Principles for Responsible Investment

POLICY REPORT

118th CONGRESS: SUMMARY AND ANALYSIS OF SELECT PROPOSED LEGISLATION IN THE FINANCIAL SERVICES SECTOR

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THE PRINCIPLES FOR RESPONSIBLE INVESTMENT

The Principles for Responsible Investment (PRI) works with its international network of signatories to put the six Principles for Responsible Investment into practice. Its goals are to understand the investment implications of environmental, social and governance (ESG) issues and to support signatories in integrating these issues into investment and ownership decisions. The PRI acts in the long-term interests of its signatories, of the financial markets and economies in which they operate and ultimately of the environment and society as a whole.

The six Principles for Responsible Investment are a voluntary and aspirational set of investment principles that offer a menu of possible actions for incorporating ESG issues into investment practice. The Principles were developed by investors, for investors. In implementing them, signatories contribute to developing a more sustainable global financial system. More information: www.unpri.org

ABOUT THIS BRIEFING

This document presents summary and analysis of select proposed bills pending before the US House of Representatives and US Senate as of July 21st, 2023.

The PRI develops policy analysis and recommendations based on signatory views and evidence-based policy research. The legislative analysis below reflects the assessment of staff and does not represent an endorsement or recommendation except where explicitly stated.

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SUMMARY OF LEGISLATION

This briefing provides summary and analysis of legislative proposals that would have impacts on responsible investment practices in the United States. The briefing also includes information on a subset of related proposals that were recently introduced as part of the House Committee on Financial Services hearing "Protecting Investor Interests: Examining Environmental and Social Policy in Financial Regulation".[1] The following proposals are included in this briefing:

- **Ensuring Sound Guidance (ESG) Act:** To amend the Investment Advisers Act of 1940 and the Employee Retirement Income Security Act (ERISA) of 1974 to specify requirements concerning the consideration of pecuniary and non-pecuniary factors.
- **Freedom to Invest in a Sustainable Future Act:** To amend the Employment Retirement Income Security Act (ERISA) of 1974 to specify that retirement plans may consider certain factors when making investment decisions.
- **Investor Democracy is Expected (INDEX) Act:** To amend the Investment Advisers Act of 1940 to establish guidelines for passively managed funds (i.e., index funds) that vote shares on behalf of fund investors in proxy shareholder votes, requiring funds to vote shares on a proportional basis according to instructions from fund investors.
- **Mandatory Materiality Requirement Act:** To allow companies to only disclose SEC-mandated disclosures if the company deems the disclosure material.
- **Protect Farmers from the SEC Act:** To prevent the Securities and Exchange Commission (SEC) from requiring companies to disclose greenhouse gas emissions tied to upstream and downstream activities involving agricultural products.
- **Protecting Americans' Retirement Savings Act (PARSA):** To amend the Employment Retirement Income Security Act (ERISA) of 1974 to prohibit new plan investments in foreign adversary and sanctioned entities, and to require disclosure of existing investments in such entities.
- **Putting Investors First Act:** To increase SEC oversight of proxy advisory firms by requiring such firms to register with the SEC.

[1] House Committee on Financial Services, Hearing Entitled: "Protecting Investor Interests: Examining Environmental and Social Policy in Financial Regulation" (July 12, 2023), available at: https://financialservices.house.gov/calendar/eventsingle.aspx?EventID=408893.

ENSURING SOUND GUIDANCE (ESG) ACT

The Ensuring Sound Guidance (ESG) Act[2] was introduced by Rep. Andy Barr (R-KY) on June 21, 2023.[3] The proposal would amend the Investment Advisers Act of 1940 and ERISA to specify requirements concerning the consideration of pecuniary and non-pecuniary factors.

Summary

Section 2 would amend the Investment Advisers Act of 1940 to specify that "the best interest of a customer shall be determined using pecuniary factors, unless the customer specifically requests in writing that non-pecuniary factors be considered." If so directed, the fiduciary would be required to disclose expected effects. The fiduciary would have to disclose the effects compared to a similar index or basket of securities, including costs of considering non-pecuniary factors.

Section 3 would amend ERISA to specify that fiduciaries are considered to act solely in the interest of participants if their actions are "based only on pecuniary factors." The proposal would further prevent fiduciaries from "subordinating the interests of participants and beneficiaries" to other objectives and from sacrificing investment returns for non-pecuniary benefits or goals.

Fiduciaries would be able to use non-pecuniary factors as the deciding factor in a "tiebreaker" if they document why pecuniary factors alone were insufficient to make such a determination, how the selected investment compares to alternative investments, and how the selected nonpecuniary factor(s) are consistent with the interests of participants and beneficiaries.

Fiduciaries would not be prohibited from selecting investment options that promote non-pecuniary benefits or goals if they follow the other provisions of the proposal. However, the proposal would prevent investment options "with principal goals or strategies that use nonpecuniary factors" being used as default investment options. The proposal defines pecuniary factors as those "that a fiduciary prudently determines is expected to have a material effect on the risk and return of an investment based on appropriate investment horizons consistent with the plan's investment objectives..."

