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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: Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights**

*RE: RIN 1210-AC03*

To Whom It May Concern:

We are writing in respect of Proposed Rule RIN 1210-AC03, 85 FR 57272 (the “Proposed Rule”) and the accompanying supplementary information (the “Release”).

The Shareholder Commons (TSC) is a nonprofit organization focused on ensuring that companies act in a manner that promotes the best interests of their investors and that asset owners and managers act in the best interests of their beneficiaries, in each case by protecting the social and environmental systems upon which diversified shareholders rely. [B Lab USA/CAN is a nonprofit that serves a movement of people using business as a force for good.]

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## **A. Introduction**

### *1. Statement of support for the Proposed Rule*

We support the Proposed Rule because it clarifies that environmental and social issues are financially material to plans and that there should be no presumption against the consideration of such issues in selecting securities, engaging with companies, or exercising voting rights.

### *2. The Proposed Rule clearly endorses ESG integration*

A company's focus on environmental and social issues can contribute to its financial performance in myriad ways, including reduced cost structures, improved reputation, and recognition of growth opportunities. The Proposed Rule appropriately clarifies that plan fiduciaries should consider these and other effects that social and environmental issues may have on the financial performance of the companies in their portfolios. Consideration of the interaction between social, environmental (and

governance) issues and individual company financial performance is often referred to as “ESG integration.”

*3. System stewardship is distinct from ESG integration*

ESG integration addresses the effects that social and environmental issues—and a portfolio company’s reactions to them—have on such company’s financial performance. But the causal chain runs in both directions: the performance of companies also has a profound effect on society, the environment, and the economy, and consequently on the financial performance of other companies in a plan portfolio. Indeed, the state of social and environmental systems is a key determinant in the financial performance of a diversified portfolio. This means that plan fiduciaries can improve plan performance by managing the effects that portfolio companies have on society and the environment. This use of social and environmental factors has been labeled “system stewardship.” The Proposed Rule lacks explicit endorsement of system stewardship.

*4. The Final Rule should clarify that system stewardship benefits participants*

We submit this comment letter to request further clarification that there is no presumption against system stewardship, just as there is no presumption against ESG integration. The Rule should be clear that a plan decision intended to positively affect social and environmental systems will be presumed to have been made “for the exclusive purpose of providing benefits to the plan” as long as the object of the decision is improvement of the financial performance of the plan portfolio as a whole, even if the decision might hinder the financial performance of a particular investment or portfolio company.

As shown in Part B, (1) overall market performance is much more important to the success of a diversified plan than is the performance of any particular company and (2) overall market performance is determined by the health of social and environmental systems. Thus, system stewardship—which focuses on improving systems and market performance—is more important to the ability of a plan to provide benefits than is ESG integration—which only focuses on improving the performance of individual companies. The Rule should reflect the relative importance of system stewardship. Failure to do so would ignore economic reality and the growing recognition in the investor, legal, and academic communities that system stewardship is critical for the long-term health of the economy and diversified portfolios. It would also encourage fiduciaries and service providers to apply system stewardship to social and environmental problems that ESG integration cannot solve.

We therefore urge the Department to revise the Proposed Rule to clarify that there is no presumption against using principles of system stewardship to make decisions concerning security selection, company engagement, or proxy voting.

Proposed changes are attached as an Appendix to this comment letter.

## **B. Plan Fiduciaries Can Best Serve the Interests of Participants by Ensuring that their Investees Do Not Harm Social and Environmental Systems**

### *1. Plans must diversify*

Investment principles mandate that fiduciaries adequately diversify their portfolios.<sup>1</sup> Diversification allows investors to reap the increased returns available from risky securities, but to greatly reduce that risk; this insight defines Modern Portfolio Theory.<sup>2</sup>

This core principle is reflected in ERISA itself, which requires plan fiduciaries to “diversify[] the investments of the plan.”<sup>3</sup> The wisdom of a diversified investment strategy was summarized by the late John Bogle, founder of Vanguard, one of the largest mutual funds companies in the world: “Don’t look for the needle in the haystack; instead, buy the haystack.”<sup>4</sup>

### *2. The performance of a diversified portfolio depends upon beta (overall market return)*

Diversification is thus required by accepted investment theory and ERISA itself. However, once a portfolio is diversified, the most important factor determining return will not be how the companies in that portfolio perform relative to other companies (“alpha”), but rather how the market performs as a whole (“beta”).<sup>5</sup>

For example, consider an investor whose stock portfolio consists entirely of an index fund that owns a proportionate share in the 3,000 largest U.S. companies. If one of the companies in the index increases its value by 10 percent while the entire index falls by 0.1 percent, the indexed investor loses, because her overall portfolio falls in value, despite the large gain at an individual company within the portfolio. This effect holds no matter how large the positive alpha of the company and no matter how small the beta loss.

But a plan need not be indexed for the effects of beta to outweigh alpha—that will be the case whenever a portfolio is adequately diversified. As one work describes this, “[a]ccording to widely accepted research, alpha is about one-tenth as important as beta [and] drives some 91 percent of the average portfolio’s return.”<sup>6</sup> One business-press columnist recently described the situation as follows:

*In modern markets, the paradigmatic shareholder is broadly diversified,*

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<sup>1</sup> See generally, Burton G. Malkiel, *A Random Walk Down Wall Street* (2015).

<sup>2</sup> *Id.*

<sup>3</sup> 29 USC Section 404(a)(1)(C); see also Uniform Prudent Investor Act, § 3 (“[a] trustee shall diversify the investments of the trust unless the trustee reasonably determines that, because of special circumstances, the purposes of the trust are better served without diversifying.”).

<sup>4</sup> John C. Bogle, *The Little Book of Common Sense Investing: The Only Way to Guarantee your Fair Share of the Stock Market*, 86 (2007).

<sup>5</sup> This colloquial use of the term beta differs from its technical meaning in finance, where it represents the difference between overall market volatility and the volatility of an individual security (just as alpha means the difference between the return of the market and the return of a particular security). However, practitioners have taken to using the term to contrast market return with individual security return and we do the same in this comment letter.

<sup>6</sup> Stephen Davis, Jon Lukomnik, and David Pitt-Watson, *What They Do with Your Money* (2016).

