

December 13, 2021

Mr. Fred Wong
Acting Chief of the Division of Regulations
Office of Regulations and Interpretations, Employee Benefits Security Administration
U.S. Department of Labor
Employee Benefits Security Administration
200 Constitution Avenue NW, Suite N-1513
Washington, DC 20210.

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

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

Dear Messrs. Wong and Khawar,

The Coalition for a Prosperous America (CPA) is the only national nonprofit organization representing the interests of domestic manufacturers, farmers, ranchers and workers.

Summary

We respectfully ask that you expand your criterion when providing greater guidance to fiduciaries on ESG factors. Specifically, social and governance factors should include consideration of

1. national security risks,
2. political risks,
3. existing sanctions on related entities or persons
4. human rights violations,
5. linkages to state-owned or state-controlled industries in countries whose governments are adversaries of the United States, and
6. compliance with investor protection rules and basic compliance standards.

Background

Title I of the Employee Retirement Income Security Act of 1974 (ERISA) establishes minimum standards that govern the operation of private-sector employee benefit plans, including fiduciary responsibility rules. Section 404 of ERISA, in part, requires that plan fiduciaries act prudently and diversify plan investments so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so. Sections 403(c) and 404(a) also require

fiduciaries to act solely in the interest of the plan's participants and beneficiaries, and for the exclusive purpose of providing benefits to participants and beneficiaries and defraying reasonable expenses of administering the plan. We believe it is important to provide guidance to fiduciaries such as to protect beneficiaries and participants.

As stated in the rulemaking announcement, proposed amendments are drafted to 29 CFR 2550.404a-1, intended to clarify the legal standard imposed by sections 404(a)(1)(A) and 404(a)(1)(B) of ERISA with respect to the selection of a plan investment or, in the case of an ERISA section 404(c) plan or other individual account plan, a designated investment alternative under the plan, and with respect to the exercise of shareholder rights, including proxy voting,

To be clear, CPA interprets this proposed rulemaking is intended to accomplish a multifaceted goal: First, **acting on material climate change and other ESG factors in these contexts**, and in a manner consistent with the proposal, is anticipated to impact employee benefit plans covered by ERISA and their participants and beneficiaries, and second, as stated¹ in the Federal Register, the new rule is to have **impact “to society more broadly** but without any detriment to the participants and beneficiaries in ERISA plans. The Department anticipates that **the resulting benefits will be appreciable.”** It is important to clarify this context of the Department’s intentions to have an impact on society more broadly, as our comments are taken into consideration. We believe our recommendations will benefit not simply plan-holders, but all of society and that they will have a long-term, appreciable affect.

As stated², “The proposed addition of paragraph (b)(4), which complements paragraph (b)(2)(ii)(C), is a new provision that addresses uncertainty under the current regulation as to whether a fiduciary may consider climate change and other ESG factors in making plan-related decisions under ERISA.” This paragraph is intended to clarify that a fiduciary may consider any factor that is material to the risk-return analysis, including climate change and other ESG factors.

For the sake of clarity and to eliminate any doubt caused by the current regulation, paragraph (b)(4) of the proposal provides examples of factors, including climate change and other ESG factors, that a fiduciary may consider in the evaluation of an investment or investment course of action if material, including: (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, 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.”

¹ <https://www.federalregister.gov/d/2021-22263/p-189>

² <https://www.federalregister.gov/d/2021-22263/p-191>

Recommendations for Improvements to Proposed Rule

Optimistically, the Department believes that many of the anticipated economic benefits under this proposal derive from the examples in paragraph (b)(4) and the clarity they provide to plan fiduciaries. “In the Department's view, and consistent with the comments of the concerned stakeholders mentioned above, the examples in paragraph (b)(4) of the proposal should go a long way to overcoming unwarranted concerns about investing in climate-change-focused or ESG-sensitive funds that are economically advantageous to plans.” **We believe, however, that these examples are lacking in comprehensiveness and the Department’s view is overly rosy, failing to account for a variety of factors, and improperly letting climate change and other environmental factors outweigh the other factors that must be considered.** Throughout the rulemaking notice, the Department repeatedly uses the phrase “climate change and other ESG factors” – continuously giving more weight to the “E” in ESG than all other factors that must be considered. This imbalanced approach to ESG is troubling and overall leaves other critical points out of consideration or evaluation altogether, while overemphasizing only one of many factors plan holders and beneficiaries value and that fiduciaries ought to take into consideration.

The proposed paragraph (b)(4) and its examples fail to provide clarity on factors such as national security risk, political risk, or other governance factors such as human rights violations records, linkages to state-owned or state-controlled industries in countries whose governments are adversaries of the United States or whose companies or leaders are sanctioned, and lack of transparency or failure to meet other compliance standards due to geographic location of a particular fund or companies represented in funds, plans, or other investor products. There is responsibility to investors, plan holders and beneficiaries, to consider political risk factors, national security risk factors, and other factors in the makeup of ESG. Paragraph (b)(4) must be amended to reflect these, as well as to account for other concerns such as how fiduciaries balance components of E, S, and G simultaneously. It is not simply acceptable to claim a plan is effective at meeting climate factors or the “E” side of ESG, if the plan invests in funds – and ultimately, companies – that are known or sanctioned for using forced labor (for an example). In terms of corporate governance, workforce development, labor, and human rights – factors under S and G categorically – steps must be taken to ensure these variables are not overwhelmed by or discounted for the sake of the “E” or climate change factor.