Sections 4-6 order studies of related issues, such as the impact of underfunded state and local pension plans on the federal government, including the extent to which such plans subordinate pecuniary interests to ESG objectives, and the extent to which issuers of municipal securities disclose climate change and other environmental matters to investors.

Related Legislation

Similar legislation would require pecuniary factors be used to determine customer best interest.[4]

Analysis

The proposal reflects an assessment that investment advisors and asset managers currently undertake investment analysis and decision-making that improperly considers certain factors deemed "non-pecuniary". However, current fiduciary duties in both the Investment Advisers Act and ERISA already state the responsibility investors have to clients. It is unclear what correlation there is between an additional level of scrutiny against certain information and the protections already afforded to investors. Rather, the proposal would create a subjective and arbitrary barrier for investment professionals that could limit their ability to maximize returns for clients.

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[2] Congressman Barr, "Ensuring Sound Guidance Act" (2023), working text available at https://aboutblaw.com/8NM.
[3] Congressman Barr, "H.R.4237" (June 2023), available at: https://www.congress.gov/bill/118th-congress/house-bill/4237/text?s=1&r=2.
[4] House Committee on Financial Services, "To amend the Investment Advisers Act of 1940 to specify requirements... (2023)," draft text available at: https://docs.house.gov/meetings/BA/BA00/20230712/116194/BILLS-118pih-pecuniaryandnon-pecuniaryfactors.pdf.

The term pecuniary was most prominently used in 2020 by the Department of Labor in its rulemaking, "Financial Factors in Selecting Plan Investments."[5] That rule received significant comment from the public in opposition to the proposal, specifically around the addition of the pecuniary language. When the Department proposed a new rulemaking in 2021 which removed the pecuniary language, 97% of public comments supported the new proposal.[6]

A recent academic paper[7] analyzing state-level legislation with similar pecuniary language enumerated the significant practical and legal issues with the proposed approach, calling the proposed distinction between pecuniary and non-pecuniary "unworkable". An example provided in the paper is divestment from assets linked to Russia after the Russian invasion of Ukraine in February 2022 – this action could be defined as non-pecuniary, as continuing to invest in Russian gas, for example, would have been more profitable than abandoning those investments. However, investors rewarded those who abandoned Russian investments with an increase in stock price, even when those actions created a short-term loss. Under the proposed legislation, it would be untenable to unravel pecuniary versus non-pecuniary considerations in this example.

Furthermore, by requiring that fiduciaries analyze pecuniary impacts of incorporating "nonpecuniary" factors over a maximum of three years, the proposal forces a short-term horizon on ERISA fiduciaries. As retirement plans are charged with providing for participants over multiple decades, this restriction on investment analysis runs contrary to prudent long-term investment practices.

Many organizations have already conducted analysis to determine the effectiveness of regulations like that proposed. For example, legislation purporting to prevent subordination of pecuniary interests to non-pecuniary interests in state pension funds has recently been considered in many state legislatures across the country. Fiscal analyses of these provisions determined they would impose additional (sometimes extreme) costs to taxpayers and beneficiaries. Nonpartisan legislative analysts and investment professionals covering state pension funds in Arkansas, Kansas, Texas, Indiana and Oklahoma projected lower rates of return as a result of such bills, with decadal costs ranging in the tens of millions to billions of dollars.[8]

The PRI has compiled a variety of reports and tools covering sub-sovereign debt, including the American municipal bond market specifically. Sub-sovereign (in this case, municipal) issuers often require funding to finance public services and infrastructure, which have a clear link to ESG-related outcomes.[9] PRI research has previously demonstrated the materiality of ESG risks in the US municipal debt market, which has led to growing investor demand for consistent and comparable ESG-related information from issuers.[10] The PRI has published two research reports studying ESG integration in this market,[11] as well as the critical role of municipal debt issuers in the quality of life for American families.

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[5] U.S. Department of Labor, Employee Benefits Security Administration, "Financial Factors in Selecting Plan Investments – Final Rule (November 13, 2020)," available at: https://www.federalregister.gov/documents/2020/11/13/2020-24515/financial-factors-in-selecting-plan-investments.

[6] Joel Kranc, BenefitsPRO, "Analysis of 22,000 comments on DOL stance on ESG shows majority support reversing 2020 rule (March 15, 2022)," available at: https://www.benefitspro.com/2022/03/15/analysis-of-22000-comments-on-dol-stance-on-esg-shows-majority-support-reversing-2020-rule/.

[7] David H. Webber, David Berger, and Beth Young, Harvard Law School Forum on Corporate Governance, "The Liability Trap: Why the ALEC Anti-ESG Bills Create a Legal Quagmire for Fiduciaries Connected with Public Pensions (February 27, 2023), available at: https://corpgov.law.harvard.edu/2023/02/27/the-liability-trap-why-the-alec-anti-esg-bills-create-a-legal-quagmire-for-fiduciaries-connected-with-public-pensions/

[8] Freedom to Invest, Economic Impacts (2023), available at: https://www.freedomtoinvest.org/economic-impacts/

[9] PRI, Investment Tools, "Sub-sovereign debt" (2023), available at: https://www.unpri.org/investment-tools/fixed-income/sub-sovereign-debt.