*and there is less reason to care about what any particular company does.  
... Companies are just data points; what you care about is aggregates.<sup>7</sup>*

### 3. Beta depends upon global economic performance

Over long time periods, beta is influenced chiefly by the performance of the economy itself, because the value of the investable universe is equal to the percentage of the productive economy that the companies in the market represent.<sup>8</sup> Of course, valuation multiples of stocks (i.e., the ratio of share price to earnings or other valuation metrics) rise and fall, but they ultimately revert to a mean, leaving GDP as the key determinant of the value of a diversified portfolio:

*[T]he long-term price of a universally-owning institutional investor's portfolio represents the Universal Owner's part of the appropriately discounted sum of all future GDP proportions of corporations. ...*

*[T]he relationship between GDP and the price of the portfolio of a Universal Owner is linear in the long term.<sup>9</sup>*

While the quoted work puts this idea into a mathematical proof, Warren Buffet, the world's most famous investor, uses common-sense language to make the same point, explaining that the ratio of total market capitalization to GDP "is probably the best single measure of where valuations stand at any given moment."<sup>10</sup> In other words, a healthy GDP means healthy diversified portfolios.

### 4. Global economic performance depends upon healthy social and environmental systems

It seems intuitive that a productive economy—and consequent GDP growth—is built upon healthy social and environmental systems. It would be difficult to do business in a society that lacked trust, cohesion, order, and a shared sense of norms. By the same token, where the natural systems upon which we depend are failing, it is difficult to grow the economy.

Recent economic literature reinforces this intuition. The World Economic Forum estimates that more than half the world's GDP is dependent on nature and the services it provides:

*Our research shows that \$44 trillion of economic value generation – more*

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<sup>7</sup> Matthew Levine, *Money Stuff* (Bloomberg Sept. 30, 2021) available at <https://news.bloomberglaw.com/mergers-and-acquisitions/matt-levines-money-stuff-goldman-compliance-analyst-slipped-up>.

<sup>8</sup> Principles for Responsible Investment & UNEP Finance Initiative, *Universal Ownership: Why Environmental Externalities Matter to Institutional Investors*, Appendix IV, [https://www.unepfi.org/fileadmin/documents/universal\\_ownership\\_full.pdf](https://www.unepfi.org/fileadmin/documents/universal_ownership_full.pdf).

<sup>9</sup>*Id.* The term "universal owner" is used to refer to investors that are required to invest for long time periods and who must broadly diversify to avoid the idiosyncratic risk of particular companies. Pension funds are the quintessential universal owner.

<sup>10</sup> Warren Buffett & Carol Loomis, *Warren Buffett on The Stock Market*, *Fortune* (December 10, 2001), [https://archive.fortune.com/magazines/fortune/fortune\\_archive/2001/12/10/314691/index.htm](https://archive.fortune.com/magazines/fortune/fortune_archive/2001/12/10/314691/index.htm). See also James Hawley and Andrew Williams, *The Rise of Fiduciary Capitalism: How Institutional Shareholders Can Make America More Democratic* (2000), p.xv ("a universal owner's cumulative long-term return is determined not merely by the performance of each individual firm it owns, but by the performance of the economy as a whole.")

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*than half of the world's total GDP – is moderately or highly dependent on nature and its services, and therefore exposed to risks from nature loss.<sup>11</sup>*

A 2011 study estimated the value of services provided by the earth's ecosystem at \$125 trillion.<sup>12</sup> The same article estimated that land use had reduced the value of eco-services by \$4.3 trillion to \$20.2 trillion per year between 1997 and 2011.<sup>13</sup> The *Dasgupta Review*, a 2021 study of the economics of biodiversity commissioned by the United Kingdom Treasury, explained the nature of this dependence:

*We rely on Nature to provide us with food, water and shelter; regulate our climate and disease; maintain nutrient cycles and oxygen production; and provide us with spiritual fulfilment and opportunities for recreation and recuperation, which can enhance our health and well-being. We also use the planet as a sink for our waste products, such as carbon dioxide, plastics and other forms of waste, including pollution. Nature is therefore an asset, just as produced capital (roads, buildings and factories) and human capital (health, knowledge and skills) are assets.<sup>14</sup>*

Social systems support productivity just as do environmental systems: “a lack of social development, including poverty, inequality and weak rule of law, can hamper business operations and growth.”<sup>15</sup> Examples of specific social and environmental risks that threaten to GDP are included in the following section.

The relationship between GDP, social and environmental systems, and market returns means that the centrality of beta cannot be avoided simply by picking stocks that outperform. Diversified investors cannot avoid certain common risks almost all companies face. These are the risks to the social and environmental systems in which the economy is embedded. One recent work explained that these systematic risks inevitably “swamp” any alpha strategy:

*It is not that alpha does not matter to an investor (although investors only want positive alpha, which is impossible on a total market basis), but that **the impact of the market return driven by systematic risk swamps virtually any possible scenario created by skillful analysis or trading or***

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<sup>11</sup> *Nature Risk Rising: Why the Crisis Engulfing Nature Matters for Business and the Economy*, New Nature Economy, World Economic Forum (2020), available at [https://www3.weforum.org/docs/WEF\\_New\\_Nature\\_Economy\\_Report\\_2020.pdf](https://www3.weforum.org/docs/WEF_New_Nature_Economy_Report_2020.pdf).

<sup>12</sup> Robert Costanza, et al, *Changes in the Global Value of Ecosystem Services*, 26 *Global Environmental Change* 152 (2014).

<sup>13</sup> *Id.*

<sup>14</sup> *The Economics of Biodiversity: The Dasgupta Review; Headline Messages* (2021), available at [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/957629/Dasgupta\\_Review\\_-\\_Headline\\_Messages.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/957629/Dasgupta_Review_-_Headline_Messages.pdf).

<sup>15</sup> United Nations Global Compact, *Do Business in Ways that Benefit Society and Protect People*, available at <https://www.unglobalcompact.org/what-is-gc/our-work/social>.

***portfolio construction.***<sup>16</sup>

A new report from the international law firm Freshfields Bruckhaus Deringer explains how the reality of externalized costs reverberates in the fiduciary duty of investment trustees across jurisdictions:

*In recent years investors have increasingly focused on what must be done to protect the value of their portfolios from system-wide risks created by the declining sustainability of various aspects of the natural or social environment. System-wide risks are the sort of risks that cannot be mitigated simply by diversifying the investments in a portfolio. They threaten the functioning of the economic, financial and wider systems on which investment performance relies. If risks of this sort materialised, they would therefore damage the performance of a portfolio as a whole and all portfolios exposed to those systems.*<sup>17</sup>

5. *Systemic health depends upon investee behavior*

The foregoing sections have established that (1) plans must be diversified, (2) they therefore rely on beta, (3) beta relies on a healthy economy, and (4) a healthy economy relies on critical social and environmental systems. In this section we show that the very companies plans own are responsible for whether those systems thrive, due to the social and environmental impacts they externalize.

