (enclosed), we provided ample evidence supporting this thesis, and the evidence has only grown in the intervening time.

Briefly stated, our extensive research and discussions with investors and CFA Institute members have shown that the ESG market value proposition is rooted in investor demand for risk management, growth opportunities and increasingly sophisticated investment analysis. Critics of ESG investing often look to fund performance history to disprove the value of ESG factors, but the narrative around ESG performance/underperformance can fluctuate by simply defining ESG in a way that supports a given thesis, largely because there is not one agreed upon definition of "ESG." By analogy, as is the case with value investing and investing based on growth, there are times when ESG investing will outperform and times when it will underperform the market. Critically, the thesis behind ESG integration is a sound one – ESG analysis enhances the investment decision-making process.

Our latest member survey, conducted in March 2020, substantiates this: 85% of CFA Institute members now take E, S, and/or G factors into consideration in their investing, up from 73% in 2017.[8] With respect to the "E" of ESG, the 2020 CFA Institute report on *Climate Change Analysis in the Investment Process*[9] is particularly revealing on the primacy of climate risk considerations to investment professionals in the U.S. and globally. The U.S.-specific findings show:

Of the 40% who *do* integrate climate risk into the investment process,

- 75% do so because they believe climate change is a material issue; 49% because of client demand;
- 54% focus on physical risk; 51% on transition risk; 45% on credit risk; and 44% on stranded asset risk.

Of those who *do not* integrate climate change analysis into the investment process,

- 57% explain the underlying reason is a lack of measurement tools.

Among those surveyed in the U.S., the demand for greater issuer disclosure is robust:

- 47% seek additional information from issuers on climate-related risks;

[8] https://www.cfainstitute.org/-/media/documents/survey/future-of-sustainability.pdf
[9] https://www.cfainstitute.org/-/media/documents/article/industry-research/climate-change-analyis.pdf

- 46% seek greater disclosure from issuers on climate strategy; and 42% on climate risk and scenario analysis.

Also of note, 58% believe engagement is "more effective" than divestment in supporting a sustainable economy, a conclusion that supports the Proposal's premise of the value of proxy voting to a Plan's assets.

Whether E, S or G, investors often see "ESG" as a proxy for management and board quality.[10] Investors are still grappling with a lack of comparable, decision-useful ESG data and the best methods to measure ESG performance, but their main belief is that companies that manage for ESG issues are managing for the long-term, as most ESG issues are long-term in nature.[11]

B. Consideration of ESG and all relevant factors

The Financial Factors Rule, too, acknowledges that some ESG factors can be material, but it cautions ERISA fiduciaries against "too readily"[12] incorporating ESG factors, and in the preamble pre-judges ESG investing:

> *"**ESG investing raises heightened concerns** under ERISA….The Department is concerned that the growing emphasis on **ESG investing, and other non-pecuniary factors**, may be prompting ERISA plan fiduciaries to make investment decisions for purposes distinct from their responsibility to provide benefits to participants and beneficiaries and defray reasonable plan administration expenses"* (emphasis ours).[13]

In effect, the Financial Factors Rule presumes that fiduciaries investing using non-pecuniary - that is, ESG - factors have violated their ERISA obligations or arrived at their conclusion imprudently unless they provide documentation to prove otherwise. This special scrutiny contradicts what the Department has long emphasized: that it, by statute, cannot single out any type of investment as permissible or impermissible. Further, as discussed above, there is no evidentiary basis for the heightened concerns. Although the availability and quality of ESG data continues to evolve, we believe ERISA fiduciaries are well-equipped to navigate these challenges without compromising their core fiduciary responsibilities.