[10] Carmen Nuzzo and Jasper Cox, PRI, Blog: "US municipal bonds, ESG investors play catch up" (September 16, 2021), available at: https://www.unpri.org/pri-blog/us-municipal-bonds-esg-investors-play-catch-up/8531.article

[11] PRI, Investment Tools, "ESG Integration in Sub-Sovereign Debt: The US Municipal Bond Market" (July 28, 2021), available at: https://www.unpri.org/fixed-income/esg-integration-in-sub-sovereign-debt-the-us-municipal-bond-market/8079.article.

FREEDOM TO INVEST IN A SUSTAINABLE FUTURE ACT

The Freedom to Invest in a Sustainable Future Act, was introduced by Sen. Tina Smith (D-MN) on February 16, 2023,[12] and Rep. Suzan DelBene (D-WA) on February 21, 2023[13]. The proposal would amend the Employment Retirement Income Security Act (ERISA) of 1974 to specify that retirement plans may consider certain factors when making investment decisions.

Summary

The proposal would amend section 404(a) of ERISA, explicitly permitting fiduciaries to consider "environmental, social, governance (ESG), or similar factors" when making investment decisions, deciding strategy or setting objectives. It would also permit such information to be considered in tiebreakers when comparing investments with similar performance over the appropriate time horizon.

The proposal would exempt fiduciaries from any greater justification or documentation requirements for actions taken under the above.

The proposal would not preclude investments selected under the above provisions from "being treated as a default investment or a component of such a default investment" if it would otherwise qualify as such.

Analysis

ESG-related factors can be material and should be considered in investor risk-return analysis just as any other fact. As such, this proposal is not necessary in order to allow investors to engage in the actions it codifies. However, the inconsistent regulatory history of ESG consideration at the Department of Labor (going back more than two decades), has created continuing uncertainty for investors. The proposal would provide clarity for investors and make further iterations of the regulatory back-and-forth on the ability of ERISA fiduciaries to consider ESG-related factors less likely.

Under the proposal, fiduciaries do not need to consider ESG factors, but may do so if they believe such information would be financially material to the risk/return profile of an investment decision. The proposal does not require investors to overweight environmental, social or governance (ESG) factors, or to make investment decisions that are not in line with their fiduciary duties. Rather, it would help ensure investors' ability to utilize all available tools and information and to invest unencumbered.

The proposal codifies a number of provisions in the Department of Labor's rulemaking, "Prudence and Loyalty in Selecting Plan Investments," (the Rule) finalized in November 2022.[14] The Rule clarified that ERISA fiduciaries can consider climate and other ESG-related factors when making investment decisions and exercising shareholder rights in line with their fiduciary duties and overarching investment strategy. This provided certainty to regulated investors, allowing them to consider all factors they deem appropriate to further goals on behalf of clients. The Rule received more than 20,000 public comments, with 97% of all commenters supporting the proposal.[15]

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[12] Senator Smith, "S.523 – Freedom to Invest in Sustainable Future Act" (February 16, 2023), available at: https://www.congress.gov/bill/118th-congress/senate-bill/523/text?s=1&r=1.
[13] Representative DelBene, "H.R.1119 – Freedom to Invest in a Sustainable Future Act" (February 21, 2023), available at: https://www.congress.gov/bill/118th-congress/house-bill/1119.
[14] U.S. Department of Labor, Employee Benefits Security Administration, "Final Rule on Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights" (November 22, 2022), available at: https://www.dol.gov/agencies/ebsa/about-ebsa/our-activities/resource-center/fact-sheets/final-rule-on-prudence-and-loyalty-in-selecting-plan-investments-and-exercising-shareholder-rights.
[15] US SIF, "Blog: Public Comments Overwhelmingly Support US Labor Department Proposal To Allow ESG Considerations In Retirement Plans" (January 26, 2022), available at: https://www.ussif.org/blog_home.asp?display=182.

The Department's "Prudence and Loyalty" rulemaking was promulgated in response to two rulemakings finalized by the Department in 2020, "Financial Factors in Selecting Plan Investments"[16] and "Fiduciary Duties Regarding Proxy Voting and Shareholder Rights Changes"[17]. These rules stated that ERISA fiduciaries could only consider "pecuniary" factors (labelling ESG-related factors as generally "non-pecuniary"), imposed additional burdens on investment managers using ESG-related information, and prevented managers from using ESG-related factors in default investment options (QDIAs). These proposals were viewed as confusing and unnecessary and had the net effect of making fiduciaries wary of considering ESG-related information in risk-return analyses.[18]