A recent study determined that, in 2018, publicly listed companies around the world imposed social and environmental costs on the economy with a value of \$2.2 trillion annually—more than 2.5 percent of global GDP.<sup>18</sup> This cost was more than 50 percent of the profits those companies reported. Not surprisingly, climate change is one of the critical externalities that companies create. One study estimated that a global temperature increase of 2.1 degrees Celsius by 2050 would reduce GDP by 17.78 percent.<sup>19</sup> Moreover, just 100 companies are responsible for 71 percent of industrial global greenhouse gas emissions.<sup>20</sup> The carbon footprint of these companies affects beta, and thus the return of a diversified portfolio, no less (and perhaps more) than their own profitability.

Climate change is not the only systemic issue where corporate activity has enormous effects on global economic performance. For example:

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<sup>16</sup> Jon Lukomnik & James P. Hawley, [Moving beyond Modern Portfolio Theory: Investing that Matters](#), Chapter 5, Routledge (April 30 2021) (emphasis added).

<sup>17</sup> *A Legal Framework for Impact: Sustainability Impact in Investor Decision-Making* (2021). The report, which ran to 558 pages, studied the law of jurisdictions significant to global capital markets, including the United States, and the conclusions cited in this comment letter extend to U.S., trustee law.

<sup>18</sup> Andrew Howard, *SustainEx: Examining the social value of corporate activities*, Schroders (April 2019), available at <https://www.schroders.com/en/sysglobalassets/digital/insights/2019/pdfs/sustainability/sustainex/sustainex-short.pdf>.

<sup>19</sup> See *supra*, n.8.

<sup>20</sup> Swann Bommier & Cécile Renouard, *Corporate Responsibility in the Climate Crisis*, PUBLIC BOOKS and LA VIE DES IDÉES (January 21, 2019), available at <https://www.publicbooks.org/corporate-responsibility-in-the-climate-crisis/#:~:text=Although%20states%20are%20largely%20responsible,global%20industrial%20greenhouse%20gas%20emissions>

- *Obesity.* The World Health Organization assesses the unpriced social burdens of obesity as equaling almost 3 percent of global GDP annually.<sup>21</sup> The food and beverage business bears significant responsibility for this issue.<sup>22</sup>
- *Inequality.* It has been estimated that inequality has reduced demand by 2 to 4 percent of GDP in recent years.<sup>23</sup> In the United States, corporate depression of wages for low-income workers and exploding executive pay are expanding inequality.<sup>24</sup>
- *Racial and gender disparities.* Gender and racial gaps created \$2.9 trillion in losses to U.S. GDP in 2019,<sup>25</sup> and racial disparities are projected to cost the U.S. economy \$5 trillion over five years.<sup>26</sup> The latter report details how corporations can address this issue should they choose to do so.
- *Antimicrobial Resistance.* The World Bank projects that antimicrobial resistance will reduce global GDP by as much as 3 percent by 2030 and almost 4 percent by 2050; at an intermediate discount rate, this will amount to economic losses by 2050 with a current value of \$54 trillion.<sup>27</sup> A UK government-commissioned study puts the figure at \$100 trillion.<sup>28</sup> Scholarship links this increasing resistance in part to commercial pressures in agriculture and consumer packaged goods industries.<sup>29</sup>
- *Democracy at risk.* Social media companies, in their search for platform traffic and advertising revenues, have been fundamental to the rise of far-right and authoritarian

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<sup>21</sup> See Andrew Howard, *supra* n. 18.

<sup>22</sup> See, e.g., <https://www.hsph.harvard.edu/nutritionsource/healthy-drinks/sugary-drinks/>

<sup>23</sup> Josh Bivens, *Inequality is slowing U.S. economic growth: Faster wage growth for low- and middle-wage workers is the solution*, Economic Policy Institute (December 12, 2017), available at <https://www.epi.org/publication/secular-stagnation/>

<sup>24</sup> Sam Pizzigati, *Putting the Brakes on Corporate America's Inequality Engine*, Inequality.org (November 15, 2019), available at <https://inequality.org/great-divide/putting-the-brakes-on-corporate-americas-inequality-engine/#:~:text=Corporations%20are%20contributing%20to%20inequality%20on%20two%20fronts.&text=The%20legislation%20%E2%80%94%20the%20tax%20excessive,the%20higher%20the%20tax%20rate.> See generally, Heather Boushey, UNBOUND: HOW INEQUALITY CONSTRICTS OUR ECONOMY AND WHAT WE CAN DO ABOUT IT, Harvard University Press (October 15, 2019).

<sup>25</sup> Shelby R. Buckman et al., *The Economic Gains from Equity*, Federal Reserve Bank of San Francisco (January 19, 2021), available at <https://www.frbsf.org/our-district/files/economic-gains-from-equity.pdf>.

<sup>26</sup> Dana M. Peterson and Catherine L. Mann, *Closing the Racial Inequality Gaps: The Economic Cost of Black Inequality in the U.S.*, Citi GPS (September 2020), available at <http://citi.us/3olxWH0>.

<sup>27</sup> Drug-Resistant Infections: A Threat to Our Economic Future, World Bank Group (March 2017), available at <http://documents1.worldbank.org/curated/en/323311493396993758/pdf/final-report.pdf>

<sup>28</sup> *Antimicrobial Resistance: Tackling a crisis for the health and wealth of nations*, UK Government Review on Antimicrobial Resistance (December 2014), available at [https://amr-review.org/sites/default/files/AMR%20Review%20Paper%20-%20Tackling%20a%20crisis%20for%20the%20health%20and%20wealth%20of%20nations\\_1.pdf](https://amr-review.org/sites/default/files/AMR%20Review%20Paper%20-%20Tackling%20a%20crisis%20for%20the%20health%20and%20wealth%20of%20nations_1.pdf).