Indeed, "ESG" is not new to the Department. Over the years, "ESG" has been described synonymously with economically targeted investments, socially responsible or sustainable investing, or corporate social responsibility. The term "ESG" has simply become a "wrapper," or

---

[10] Eccles, Robert G. and Ioannou, Ioannis and Serafeim, George, The Impact of Corporate Sustainability on Organizational Processes and Performance (December 23, 2014). Management Science, Volume 60, Issue 11, pp. 2835-2857, February 2014, Available at SSRN: https://ssrn.com/abstract=1964011
[11] https://blogs.cfainstitute.org/marketintegrity/2019/09/18/are-esg-factors-relevant-only-for-investors-with-long-term-investment-horizons/
[12] 2020 Financial Factors Rule at 72,847.
[13] Financial Factors Rule at 72,848.

an acronym meant to capture issues important to investors, issuers, and asset managers.[14] The Department has long weighed these investment factors and though pre-2020 Department guidance, changed course on the consideration of ESG factors, the Department has consistently maintained that so long as the factors are economically relevant to the investment process and are prudently selected, they merit consideration.[15]

For these reasons, we agree with the proposed elimination of the "pecuniary" and "non-pecuniary" distinction in evaluating ESG and other factors, and support the proposed affirmation of the Department's long-standing position on consideration of relevant factors in the following streamlined statement:

> *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" (emphasis added).*[16]

This approach aligns with the Department's history of guidance and, importantly, does not prescribe or proscribe any single type of investment or investment strategy. We suggest the Department also consider clarifying Proposal language to avoid a potential misreading that ESG integration is mandatory, by either changing the language using our recommendation below or altogether eliminating the "which" sentence clause:

> *The projected return of the portfolio relative to the funding objectives of the plan, which may [include] ~~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.*[17]

Furthermore, we recommend that the Department include the proposed non-exclusive list of ESG factors[18] in the preamble but not memorialize these examples in the rule text. This would maintain flexibility of the rule text and preclude the Department from having to update the categories in the future.

Finally, to remain consistent with its pre-2020 guidance and avoid regulatory uncertainty, we also suggest the Department use the term "relevant" factors, rather than "material" factors. Whereas the concept of "materiality" arises out of antifraud case law, the term "relevant" has been the ERISA standard.

C. Reformulation of the "All things being equal test" or the "Tie-breaker" standard

---

[14] Evan Epstein. "David Curran: ESG is a Moving Target Even for the Best Companies." *Boardroom Governance.* Episode 31, Spotify, Apr. 7, 2021, https://boardroom-governance.com/episodes/david-curran (see minutes 12-20 on the origins of the "ESG" acronym)
[15] https://www.groom.com/wp-content/uploads/2018/04/DOL_and_ESG_Investing_Evolving_Guidance.pdf
[16] Proposal at 57,302 under paragraph (b)(4).
[17] *Id.*
[18] *Id.*

CFA Institute supports the Proposal amending the "all things being equal test" to allow ERISA fiduciaries to consider "collateral benefits" when the investment choices or courses of action ''equally serve the financial interests of the plan.''[19] Whereas the 2020 Financial Factors Rule required that competing investments must be "indistinguishable" based on consideration of risk and return,[20] the Proposal correctly determined that this test is unworkable and, in some cases, inappropriate. For example, the Department notes:

> *"…two investments may differ on a wide range of attributes, yet when considered in their totality, can serve the financial interests of the plan equally well."*[21]
>
> *"Similarly, a fiduciary may prudently choose an investment as 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."*[22]

Additionally, the presumption in the 2020 Financial Factors Rule that ESG factors are generally non-pecuniary creates the perception that ESG factors are relevant only in the tie-breaker context, if at all; and if considered, require additional documentation. In our view, this effectively means that ESG integration, even where relevant to risk-return, is subject to unique obligations above and beyond what is already required under ERISA. As the Department notes in the Preamble, this special scrutiny tips the scale against ESG investments that offer collateral benefits and may have a broader chilling effect still, such as when investment selection takes into account "participant interest in investment options in order to increase retirement plan savings."[23]

Here too, we do not see a need for the additional safeguards or restrictions. We agree that the ERISA general prudence obligation is "sufficiently protective in this context"[24] and special documentation requirements are unnecessary.