[16] U.S. Department of Labor, Employee Benefits Security Administration, "Financial Factors in Selecting Plan Investments" (November 13, 2020), available at: https://www.federalregister.gov/documents/2020/11/13/2020-24515/financial-factors-in-selecting-plan-investments.
[17] U.S. Department of Labor, Employee Benefits Security Administration, "Fiduciary Duties Regarding Proxy Voting and Shareholder Rights" (December 16, 2020), available at: https://www.federalregister.gov/documents/2020/12/16/2020-27465/fiduciary-duties-regarding-proxy-voting-and-shareholder-rights.
[18] PRI, "Consultation Response: U.S. Department of Labor: Financial Factors in Selecting Plan Investments" (July 30, 2020), available at: https://dwtyzx6upklss.cloudfront.net/Uploads/f/n/b/pricomment_dolerisaproposedrule30july2020_986374.pdf; and "Consultation Response: U.S. Department of Labor: Fiduciary Duties Regarding Proxy Voting and Shareholder Rights" (October 5, 2020), available at: https://dwtyzx6upklss.cloudfront.net/Uploads/d/h/r/pricomment_dolfiduciarydutiesreproxyvotingandshareholderrightsrin1210ab91_20956.pdf.

INDEX ACT

The Investor Democracy is Expected (INDEX) Act was introduced by Rep. Bill Huizenga (R-MI) on July 27, 2022,[19] and by Sen. Dan Sullivan (R-AK) on June 14, 2022.[20] The proposal would amend the Investment Advisers Act of 1940 to establish guidelines for passively managed funds that vote shares on behalf of fund investors in proxy shareholder votes. Under the proposal, these funds would be required to vote shares on a proportional basis according to instructions from fund investors.

Summary

Section 2 would require certain funds to allow the underlying asset owner to determine how their portion of shares vote on proxy matters. The proposal would bar funds from voting proportional shares where they have not received instructions from asset owners. This rule includes funds defined as passively managed (those allocating at least 40% of funds to passive strategies) that are controlled by advisors with more than 1% ownership of a company. Advisers would be able to vote on routine matters without instruction, but not items such as shareholder proposals or election of directors.[21]

Fund managers would further be required to provide the same voting information to all asset owners on a regular basis, including a proxy/information statement, an annual report from the applicable registrant, and voting instructions. Fund managers would be able to provide voting recommendations from an external adviser if they also allowed recommendations to be provided "by third parties on a non-discriminatory basis and on a wide range of views."

Finally, the proposal would amend the Investment Advisers Act of 1940 to require investment advisers of passively managed funds to arrange for pass-through voting of proxies for certain securities.

Related Legislation

A similar proposal[22] would replace the proportional voting requirements in the original proposal with a requirement that an investment adviser to vote covered securities "in accordance with the instructions of the beneficial owner," "in accordance with the voting instructions of such issuer," or to abstain from voting. This would not apply to routine matters.

Analysis

The proposal risks increasing the costs and administrative burdens for asset owners by requiring them to perform a core function that already exists within the fiduciary duties assigned to professional asset managers. Rather, efforts should be made to empower managers to engage with investee companies and to better understand and incorporate the preferences of beneficiaries.

Voting proxies is an effective tool that listed equity investors use to engage with investee company management and share their views and expectations. Many institutional investors recognize proxy voting as part of their fiduciary duty to clients and beneficiaries because it can be used to influence

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[19] Congressman Huizenga, "H.R.8521 – INDEX Act" (July 27, 2022), available at: https://www.congress.gov/bill/117th-congress/house-bill/8521.
[20] Senator Sullivan, "S.4241 – INDEX Act" (June 14, 2022), available at: https://www.congress.gov/bill/117th-congress/senate-bill/4241.
[21] Thomas W. Christopher, Taylor Pullins, and Fatima A. Hassan Ali, White & Case LLP, "The INDEX Act: A challenge to the voting influence of institutional investors that may yield unintended consequences" (November 3, 2022), available at: https://www.whitecase.com/insight-our-thinking/index-act-challenge-voting-influence-institutional-investors-may-yield.
[22] House Committee on Financial Services, "To amend the Investment Advisers Act of 1940 with respect to proxy voting…" (2023), draft text available at: https://docs.house.gov/meetings/BA/BA00/20230712/116194/BILLS-118pih-InvestmentAdvisersActof1940withrespecttoproxyvotingofpassivelymanagedfundsandforotherpurposes.pdf.

corporate behavior, and thus, returns. While shareholder resolutions are nonbinding, they set clear expectations and communicate investor preferences.[23]

The proposal implies that fund managers do not always vote in the best interest of the fund and underlying asset owners. However, current fiduciary duties in both the Investment Advisers Act and ERISA already state the responsibility investors have to clients. There also currently exists a robust system of disclosures for funds that fully enumerate objectives, strategy, and voting history for investors to understand and monitor the activities of fund managers.

As recently as 2021 and 2022, the Securities and Exchange Commission (SEC) finalized two rules to improve the proxy voting process via better communication and enhanced disclosure:

- The SEC established universal proxy voting cards, establishing a more transparent process for shareholders when voting for board candidates.[24]
- The SEC enhanced the required disclosures of Form N-PX, the annual disclosure required of all funds enumerating its proxy votes, to make the form more understandable for investors.[25]

The SEC has also proposed updates to the Investment Company Names[26] rule to ensure a fund's name—the most prominent disclosure of a fund—matches the underlying assets within that fund, and a new rule to improve ESG-related disclosure from funds and advisers[27].