<sup>29</sup> Carolyn Anne Michael, Dale Dominey-Howes, and Maurizio Labbate, *The Antimicrobial Resistance Crisis: Causes, Consequences, and Management*, *Frontiers in Public Health* vol. 2 145 (September 16, 2014), available at <https://www.ncbi.nlm.nih.gov/pmc/articles/PMC4165128/>.

politicians and governments.<sup>30</sup> The election of Jair Bolsonaro as president of Brazil is due in part to this phenomenon, and is hastening the climate crisis.<sup>31</sup>

- *Political influence.* Companies also affect systems through political influence. A recent International Energy Agency study estimates that the investment necessary to create a net-zero economy by 2050 would increase global GDP by 4 percent by 2030,<sup>32</sup> which would benefit diversified investors greatly. Yet to increase their own financial returns, many individual companies spend considerable resources trying to convince policymakers and the public that constraining climate change is unnecessary.<sup>33</sup>

One commentator recently explained how the external costs of business activity were the most important factor with which investors should be concerned:

*Hence, far from externalities being peripheral, they may be the main event!  
In other words, more of the environmental and social exchanges that  
shape our wellbeing may be unpriced than priced, yet we increasingly  
steer by the priced exchanges only.*<sup>34</sup>

### C. Plan Fiduciaries Must Move beyond ESG Integration in Order to Serve Participants

1. *Plan fiduciaries must not allow portfolio companies to threaten beta to achieve alpha*

Part B of this comment letter demonstrates the following causal chain of relationships:

**CORPORATE SOCIAL AND ENVIRONMENTAL IMPACTS → SYSTEMIC HEALTH → GLOBAL ECONOMIC  
PERFORMANCE → BETA → DIVERSIFIED PORTFOLIO PERFORMANCE**

While other factors (including alpha) also affect portfolio performance, the above relationships are very strong. In particular, the evidence cited in Section B.2 shows that beta is a more important factor in

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<sup>30</sup> Heidi Beirich and Wendy Via, *Democracies under Threat*, Global Project against Hate and Extremism (March 2021), available at [https://www.politico.eu/wp-content/uploads/2021/03/16/GPAHE\\_Democracies-Under-Threat.pdf](https://www.politico.eu/wp-content/uploads/2021/03/16/GPAHE_Democracies-Under-Threat.pdf).

<sup>31</sup> Jonathan Witts, *Amazon Rainforest 'Will Collapse If Bolsonaro Remains President'*, The Guardian (July 14, 2021) (“There are also global repercussions because land clearance is turning the Amazon region from climate friend to climate foe. A study published in Nature reveals forest burning now produces about three times more CO2 than the remaining vegetation is able to absorb. This accelerates global heating.”)

<sup>32</sup> Stéphanie Bouckaert et al., *Net Zero by 2050: A Roadmap for the Global Energy Sector*, International Energy Agency (May 2021), available at <https://www.iea.org/reports/net-zero-by-2050>.

<sup>33</sup> See, e.g., Hiroko Tabuchi, *How One Firm Drove Influence Campaigns Nationwide for Big Oil*, NEW YORK TIMES (November 11, 2020), available at <https://www.nytimes.com/2020/11/11/climate/fti-consulting.html>. (Reporting that FTI Consulting, a publicly traded company, “helped design, staff and run organizations and websites funded by energy companies that can appear to represent grass-roots support for fossil-fuel initiatives.”)

<sup>34</sup> Austin, D. (2019), *Greenwish: The Wishful Thinking Undermining the Ambition of Sustainable Business*, available at <https://preventablesurprises.com/publications/blog/greenwish-the-wishful-thinkingundermining-the-ambition-of-sustainable-business-by-duncan-austin/>.

portfolio performance than alpha, and Section B.5 shows that the pursuit of alpha by individual companies can threaten beta.

Given the very different relationships alpha and beta have to portfolio performance, fiduciaries must make sure that plans do not sacrifice the latter for the former. In fact, fiduciaries should abide by a simple rule: companies should pursue positive alpha, but only within boundaries of conduct that optimizes beta. But when plan fiduciaries use ESG integration as the sole mechanism for addressing social and environmental issues, they reverse this rule, and limit the potential for the increased beta that arises from improved social and environmental impacts to beta that comes about as a spill-over effect from company pursuit of alpha through ESG integration.

*2. Use of ESG integration to the exclusion of system stewardship encourages social and environmental cost externalization*

An exclusive focus on individual company financial performance is problematic because companies can (and often do) optimize their own financial returns by externalizing social and environmental costs, as shown in Section B.5. The costs include harmful emissions, resource depletion, and the social instability and lost opportunities caused by poor treatment of employees. Diversified shareholders (including plans) internalize the collective costs of such externalities (more than \$2 trillion in 2018 according to the Schroders report cited above) because these costs degrade and endanger the stable, healthy systems upon which economic growth and corporate financial returns depend.<sup>35</sup>

PRI, an investor initiative whose members have \$89 trillion in assets under management, recently described a variety of corporate practices that can boost individual company returns while threatening the economy and diversified investor returns:

*A company strengthening its position by externalising costs onto others. The net result for the [diversified] investor can be negative when the costs across the rest of the portfolio (or market/economy) outweigh the gains to the company;*

*A company or sector securing regulation that favours its interests over others. This can impair broader economic returns when such regulation hinders the development of other, more economic companies or sectors;*

*A company or sector successfully exploiting common environmental, social or institutional assets. Notwithstanding greater harm to societies, economies, and markets on which investment returns depend, the benefits*

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<sup>35</sup> See *The Economics of Biodiversity: The Dasgupta Review: Abridged Version* (“The inability of societies to honour [extra-legal] property rights even when they can be defined gives rise to externalities, which are the unaccounted-for consequences for others, including future people, of actions taken by one or more persons.”) available at [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/957292/Dasgupta\\_Review\\_-\\_Abridged\\_Version.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/957292/Dasgupta_Review_-_Abridged_Version.pdf)

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*to the company or sector can be large enough to incentivise and enable them to overpower any defence of common assets.<sup>36</sup>*

Thus, while individual companies driven by alpha alone can profitably externalize costs from their own narrow perspective (and the perspective of a shareholder of just that company), plans will almost surely pay these costs through lowered return on their diversified portfolios for the reasons discussed in Part B, above. Accordingly, plan fiduciaries must explicitly be empowered to go beyond ESG integration and apply system stewardship to address any and all corporate cost externalization that threatens the economy.