C. Standards governing Qualified Default Investment Alternative (QDIA)

The 2020 Financial Factors Rule excludes from treatment as a QDIA a fund "if it, or any of its component funds in a fund-of-fund structure, has investment objectives, goals, or principal investment strategies that include, consider, or indicate the use of non-pecuniary factors."[25] In practice, this means a fiduciary is prohibited from considering a fund as a default option solely because it considers non-pecuniary factors, even if the fund is an economically prudent selection from a risk-return perspective. This requirement is unreasonable and aims to trap (or at least corral) Plan fiduciaries.

---

[19] Proposal at 57, 278.
[20] 2020 Financial Factors Rule under paragraph (c)(2).
[21] Proposal at 57,278
[22] *Id.*
[23] Proposal at 57,279
[24] I*d.*
[25] Proposal at 57,280

The Proposal correctly asserts that if a fund is financially prudent and meets the protective standards set out in the QDIA regulation "there appears to be no reason to foreclose plan fiduciaries from considering the fund as a QDIA."[26] The Proposal also allows consideration of collateral benefits in selecting the QDIA for individual account plans. CFA Institute welcomes this more reasoned approach of uniformly applying the same fiduciary standards to QDIA selection and monitoring and other designated investment alternatives.

Put simply, we support the Proposal in (1) clarifying that ESG factors can be relevant and are subject to ERISA obligations; (2) providing a non-exclusive list of ESG factors by way of examples; while (3) emphasizing that ESG integration is no different from other investment processes and should not be treated as such.

II. Exercise of Shareholder Rights and Proxy Voting

A. Standards governing exercise of shareholder rights

The Department has long recognized the value of exercising shareholder rights and proxy voting, a fiduciary act subject to ERISA's core fiduciary duties of loyalty and prudence.[27] As we explained in our comment on the 2020 Proxy Voting proposal (enclosed), CFA Institute agrees that proxy voting is a fundamental shareowner right, a source of value to shareowners,[28] and "a crucial lever in ensuring that shareholders' interests, as the company's owners, are protected."[29]

In our view, the 2020 Proxy Voting Rule, motivated by unfounded concerns regarding proxy voting, was an unnecessary departure from prior guidance. Contrary to the assertion in the 2020 Proxy Voting Rule, there is no evidence to confirm that "existing sub-regulatory guidance may have inadvertently created the perception that fiduciaries must vote proxies on every shareholder proposal to fulfill their obligations under ERISA,"[30] and the 2020 comment file reflects this reality. The claim in the 2020 Proxy Voting Rule that there is "mixed" evidence[31] on the effectiveness of shareholder voting is similarly easily disproved by the cumulative advances that shareowner engagement has brought to corporate governance of U.S. public companies.

---

[26] I*d.*
[27] *See* Letter from US. Department of Labor to Mr. Helmuth Fandl, Chairman of the Retirement Board of Avon Products, Inc. (Feb. 23, 1988), 198 WL 897696 ("In general, the fiduciary act of managing plan assets which are shares of corporate stock would include the voting of proxies appurtenant to those shares of stock."). The Department reiterated its view in subsequent bulletins: Interpretive Bulletin 94-2; Interpretive Bulletin 2008-02; Interpretative Bulletin 2016-01; Field Assistance Bulletin 2018-01.
[28] CFA Institute, *The Corporate Governance of Listed Companies*, 49 (2018), https://www.cfainstitute.org/-/media/documents/article/position-paper/corporate-governance-of-listed-companies-3rd-edition.ashx (concluding that "[t]he value of a financial security is determined not only by its claim on the company's future earnings but also by the rights associated with that security." *See also* 2020 letter from Council of Institutional Investors (CII) on the Proxy Voting proposal (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.")
[29] Proposal at 57, 281.
[30] 2020 Proxy Voting rule at 81, 681.
[31] 2020 Proxy Voting rule at 81, 682.