Requiring affirmative instructions from asset owners in order to vote proxies is overly burdensome and would prevent fiduciaries from fully utilizing their delegated authority to maximize returns for clients. This additional barrier to shareholder engagement could lead to a hemorrhaging of affected shareholder votes, and a significant weakening of the power of shareholders to voice their opinion with management. The role of professional asset managers is to manage financial matters for clients (with varying levels of financial expertise) who are then free to focus on areas of expertise where their time is more economically utilized.

Finally, the provision concerning whether an "adviser permits voting recommendations to be provided to voting persons by third parties" would breach the fiduciary duties of the client-advisor relationship. As written, the full implications of this provision are unclear and pose a risk to the financial interests of investors. For example, it is unclear:

- If third parties would be bound by the same fiduciary duties as investment managers.
- Who pays for the advice and operations of third parties.
- Which party assumes the cost of incorporating recommendations from interested parties.

Inclusion of "third party" recommendations would require either that third parties are funded by outside interests—which may or may not align with the interests of the asset owner—or are subsidized by the asset owner whether they want additional opinions or not. This provision runs counter to the heightened fiduciary protection the proposal alleges to strengthen.

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[23] PRI, Investment Tools, "Are corporate boards responding to successful shareholder ESG proposals? (March 1, 2023), available at: https://www.unpri.org/active-ownership-20/are-corporate-boards-responding-to-successful-shareholder-esg-proposals/11160.article.
[24] PRI, "Consultation Response: Securities and Exchange Commission: Reopening of Comment Period on Universal Proxy" (June 7, 2021), available at: https://dwtyzx6upklss.cloudfront.net/Uploads/l/t/a/priuniversalproxyconsultation7june_977493.pdf.
[25] PRI, "Consultation Response: Enhanced Reporting of Proxy Votes by Registered Management Investment Companies; Reporting of Executive Compensation Votes by Institutional Investment Managers; File Number S7-11-21" (December 14, 2021), available at: https://dwtyzx6upklss.cloudfront.net/Uploads/w/v/c/priconsultation_formnpx_442144.pdf.
[26] U.S. Securities and Exchange Commission, "SEC Proposes Rule Changes to Prevent Misleading or Deceptive Fund Names" (May 25, 2022), available at: https://www.sec.gov/news/press-release/2022-91.
[27] U.S. Securities and Exchange Commission, "SEC Proposes to Enhance Disclosures by Certain Investment Advisers and Investment Companies About ESG Investment Practices" (May 25, 2022), available at: https://www.sec.gov/news/press-release/2022-92.

MANDATORY MATERIALITY REQUIREMENT ACT

The Mandatory Materiality Requirement Act was introduced by Sen. Mike Rounds (R-SD)[28] and by Reps. Barr (R-KY) and Huizenga (R-MI) on June 15, 2023.[29] It would allow companies to only disclose SEC-mandated disclosures if the company deems the disclosure material.

Summary

The proposal would amend the Securities Act of 1933 and the Securities Exchange Act of 1934 such that when the SEC considers new rules regarding disclosure obligations, issuers would only be required to disclose such information “if the issuer has determined that such information is important with respect to a voting or investment decision regarding the issuer.”

The proposal would define information as important with respect to a voting or investment decision “if there is a substantial likelihood that a reasonable investor would view the failure to disclose that information as having significantly altered the total mix of information made available to the investor.”

Related Legislation

A similar proposal[30] would require the SEC to report on mandates under federal securities laws and regulations that require disclosure of non-material information, and exempt persons who fail to disclose such information from liability in private action.

Analysis

The proposal would fundamentally redefine the securities disclosure laws that have been in place since after the Great Depression, allowing public issuers to opt out of any disclosure they deem immaterial. This would significantly limit the SEC’s ability to carry out its statutory mission and have substantial material consequences for the information provided to investors.

Materiality is not an appropriate limitation to set on a regulatory agency charged with protecting the savings of Americans and ensuring the long-term stability of US financial markets. Materiality is merely a tool, for example, to assist corporate managers in determining what set of information to share with owners, and for investors in determining how to sift through the universe of information for that relevant to an investment decision. The subjective and temporal nature of a determination of materiality for any piece of information makes this proposal unworkable and unenforceable.

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[28] Senator Rounds, “S.2005 – Mandatory Materiality Requirement Act of 2023” (June 15, 2023), available at: https://www.congress.gov/bill/118th-congress/senate-bill/2005/text?s=2&r=7.

[29] Representative Huizenga and Representative Barr, “H.R.4168 – To amend the Securities Act of 1933 to require that information required to be disclosed…” (June 15, 2023), available at: https://www.congress.gov/bill/118th-congress/house-bill/4168?s=1&r=7.

[30] House Committee on Financial Services, “To amend the Securities Exchange Act of 1934 to require the Securities and Exchange Commission to disclose…” (2023), draft text available at: https://docs.house.gov/meetings/BA/BA00/20230712/116194/BILLS-118pih-non-materialdisclosuremandatesandforotherpurposes.pdf.