### 3. *System stewardship is a critical aspect of managing a diversified portfolio*

Because investors have the power to vote on directors and other matters at investees that endanger systems critical to all companies, they have the power—and the responsibility—to steward companies away from such practices. The PRI report cited above described the investor action necessary to manage social and environmental systems:

*Systemic issues require a deliberate focus on and prioritisation of outcomes at the economy or society-wide scale. This means stewardship that is less focused on the risks and returns of individual holdings, and more on addressing systemic or 'beta' issues such as climate change and corruption. It means prioritising the long-term, absolute returns for universal owners, including real-term financial and welfare outcomes for beneficiaries more broadly.<sup>37</sup>*

In a similar vein, the Freshfields report suggests that alpha-oriented strategies (e.g., ESG integration) are of limited value to diversified shareholders, and that system stewardship is the best way for investors to improve performance:

***The more diversified a portfolio, the less logical it may be to engage in stewardship to secure enterprise specific value protection or enhancement. Diversification is specifically intended to minimise idiosyncratic impacts on portfolio performance...***

*Yet diversified portfolios remain exposed to nondiversifiable risks, for example where declining environmental or social sustainability undermines the performance of whole markets or sectors... **Indeed, for***

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<sup>36</sup> *Active Ownership 2.0: The Evolution Stewardship Urgently Needs*, PRI (2019) available at <https://www.unpri.org/download?ac=9721>. See also *Addressing Climate as a Systemic Risk: A call to action for U.S. financial regulators*, Ceres (June 1, 2020), available at <https://www.ceres.org/resources/reports/addressing-climate-systemic-risk>. (“The SEC should make clear that consideration of material environmental, social and governance (ESG) risk factors, such as climate change, to portfolio value is consistent with investor fiduciary duty.”) Ceres is a non-profit organization with a network of investors with more than \$29 trillion under management.

<sup>37</sup> *Id.*

***investors who are likely to hold diversified portfolios in the long-term, the question is particularly pressing since these are likely to be the main ways in which they may be able to make a difference.***<sup>38</sup>

For similar reasons, Professor John Coffee, the Adolf A. Berle Professor of Law at Columbia University Law School and Director of its Center on Corporate Governance, predicted that system stewardship would surpass ESG integration in a recent law review article:

*This latter form of activism [system stewardship] is less interested in whether the target firm's stock price rises (or falls) than in whether the activist investor's engagement with the target causes the total value of this investor's portfolio to rise (which means that the gains to the other stocks in the portfolio exceed any loss to the target stock). This recognition that change at one firm can affect the value of other firms in the portfolio implies a new goal for activism: namely, to engineer a net gain for the portfolio, possibly by reducing "negative externalities" that one firm is imposing on other firms in the investor's portfolio.*<sup>39</sup>

The logic in both these resources is undeniable: given the critical importance of overall market return, and the danger to that return from corporate activity that damages social and environmental systems, plan fiduciaries must have the discretion to protect plans from individual companies that focus on their own performance in ways that damage overall market return. The Department can provide plan fiduciaries with confidence they can do so by clarifying that plan fiduciaries can engage with an investee to limit threats to the social and economic systems upon which other companies in the plans rely—whether or not the engagement has the purpose of enhancing the company's own financial performance.

## **6. The Proposed Rule Should Be Amended to Address Fully the Need for System Stewardship**

1. *The Proposed Rule is best read to permit system stewardship, but this authorization should be clarified*

The better reading of the Proposed Rule is that it permits plan fiduciaries to engage in system stewardship as described in the sections of *Active ownership 2.0*, the Freshfields report, and Professor Coffee's article cited in Section C.3. For the reasons described in this comment letter, system stewardship is permitted by the Proposed Rule because it is undertaken "for the exclusive purpose of providing benefits"<sup>40</sup> to participants and beneficiaries, to "further the purposes of the plan,"<sup>41</sup> and having a

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<sup>38</sup> See *supra*, n.17.

<sup>39</sup> Coffee, John C., *The Coming Shift in Shareholder Activism: From "Firm-Specific" to "Systematic Risk" Proxy Campaigns (and How to Enable them)*, p.2 (August 26, 2021). Available at SSRN: <https://ssrn.com/abstract=3908163> or <http://dx.doi.org/10.2139/ssrn.3908163>

<sup>40</sup> Proposed Rule, section (a).

<sup>41</sup> Proposed Rule, section (b)(2)(i)

positive effect on “the investment performance of the plan’s portfolio.”<sup>42</sup> This is true even when it may lead to a decrease in the financial returns of one or more individual portfolio companies. Despite the logic of this reading, we urge the Commission to modify the Proposed Rule to further clarify that system stewardship is acceptable and sometimes necessary.

2. *Three forms of ESG shareholder activity*

A modification to the Proposed Rule could address confusion in the market among ESG integration, system stewardship, and broader shareholder activism undertaken *for the purpose of improving the system in question as an end in itself* (“ends activism”). These three different forms of activism and their respective purposes are set out below:

	RETURN ORIENTATION	WOULD HAVE PURPOSE OF PROVIDING BENEFITS TO PLAN PARTICIPANTS	CONTEMPLATED TRADE-OFFS
ESG INTEGRATION	Alpha-oriented	Yes	No trade-offs contemplated
SYSTEM STEWARDSHIP	Beta-oriented	Yes	Trades off individual company returns to increase portfolio value
ENDS ACTIVISM	Not oriented to shareholder returns	No	Trades off returns of individual companies and portfolios to improve social and environmental systems

As this chart shows, ESG integration does not fully satisfy plans’ needs because it does not include all the stewardship options that would improve portfolio return, i.e., it forgoes stewarding companies to social and environmental choices that surrender return, even when doing so would improve a plan’s overall financial performance. On the other hand, ends activism goes too far for plan fiduciaries, because it asks them to accept lower overall returns for their beneficiaries in order to improve social or environmental systems.

3. *A Change to the Proposed Rule would address confusion between forms of shareholder activism*

The distinctions among the three forms of stewardship are often lost. Some shareholders may believe ESG integration is the only viable form of shareholder activity on social and environmental matters. One law review article illustrated this confusion in describing the logic behind treating ESG integration as mandatory:

<sup>42</sup> Proposed Rule (d)(3)(iii).

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*So, what has led commentators to conclude that ESG investing is mandated by the duty of prudence? The argument usually takes the form of a syllogism as follows: (1) ESG factors are related to a firm's long-term financial performance; (2) the duty of prudence requires a trustee to consider material information; and therefore (3) a trustee must consider ESG factors.<sup>43</sup>*

The confusion can be seen in the first clause of the syllogism—that the relationship of social and environmental factors to enterprise value is what motivates “ESG investing.” While this is sometimes true, it ignores the more important relationship between these factors and portfolio value discussed in Section B. The Final Rule must be grounded in the understanding that company impact on social and environmental systems is a critical determinant of portfolio returns.