The Proposal correctly points out that, by virtue of heightened scrutiny, reporting and monitoring obligations, the overall effect of the Proxy Voting Rule is to discourages proxy voting:

> The regulation "*treat[s] 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.*"[32]

The Department is also right to conclude that, taken together, the ''ʼno voteʼ'' statement[33] and the two safe harbors[34] in the current regulation "may be construed as little more than regulatory permission for plans to broadly abstain from proxy voting without properly considering their interests as shareholders and without legal repercussions."[35] Indeed, abstaining from a vote is "not a neutral act."[36] Depending on the relevant voting standard under state law and the company's governing documents, an abstention can be counted as a "no" vote.[37]

For these reasons, we welcome the elimination of the "no vote" language, the two safe harbors, and the additional reporting requirements. The Department's affirmation that a fiduciary's exercise of shareowner rights, including voting rights, must be performed prudently and solely for the economic benefit of plan participants and beneficiaries is the better regulatory alternative, and one that sets a clear and historically consistent baseline:

> *"The Department's longstanding view of ERISA is 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)."*[38]

---

[32] Proposal at 57, 281.
[33] Proxy Voting Rule under paragraph (e)(2)(ii), (*''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.'')*
[34] Proxy Voting Rule under paragraph (e)(3)(i). One safe harbor is for a policy of voting only on "particular types of proposals that . . . are substantially related to the issuer's business activities or are expected to have a material effect on the value of the investment;" and the second is for a not-voting policy unless the plan's holdings of the company involved exceeds threshold of the plan's holdings (in its preamble. the 2020 Proxy Voting Rule suggested 5% as a threshold).
[35] Proposal at 57, 282.
[36] Proposal at 57, 281.
[37] *See* Kahan, Marcel and Rock, Edward B., The Hanging Chads of Corporate Voting. Georgetown Law Journal, Vol. 96 p. 1227, 2008, U of Penn, Inst for Law & Econ Research Paper No. 07-18, NYU Law and Economics Research Paper No. 07-29, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=10070651, ("For example, in uncontested director elections, an "abstention" takes the form of "withholding" of authority to vote in favor of the nominee and is thus indistinguishable from a vote by a holder who is affirmatively opposed to the nominee…. Shareholder proposals… require a majority of shares voting, so that abstentions have a similar effect as 'no' votes. But because shareholder proposals are typically opposed by management, an abstention on them is equivalent to a *pro-management* vote.")
[38] Proposal at 57, 281.

D. Standards governing use of proxy voting policies, investment managers, proxy advisory firms, and similar service providers

In the preamble to the Proposal, the Department explains that proxy voting policies and the use of investment managers, proxy advisory firms, and similar service providers afford ERISA fiduciaries the flexibility to prudently and cost-efficiently make decisions appropriate for plan beneficiaries:

> *"The solution to proxy-voting costs is not total abstention, but is, instead, for the fiduciary to be prudent in incurring expenses to make proxy decisions and, wherever possible, to rely on efficient structures (e.g., proxy voting guidelines, proxy advisers/managers that act on behalf of large aggregates of investors, etc.)."*[39]

We agree and support the Proposal's streamlined approach in (1) eliminating specific monitoring obligations where the authority to vote proxies or exercise shareholder rights has been delegated to an investment manager or where a fiduciary relies on proxy advisory firms for advice or voting of proxies; (2) retaining the provision allowing for proxy voting policies on the basis that they are an important part of any comprehensive investment policy and therefore consistent with the fiduciary obligations set forth in ERISA; and (3) eliminating the requirement that Plan fiduciaries maintain detailed records on their exercise of shareholder rights, including proxy voting activities. We agree with the Department that these obligations unnecessarily single out the exercise of shareholder rights for increased liability risk and impose superfluous recordkeeping requirements, where the general ERISA framework is already sufficiently stringent.

In sum, we welcome the Proposal amending current regulations to eliminate unique scrutiny of the exercise of shareholder rights and proxy voting and to align relevant ERISA fiduciary obligations generally with the pre-2020 ERISA framework that has served plan fiduciaries well.

***

On behalf of CFA Institute, we appreciate the efforts of the Department and its staff and thank you for your consideration of our comments. We would welcome the opportunity to discuss the matter with you at your convenience. Please do not hesitate to contact us at matt.orsagh@cfainstitute.org.

Respectfully,

Paul Andrews
Managing Director
Research, Advocacy and Standards
CFA Institute
Washington D.C.

[39] *Id.*

Matt Orsagh
Senior Director
Policy Advocacy
CFA Institute
Washington D.C.