PROTECT FARMERS FROM THE SEC ACT

The Protect Farmers from the SEC Act was introduced by Rep. Frank Lucas (R-OK) on February 14, 2023,[31] and by Sen. John Boozman (R-AR) on February 13, 2023.[32] The proposal would prevent the Securities and Exchange Commission (SEC) from requiring companies to disclose greenhouse gas emissions tied to upstream and downstream activities involving agricultural products.

Summary

The proposal would amend the Securities Exchange Act of 1934 to prevent the SEC from requiring an issuer "to disclose greenhouse gas emissions from upstream or downstream activities in the issuer's value chain from the production, manufacturing, or harvesting of an agricultural product...

The proposal defines "downstream activities" as activities related to "processing materials into a finished product and delivering it or providing a service to the end user. It defines "upstream activities" as activities related to "the initial stages of producing a good or service."

Analysis

The proposal risks preventing investors from having access to information material to investment performance. Access to material information is necessary to fully evaluate potential investments and derive the highest possible risk-adjusted returns for their clients. Exposure to unmitigated risks—whether direct or through value chains—must be accounted for.

Evidence of the immediate financial materiality of climate-related risks continues to grow. By excluding certain information from disclosures, investors are unable to fully understand the risks and opportunities associated with those unknown investments, in this case, agricultural. For example, California's agriculture industry has faced direct risks that include two of the largest wildfires ever recorded, occurring in only the last decade. Companies face a growing list of equally critical chronic risks, such as rising temperatures and declining water availability.

Additional disclosures do place a burden of compliance costs on firms. Recognizing this, the SEC's Proposed Rule allows for estimations to be submitted for emissions measurements and for safe harbors to be established for these estimations beyond those already in place for forward-looking disclosures. Agricultural companies should be able to utilize estimates for the vast majority of their Scope 3 emissions reporting, not requiring additional work from their smallest suppliers. Already, a wide range of tools exists to help registrants calculate such data, offered publicly by the EPA, USDA, and state agricultural agencies, as well as privately by various data services.[33]

Global markets are moving toward universal emissions disclosure. Whether required by the SEC or not, in the near future all companies will be reporting increasing emissions-related information. For example, the International Sustainability Standards Board, created by the IFRS Foundation which sets accounting standards for 140 jurisdictions, recently released its baseline climate-related disclosures for companies, including emissions disclosures.

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[31] Representative Lucas, "H.R.1018 – Protect Farmers from the SEC Act" (February 14, 2023), available at: https://www.congress.gov/bill/118th-congress/house-bill/1018/text.
[32] Senator Boozman, "S.391 – Protect Farmers from the SEC Act" (February 13, 2023), available at: https://www.congress.gov/bill/118th-congress/senate-bill/391/text.
[33] Institute for Agriculture & Trade Policy, "Letter to the SEC on the Enhancement and Standardization of Climate-Related Disclosures for Investors" (March 15, 2023), available at: https://www.iatp.org/letter-sec-enhancement-standardization-climate-related-disclosures.

PROTECTING AMERICANS' RETIREMENT SAVINGS ACT

The Protecting Americans' Retirement Savings Act (PARSA) was introduced by Rep. Jim Banks (R-IN) June 12, 2023.[34] The proposal would amend the Employment Retirement Income Security Act (ERISA) of 1974 to prohibit new plan investments in foreign adversary and sanctioned entities, and to require disclosure of existing investments in such entities.

Summary

The proposal would amend ERISA Section 404(a), the "Prudent man standard of care,"[35] to prohibit fiduciaries from allowing plans to acquire interests, lending money or extending credit, providing goods or services, or transferring assets or data to a foreign adversary or sanctioned entity. In the case of a plan holding such investments at time of enactment, they may continue to hold them if they comply with the reporting requirements; the same applies to contractually obligated investments.

The proposal would provide for additional disclosures for ERISA funds, including:

- A separate statement of all plan assets consisting of an interest in a sanctioned entity, including aggregate value of such assets, identity of sanctioned entities, and the lists where sanctioned entities are listed and reason for listing.
- A separate statement of all plan assets consisting of interests in foreign adversary entities, including aggregate value, specific interest and value, name of investment vehicle, name of fiduciary responsible for the investment, and statement of factors considered in maintaining such investment.
- A description of any ongoing agreement subject to the proposal, including assets involved, the agreement's date of expiration, date on which the commitment may be terminated, and any other information deemed appropriate.

Analysis

This proposal risks interfering with investor's risk-return analysis and investment decision-making. Investment managers acting as fiduciaries to ERISA funds should be free to determine which investment decisions will maximize returns for beneficiaries.

The PRI does not advocate divestment in any particular circumstance but rather as one tool of an investment manager. It is up to each investment manager to determine the best course of action for their client, including whether to divest or hold the investment and engage with management.[36]

One such example is the significant number of investors and companies that divested from assets linked to Russia after the Russian invasion of Ukraine in February 2022. When an investor's concern is a company's links to a particular state or region, engagement may not be a viable option, as the intent is not to influence corporate behavior but rather to contribute to a larger package of economic sanctions led by policy makers.[37] In these cases, fiduciaries should be transparent with beneficiaries regarding the extent to which divestment is driven by risk management, ethical or values-based alignment, and/or an attempt to shape real-world outcomes.