But system stewardship can also be confused with ends activism because both involve tradeoffs, unlike ESG integration. Plan fiduciaries may hesitate to engage in system stewardship out of concern that it could be misapprehended as ends activism due to this surface similarity. This is unfortunate, because the fear of liability may be interfering with the optimization of plan returns. One legal scholar recently contrasted the legal preclusion of ends activism with the need for system stewardship in fulfilling a fiduciary's obligations:

*There can be no trade off of the economic benefits for plan beneficiaries against other social values [ends activism]. But engagements aimed at reducing systematic risk [system stewardship] do not run afoul of the “exclusive benefit” criterion; rather they are in service to it. **Indeed, pension fund managers who are not thinking about the systematic dimension in their engagements are falling short of the objective of maximizing risk-adjusted returns.**<sup>44</sup>*

#### 4. *Changing the Proposed Rule could overcome structural biases against system stewardship*

Fiduciaries and their advisors may also focus on alpha (and thus ESG integration) in preference to beta (and system stewardship) because the former is much more salient when gauging the performance of portfolio managers. Alpha—both positive and negative—is assessed in relation to the performance of others. Thus, the alpha asset managers achieve will always be known, and low positive or negative alpha may trigger lower compensation, client loss, or employment termination.

In contrast, measuring contribution to beta is very difficult because all diversified portfolios share the benefits (and losses) of beta changes. Thus, plan managers and their staffs may perceive little career or compensation risk in ignoring beta threats since their comparative performance will not suffer.

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<sup>43</sup> Max M. Schanzenbach & Robert H. Sitkoff, *Reconciling Fiduciary Duty and Social Conscience: The Law and Economics of ESG Investing by a Trustee*, 72 Stan. L. Rev. 381, 450 (2020)

<sup>44</sup> Jeffrey N. Gordon, *Systematic Stewardship*, ECGI Working Paper No. 566/2021, p.3 (February 2021) (emphasis added).

In 2003, Tom Jones, then the head of Citigroup's asset management unit, expressed this perverse tension when he said, "if we spend money to do shareholder activism, Citigroup asset management shareholders bear the expense but don't get a benefit that is distinct from other shareholders."<sup>45</sup> As experts recently noted, "Jones did not deny the benefits; he just valued the commercial benefits to Citigroup as a firm above those to his beneficiaries."<sup>46</sup>

System stewardship can also present business challenges to service providers. The proxy advisers and asset managers who provide services to plans may also have corporate customers. For example, asset managers who manage plan portfolios may also seek business from corporations that need retirement plan managers. Engaging in system stewardship could put the asset manager in the position of asking clients or potential clients to sacrifice internal financial return. As discussed in the next two sections, some of the largest service providers appear to engage in ESG integration only, to the exclusion of any system stewardship efforts.

#### 5. Proxy advisory services do not provide system stewardship advice

To contend with the large number of proxy voting decisions that a diversified shareholder must make on an annual basis, many plan fiduciaries rely on proxy advisory services to vote their shares, or use asset managers who rely on such services. Two companies dominate the market for these services,<sup>47</sup> but these services only provide advice based on how a vote would affect the financial performance of the company at which the vote is taken. This means diversified shareholder plans relying on these services are receiving voting advice that runs counter to beneficiaries' best interests. Indeed, as Professor Gordon suggests, they may be falling short of the exclusive benefit criterion.<sup>48</sup> For example, if a shareholder proposal requests that a company adopt a 1.5°C Science-Based Target, but such a target would impair the company's long-term financial performance (even while raising portfolio performance for the diversified client of the proxy advisor), both services would recommend a "no" vote.

For example, Glass Lewis states:

*Glass Lewis evaluates all environmental and social issues through the lens of long-term shareholder value.*

...

*When evaluating environmental and social factors that may be relevant to a given company, **Glass Lewis does so in the context of the financial***

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<sup>45</sup> Stephen Davis, Jon Lukomnik, and David Pitt-Watson, *The New Capitalists*, Harvard Business School Press (2006)

<sup>46</sup> See *supra*, n. 16.

<sup>47</sup> Paul Rose, Manhattan Institute, *Proxy Advisors and Market Power: A Review of Institutional Investor Robovoting* (April 22, 2021) ("Institutional Shareholder Services Inc. (ISS) and Glass, Lewis & Co. (Glass Lewis) . . . together control[] more than 90% of the proxy advisory market.") available at <https://www.manhattan-institute.org/proxy-advisors-market-power-review-investor-robovoting>

<sup>48</sup> *Id.*

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***materiality of the issue to the company's operations.***<sup>49</sup>

ISS takes the same position in its description of its “Global Approach” to “Social and Environmental Issues”:

*While a variety of factors goes into each analysis, the overall principle guiding all vote recommendations **focuses on how the proposal may enhance or protect shareholder value** in either the short or long term.*

*... Management and the board should be afforded the flexibility to make decisions on specific public policy positions based on **their own assessment of the most beneficial strategies for the company.***<sup>50</sup>

A more explicit Rule that acknowledged the need for system stewardship would encourage these proxy advisors to provide system stewardship-based voting advice, filling a critical gap in the current marketplace.

6. *Many large asset managers do not engage in system stewardship*

Many plan fiduciaries rely on asset managers for both security selection and stewardship services. Review of large asset managers' public statements demonstrates that they restrict ESG stewardship to matters that affect the alpha individual companies achieve while ignoring the effect their proxy voting and other stewardship activities have on beta.

**a. BlackRock**

BlackRock is the largest investment manager in the world. In a recent document codifying its views on environmental activism, BlackRock stated:

*[BlackRock] asks companies to disclose how material natural capital risks and opportunities might affect their operations, long-term strategy, capital expenditures and risk management, as well as the communities in which they operate. We encourage companies to explain how relevant risks are identified, assessed, managed and mitigated, and how opportunities are harnessed.*

...

*A company's determination of its universe of material natural capital risks should be guided by SASB, public information, and the company's*

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<sup>49</sup> Glass Lewis, 2022 Proxy Guidelines-United States (emphasis added) available at <https://www.glasslewis.com/wp-content/uploads/2021/11/US-Voting-Guidelines-US-GL-2022.pdf?hsCtaTracking=257fcf1c-f11e-4835-81a3-d13fbc7b1f4c%7C1dad2378-213f-45f6-8509-788274627609>.

<sup>50</sup> ISS Proxy Voting Guidelines Benchmark Policy Recommendations, p. 57 (effective for 2021 proxy season)(emphasis added), available at <https://www.issgovernance.com/file/policy/active/americas/US-Voting-Guidelines.pdf>.