The problem and concern described above is not simply one of how ESG is interpreted or applied, or of some decisions that will be made by future fiduciaries, but rather one of how the overall U.S. capital market and our largest investors behave at present and what this means for Americans, retirees, pensioners, retail investors, and all of society. Ultimately, this rulemaking and interpretations of pecuniary factors, material factors, and investment behavior does not just impact beneficiaries and plan holders, but the future of our country. Our money shapes our future.

We would like to provide a few examples of how we believe changes to the interpretation of pecuniary factors in fiduciary duties and improvements through this rulemaking process would benefit plan holders, and the current unaccounted for risk exposure that we believe a proper application of ESG factors could help to mitigate. **With changes to the current rule, we believe that there will be better fiduciary decisions that protect beneficiaries from investments in**

companies that pose a material risk in the categories described above, such as national security or human rights risk, that should be considered under the ESG umbrella.

At present, analysis of the iShares ESG Aware MSCI EM ETF (ESGE), iShares Core MSCI Emerging Markets ETF (IEMG), iShares MSCI China ETF (MCHI), and iShares MSCI China A ETF (CNYA) products found that these funds are currently holding the securities of eight companies that have been placed on the U.S. Department of Commerce's Entity List for various human rights abuses, as well as three companies that are on the U.S. Department of the Treasury's Non-SDN Chinese Military-Industrial Complex Companies (CMIC) List for their involvement in China's military and surveillance sectors.

By purchasing shares in these ETFs, American retail and institutional investors are exposed to a wide range of publicly traded Chinese companies —almost all of which are not listed directly on U.S. exchanges—that are involved in malign activities that are contrary to U.S. national and economic security interests and human rights values. Many of these companies are also under U.S. economic sanctions and export controls for because they pose a direct risk to U.S. national security and are facilitating the Chinese Communist Party's (CCP) campaign of evil, including the modernization of the People's Liberation Army and Navy and China's ongoing genocide against the Uyghurs and other Muslim minorities in Xinjiang.

MSCI's criteria, and those of other index providers, to evaluate companies listed in its products fails to consider risks posed to U.S. national security, trade conflict and sanctions regimes, and human rights violations. The publicly traded securities issued by these Chinese firms represent serious risks for U.S. investors, including their failure to comply with the Public Companies Accounting Oversight Board's (PCAOB) rules for transparency and disclosure. As investment institutions know, China- and Hong Kong-based companies do not comply with the PCAOB's audit requirements, opening up American retail investors to serious fiduciary risk and potential fraud by these firms. The list of fraudulent Chinese firms listed publicly on U.S. exchanges continues to grow. While Congress and independent regulators have begun to take action to address this risk, large institutions, fund managers, and other investors have continued fiduciary malfeasance by continuing to include these bad-actor Chinese companies in its investment products. This poses a risk to all plan holders and beneficiaries if their fiduciaries are not evaluating these risks and factors, nor demanding accountability or investment behavioral change when managing these plans and choosing funds.

Congress passed the Holding Foreign Companies Accountable Act (HFCAA) to bring China- and Hong Kong-based companies into compliance with U.S. securities laws, but this new legislation only affects Chinese companies listed directly on U.S. exchanges. It neglects to address more than 4,200 A-Shares companies that are listed on Chinese exchanges but that are still available to U.S. investors through passive investment products like ETFs.

Both the Trump and Biden administrations have issued executive orders banning U.S. investment in securities of Chinese companies found to present a national security threat to the United States. Indeed, the scope of these restrictions continues to expand, with the inclusion of certain human rights abuses (by surveillance technology companies) in President Biden's Executive Order 14032 and the commitment to continue to add Chinese companies to the Non-SDN

Chinese Military Industrial Complex Companies (CMIC) List. While the rulemaking cites other executive orders as directives, including EO 14030, we ask that the capital markets sanctions EO 13959, as amended, be considered and included for evaluation of ESG factors.

Conclusion

In conclusion, we ask that you take more careful consideration to the examples outlined in proposed new paragraph (b)(4) and include examples that have a nexus to other risk factors, including national security, human rights, political, geographic, and more to adequately cover the scope of global risks experienced in today's investment market. This includes looking to executive orders and existing U.S. sanctions law where investment prohibitions are outlined for use as examples and ESG factors. While well-meaning fiduciaries see ESG as a promising way to guarantee quality to their plan holders and beneficiaries, if not properly defined, ESG is a simple farce, allowing certain companies to be heralded for checking one box, while abysmally failing to comply with the other two factors. A wholistic approach to fiduciary responsibilities and pecuniary factors when investing is a must. Climate and environmental cannot outweigh the social and governance criterion, and greater scope of variables for evaluation must be established.

CPA urges that careful consideration be given to these inclusions as the rulemaking process moves forward. ESG is a luxury of a peaceful planet working collaboratively to solve global problems through prudential investing. If not careful to steward where Americans' capital goes – and without national security safeguards – fiduciaries and our own free society will continue to funnel trillions of U.S. dollars to authoritarian regimes that do not value freedom, scoff at ESG, and build systems to destroy our very democracy and way of life. ESG is a tool and gift – it must be stewarded wisely.

Sincerely,

Robby Stephany Smith
National Security Advisor
Coalition for a Prosperous America