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[34] Representative Banks, "H.R.4008 – Protecting Americans' Retirement Savings Act" (June 12, 2023), available at: https://www.congress.gov/bill/118th-congress/house-bill/4008/text?s=1&r=7.
[35] Cornell Law School, Legal Information Institute, "29 U.S. Code § 1104 – Fiduciary duties," available at: https://www.law.cornell.edu/uscode/text/29/1104.
[36] PRI, Investment Tools, "Discussing divestment: Developing an approach when pursuing sustainability outcomes in listed equities" (April 4, 2022): available at: https://www.unpri.org/stewardship/discussing-divestment-developing-an-approach-when-pursuing-sustainability-outcomes-in-listed-equities/9594.article.
[37] Ibid.

Under ERISA, fiduciaries are charged with acting in the sole interest of plan participants and beneficiaries, “for the exclusive purpose of providing benefits to participants and their beneficiaries and defraying reasonable expenses of administering the plan.”[38] Accordingly, a fiduciary acting in the best interest of their beneficiaries should be entrusted to make reasonable decisions to improve risk-adjusted returns. Rather than dictate which actions fiduciaries must take, ERISA funds should be allowed to make their own decisions regarding engagement or divestment from any entities.

The proposed disclosures would impose burdensome reporting requirements on ERISA fiduciaries. Many companies may not perform such in-depth analysis of the locations in which they do business as would be required by the proposal. A more workable solution might be amending annual disclosures to require more in-depth detail of specific location-based business interests, which would allow financial companies to offer specific exclusionary funds, if investors demand them.[39] As is, the level of additional diligence required would be unworkable for both issuers and fiduciaries.

A more limited proposal creating additional disclosure of certain holdings could be useful, granted these disclosures are not overly costly and burdensome to produce. Providing more information to asset owners could then allow for greater engagement by asset owners and expression of beneficiary preferences.

[38] Cornell Law School, Legal Information Institute, “29 U.S. Code § 1104 – Fiduciary duties,” available at: https://www.law.cornell.edu/uscode/text/29/1104.

[39] Shivaram Rajgopal, Forbes, “How Is The GOP’s Bill Asking ERISA Fiduciaries To Avoid New Investments In “Adversarial” Countries Consistent With The Party’s Stated Ideal Of Freedom Of Choice In Investing?” (June 22, 2023), available at: https://www.forbes.com/sites/shivaramrajgopal/2023/06/22/how-is-the-gops-bill-asking-erisa-fiduciaries-to-avoid-new-investments-in-adversarial-countries-consistent-with-the-partys-stated-ideal-of-freedom-of-choice-in-investing/?sh=24c60e654380.

PUTTING INVESTORS FIRST ACT

The Putting Investors First Act was introduced by Rep. Bryan Steil (R-WI) on Jan. 24, 2023,[40] and Sen. Bill Hagerty (R-TN) on June 1, 2023,[41] respectively. The proposal would increase SEC oversight of proxy advisory firms by requiring such firms to register with the SEC. It would also prohibit unregistered proxy advisory firms from using interstate commerce to provide advice, research, analysis, or recommendations to any client.

Summary

Sections 2 and 3 would require registration of proxy advisory firms, including (but not limited to) organization, registration processes, governance structures, etc.

Section 4 would require "any covered entity that retains the services of a proxy advisory firm" to report the following to beneficiaries and customers:

- The percentage of votes cast on shareholder proposals that follow the proxy advisory firm's recommendations.
- The percentage of votes cast on ESG-related shareholder proposals that followed the proxy advisory firm's recommendations.
- An explanation of how recommendations are used and evaluated.
- A requirement to provide shareholders with a mechanism to indicate how their asset manager should vote on their behalf, as well as economic analyses used in votes.

Section 5 would require an investment company that offers an ESG fund to disclose returns and fees associated with any ESG funds and comparisons to non-ESG funds offered by the same company (or a reasonably comparable one, if the company only offers ESG funds).

Section 6 would allow for exclusion of shareholder resolutions if the issue in question is not germane (e.g., a major social issue). It would also allow resolutions to be excluded if they would address substantially the same subject matter as a proposal considered in the previous five years, and voted on most recently in the previous three years, and if the proposal received less than 5 percent of the vote during a single vote; 15 percent of the vote during two votes; or 25 percent of the vote during three votes.

Section 7 directs the SEC to issue rules prohibiting robovoting "with respect to votes related to proxy or consent solicitation materials."

Section 8 creates liability for failures to disclose "material related to proxy voting advice."

Section 9 requires the SEC to report, every five years, the costs incurred by issuers in responding to "politically, environmentally, or socially motivated shareholder proposals," and proposals "that failed to be agreed to more than once," as well as qualifications, fee structures sources, and potential legal violations and associated costs that could arise from following proxy voting advice.