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*stakeholder engagement. We ask questions to understand the company's perspectives and provide feedback based on our assessment of a company's approach, but we do not tell management what to do.*<sup>51</sup>

The reliance on SASB as the primary determinant of materiality demonstrates BlackRock's failure to consider companies' environmental impact beyond the limited effect that impact has on the company itself. SASB is a reporting framework that establishes standards for reporting on social and environmental issues, but determines the materiality of such issues solely by reference to their effects on the reporting company's financial performance:

*The SASB Standards... focus exclusively on enabling companies to identify the sub-set of sustainability information that is material for enterprise value creation.*<sup>52</sup>

Even more troubling is BlackRock's promise "not to tell management what to do." BlackRock and other investors' failure to impose boundaries on portfolio companies has led to a "tragedy of the commons" because in profit-driven markets, companies will not forgo profit opportunities unless their owners insist.<sup>53</sup>

Thus, a pledge from an asset owner such as BlackRock not to establish limits eliminates the possibility for effective system stewardship to address companies' negative impact on society and the environment whenever the company in question can profitably externalize such costs. As Professor Coffee explained:

*If some companies are imposing negative externalities on the market as a whole, it would be both rational and feasible for large index investors to seek to curb such conduct (at least when the gains from such efforts are expected to exceed the losses to the companies imposing such externalities).*<sup>54</sup>

But the world's largest index provider has promised not to "curb" any corporate conduct because they will "not tell management what to do."

#### **b. State Street**

State Street Corporation is the world's fourth largest asset manager, and its public documents also reveal an exclusive focus on individual company value with respect to ESG matters.

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<sup>51</sup> Blackrock, *Our Approach to Engagement on Natural Capital*, pp.2-3 (2021), available at

<https://www.blackrock.com/corporate/literature/publication/blk-commentary-engagement-on-natural-capital.pdf>.

<sup>52</sup> Statement of Intent to Work Together Towards Comprehensive Corporate Reporting (September 2020) available at

<https://29kjwb3armds2g3qi4lq2sx1-wpengine.netdna-ssl.com/wp-content/uploads/Statement-of-Intent-to-Work-Together-Towards-Comprehensive-Corporate-Reporting.pdf>.

<sup>53</sup> *Supra*, n. 35 (explaining that tragedy of the commons occurs when resources are freely available: "Because users are not charged nor required to limit their use, everyone uses it excessively.")

<sup>54</sup> *Supra*, n. 39 at 6.

State Street's description of "R-Factor"—its proprietary system for "building sustainable companies"—illustrates the problem.<sup>55</sup> R-Factor relies on materiality models that stretch across industries but are still focused on companies, not systems. It leverages "widely accepted, transparent materiality frameworks from the Sustainability Accounting Standards Board (SASB) and corporate governance codes to generate a unique ESG score for listed companies."<sup>56</sup> As discussed above, use of SASB metrics precludes the type of system stewardship necessary to protect diversified shareholders.

The focus on systemic impacts on companies rather than on company impacts on systems is consistent with statements from its Proxy Voting Guidelines:

*At State Street Global Advisors, we take our fiduciary duties as an asset manager very seriously... **The underlying goal is to maximize shareholder value...***

*Proposals that are in the best interests of shareholders, **demonstrated by enhancing share value or improving the effectiveness of the company's operations**, will be supported.<sup>57</sup>*

7. *The Final Rule should address any hesitancy to engage in system stewardship by explicitly sanctioning it*

The foregoing discussion is not meant to criticize the firms described or other market participants; rather, it is intended to show that even though the fiduciary analysis described in this letter should lead plan fiduciaries to steward systems, the system has built-in biases that may discourage such stewardship, and that even the largest firms available to service plans misunderstand the need for system stewardship.

Accordingly, the Proposed Rule should be amended to clarify that plan fiduciaries have obligations to steward systems when necessary to protect their financial returns, and that they or their designees should therefore be voting on systemic risk matters based not only on risks these matters pose to companies, but also based on the risk companies pose to plan portfolios.

## 7. Description of Proposed Changes

Language should be added to the Rule to clarify that a plan fiduciary can make investment and voting decisions with the goal of enhancing or preserving social and environmental systems, as long as the ultimate purpose is to improve the plan's overall financial performance, even if the decisions will mean foregoing certain returns or influencing one or more portfolio companies to take actions that will decrease internal financial return.

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<sup>55</sup> *R-Factor™ – A Roadmap to Build Sustainable Companies*, available at <https://www.ssga.com/us/en/institutional/ic/capabilities/esg/data-scoring/r-factor-transparent-esg-scoring>.

<sup>56</sup> *Id.*

<sup>57</sup> Global Proxy Voting and Engagement Policies (March 2020) available at <https://www.ssga.com/library-content/pdfs/ic/proxy-voting-and-engagement-guidelines-principle.pdf>.

The new language should specifically endorse strategies to improve the performance of certain financial markets and consequently improve the plan’s ability to provide benefits to participants by making decisions intended to positively affect social and environmental systems—even if such decisions could lead to expected reduced returns or greater risks at one or more portfolio companies.

This concept should apply to investment decisions, investment courses of action, and proxy voting decisions. The Rule should also specify that a fiduciary may take actions related to climate change and workforce issues that are intended to positively impact environmental and social systems to support the economy. The Rule should further clarify that the collateral benefit rule does not apply when fiduciaries take action with a view toward benefiting social and environmental systems for the purpose of improving the returns of diversified portfolios if the fiduciary has determined such action to be a reasonable course of action in providing benefits to plan participants and their beneficiaries.

The Appendix includes proposed language to effect these changes.

\* \* \* \*

For all the reasons expressed above, we urge that the Proposed Rule be modified to clarify that plan fiduciaries can and should consider not just the effect of environmental and social issues on the companies in their portfolios, but also the effect the companies in their portfolios have on social and environmental systems, to the extent such systems impact their diversified portfolios’ overall financial performance. Such guidance will encourage fiduciaries, asset managers, and proxy advisors to better serve plan participants and their beneficiaries.

Sincerely,



Frederick Alexander  
Chief Executive Officer  
The Shareholder Commons



Holly Ensign-Barstow  
Director of Stakeholder Governance and Policy  
B Lab US/CAN

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## APPENDIX: Changes to Proposed Rule

2550.404a-1. Investment duties.

...

(b) Investment prudence duties. (1) With regard to the consideration of an investment or investment course of action taken by a fiduciary of an employee benefit plan pursuant to the fiduciary's investment duties, the requirements of section 404(a)(1)(B) of the Act set forth in paragraph (a) of this section are satisfied if the fiduciary:

(i) Has given appropriate consideration to those facts and circumstances that, given the scope of such fiduciary's investment duties, the fiduciary knows or should know are relevant to the particular investment or investment course of action involved, including the role the investment or investment course of action plays in that portion of the plan's investment portfolio with respect to which the fiduciary has investment duties and the potential material effects of the investment or investment course of action on other holdings of the plan portfolio; and

(ii) Has acted accordingly.

(2) For purposes of paragraph (b)(1) of this section, "appropriate consideration" shall include, but is not necessarily limited to:

(i) A determination by the fiduciary that the particular investment or investment course of action is reasonably designed, as part of the portfolio (or, where applicable, that portion of the plan portfolio with respect to which the fiduciary has investment duties), to further the purposes of the plan, taking into consideration the risk of loss and the opportunity for gain (or other return) associated with the investment or investment course of action compared to the opportunity for gain (or other return) associated with reasonably available alternatives with similar risks; and

(ii) Consideration of the following factors as they relate to such portion of the portfolio:

(A) The composition of the portfolio with regard to diversification;

(B) The liquidity and current return of the portfolio relative to the anticipated cash flow requirements of the plan; and

(C) The 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

(iii) Consideration of the effect of the investment or investment course of action on social and environmental systems that can affect the performance of certain financial markets to the extent such performance has an impact on the plan's ability to provide benefits to participants and their beneficiaries.

...

(4) 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, which might include, for example:

(i) Climate change-related factors, such as a corporation's exposure to the real and potential economic effects of climate change including exposure to the physical and transitional risks of climate change and the positive or negative effect of Government regulations and policies to mitigate climate change;

(ii) Governance factors, such as those involving board composition, executive compensation, and transparency and accountability in corporate decision-making, as well as a corporation's avoidance of criminal liability and compliance with labor, employment, environmental, tax, and other applicable laws and regulations; and

(iii) Workforce practices, including the corporation's progress on workforce diversity, inclusion, and other drivers of employee hiring, promotion, and retention; its investment in training to develop its workforce's skill; equal employment opportunity; and labor relations.

(iv) The impact that an investment or investment course of action related to climate change-related factors or workforce practices at particular companies may have on social and environmental systems that can affect the performance of certain financial markets to the extent such performance has an impact on the plan's ability to provide benefits to participants and their beneficiaries.

(c) Investment loyalty duties.

...

(3) If, after the analysis in paragraph (c)(2) of this section, a fiduciary prudently concludes that competing investments, or competing investment courses of action, equally serve the financial interests of the plan over the appropriate time horizon, the fiduciary is not prohibited from selecting the investment, or investment course of action, based on collateral benefits other than investment returns. However, if the plan fiduciary makes such a selection in the case of a designated investment alternative for an individual account plan, the plan fiduciary must ensure that the collateral-benefit characteristic of the fund, product, or model portfolio is prominently displayed in disclosure materials provided to participants and beneficiaries. A fiduciary may not, however, accept expected reduced returns or greater risks to secure such additional benefits. Nothing in this paragraph (3) shall preclude a fiduciary from selecting an investment or investment course of action that would lead to the acceptance of expected reduced returns or greater risks at one or more companies as part of a strategy to have a positive effect on social and environmental systems that can affect the performance of certain financial markets to the extent such performance has an impact on the plan's ability to provide benefits to participants and their beneficiaries.

(d) Proxy voting and exercise of shareholder rights. (1) The fiduciary duty to manage plan assets that are shares of stock includes the management of shareholder rights appurtenant to those shares, such as the right to vote proxies.

(2)(i) When deciding whether to exercise shareholder rights and when exercising such rights, including the voting of proxies, fiduciaries must carry out their duties prudently and solely in the interests of the

participants and beneficiaries and for the exclusive purpose of providing benefits to participants and beneficiaries and defraying the reasonable expenses of administering the plan.

(ii) When deciding whether to exercise shareholder rights and when exercising shareholder rights, plan fiduciaries must:

(A) Act solely in accordance with the economic interest of the plan and its participants and beneficiaries, in a manner consistent with paragraph (c)(2) of this section;

(B) Consider any costs involved;

(C) Not subordinate the interests of the participants and beneficiaries in their retirement income or financial benefits under the plan to any other objective, or promote benefits or goals unrelated to those financial interests of the plan's participants and beneficiaries;

(D) Evaluate material facts that form the basis for any particular proxy vote or other exercise of shareholder rights; and

(E) Exercise prudence and diligence in the selection and monitoring of persons, if any, selected to exercise shareholder rights or otherwise advise on or assist with exercises of shareholder rights, such as providing research and analysis, recommendations regarding proxy votes, administrative services with voting proxies, and recordkeeping and reporting services.

(F) Consider the effect of the exercise of such rights on social and environmental systems that can affect the performance of certain financial markets to the extent such performance has an impact on the plan's ability to provide benefits to participants and their beneficiaries.

(iii) A fiduciary may not adopt a practice of following the recommendations of a proxy advisory firm or other service provider without a determination that such firm or service provider's proxy voting guidelines are consistent with the fiduciary's obligations described in paragraphs (d)(2)(ii)(A) through ~~(E)~~ of this section.

(3)(i) In deciding whether to vote a proxy pursuant to paragraphs (d)(2)(i) and (ii) of this section, fiduciaries may adopt proxy voting policies providing that the authority to vote a proxy shall be exercised pursuant to specific parameters prudently designed to serve the plan's interest in providing benefits to participants and their beneficiaries and defraying reasonable expenses of administering the plan.

(ii) Plan fiduciaries shall periodically review proxy voting policies adopted pursuant to paragraph (d)(3)(i) of this section.

(iii) ~~(A)~~ No proxy voting policies adopted pursuant to paragraph (d)(3)(i) of this section shall preclude submitting a proxy vote when the fiduciary prudently determines that the matter being voted upon is expected to have a material effect on the value of the investment or the investment performance of the plan's portfolio (or investment performance of assets under management in the case of an investment manager) after taking into account the costs involved, or refraining from voting when the fiduciary prudently determines that the matter being voted upon is not expected to have such a material effect after taking into account the costs involved.

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(B) A proxy voting policy adopted pursuant to paragraph (d)(3)(iii) of this section may require votes to be cast in a manner that would lead to the acceptance of expected reduced returns or greater risks at one or more companies as part of a strategy to have a positive effect on social and environmental systems that can affect the performance of certain financial markets to the extent such performance has an impact on to the plan's ability to provide benefits to participants and their beneficiaries.

...