Related Legislation

Similar proposals would alter, replace, or expand upon provisions in the original proposal. These include proposals that would raise resubmission thresholds further than the 5, 15, 25% threshold ,[42] or

[40] Representative Steil, "H.R.448 – Putting Investors First Act of 2023" (January 24, 2023), available at: https://www.congress.gov/bill/118th-congress/house-bill/448/text.
[41] Senator Hagerty, "S.1799 – Putting Investors First Act of 2023" (June 1, 2023), available at: https://www.congress.gov/bill/118th-congress/senate-bill/1799.
[42] House Committee on Financial Services, "To authorize the exclusion of shareholder proposals from proxy or consent solicitation material…" (2023), draft text available at: https://docs.house.gov/meetings/BA/BA00/20230712/116194/BILLS-118pih-exclusionofshareholderproposalsfromproxyorconsentsolicitationmaterial.pdf.

otherwise impose restrictions on submission of shareholder proposals or empower company management to exclude or disregard a wide range of proposals[43] (such as removing the significant social policy exception).[44] A variety of proposals covering registration of proxy advisory firms recommend amended components of the original proposal, such as extensive disclosure of methodologies,[45][46] restrictions on robovoting,[47] or to extend such disclosure of due diligence to institutional investment managers.[48]

Analysis

The proposal does not accurately reflect the investment environment and the business relationship between investment advisors and fund managers. The proposal reflects an assessment that proxy advisory firms maintain inappropriate levels of influence on institutional investors and encourage investors to support non-financial objectives "at the expense of long-term shareholder returns."[49]

Voting proxies is an effective tool that listed equity investors use to engage with investee company management and share their views and expectations. Many institutional investors recognize proxy voting as part of their fiduciary duty to clients and beneficiaries because it can be used to influence corporate behavior, and thus, returns. While shareholder resolutions are nonbinding, they set clear expectations and communicate investor preferences.[50]

Investors—managers and asset owners alike—increasingly recognize that ESG-related factors are relevant to the value of their investments over the short- and long-term. Their enhanced scrutiny of corporate management of ESG-related risks and opportunities stems from the fundamental desires of investors to protect value and maximize risk adjusted returns. The underlying demands of asset owners are driving these trends toward enhanced scrutiny of corporate ESG activities not simply because they seek to "do good" but because of the potential for material impacts on returns.

Current fiduciary duties in both the Investment Advisers Act and ERISA already state the responsibility investors have to clients. As part of their duties, investment managers actively engage with portfolio companies in efforts to realize returns for clients. Like any third-party recommendation to an independent business, it is up to that business to determine how to utilize third-party advice to achieve its goals. Investment managers are ultimately responsible for conducting due diligence on third-party advisory services and ensuring their proxy voting policies are implemented correctly.

Section 6 would codify current regulations around resubmission of shareholder resolutions that were made over objections of the vast majority of public commenters and without appropriate analysis from

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[43] House Committee on Financial Services, "To amend the Securities Exchange Act of 1934 to prohibit the Securities and Exchange Commission from compelling the inclusion or discussion of shareholder proposals…" (2023), draft text available at: https://docs.house.gov/meetings/BA/BA00/20230712/116194/BILLS-118pih-toprohibittheSecuritiesandExchangeCommissionfromcompellingtheinclusion.pdf.
[44] House Committee on Financial Services, "To clarify that an issuer may exclude a shareholder proposal…" (2023), draft text available at: https://docs.house.gov/meetings/BA/BA00/20230712/116194/BILLS-118pih-24014a-8ioftitle17.pdf.
[45] House Committee on Financial Services, "To amend the Securities Exchange Act of 1934 to provide for the registration of proxy advisory firms, and for other purposes" (2023), draft text available at: https://docs.house.gov/meetings/BA/BA00/20230712/116194/BILLS-118pih-registrationofproxyadvisoryfirms.pdf.
[46] House Committee on Financial Services, "To amend the Securities Exchange Act of 1934 …" (2023), draft text available at: https://docs.house.gov/meetings/BA/BA00/20230712/116194/BILLS-118pih-provideforliabilityforcertainfailurestodisclose.pdf.
[47] House Committee on Financial Services, "To amend the Securities Exchange Act of 1934 to prohibit robovoting with respect to votes related to proxy…" (2023), draft text available at: https://docs.house.gov/meetings/BA/BA00/20230712/116194/BILLS-118pih-prohibitrobovotingwithrespecttovotesrelatedtoproxyorconsentsolicitationmaterials.pdf.
[48] House Committee on Financial Services, "To amend the Securities Exchange Act of 1934 …" (2023), draft text available at: https://docs.house.gov/meetings/BA/BA00/20230712/116194/BILLS-118pih-providefordutiesofcertaininvestmentadvisorsassetmanagersandpensionfunds.pdf.
[49] U.S. Chamber of Commerce, "U.S. Chamber Letter on the "Putting Investors First Act"" (January 26, 2023), available at: https://www.uschamber.com/finance/u-s-chamber-letter-on-the-putting-investors-first-act.
[50] PRI, Investment Tools, "Are corporate boards responding to successful shareholder ESG proposals?" (March 1, 2023), available at: https://www.unpri.org/active-ownership-20/are-corporate-boards-responding-to-successful-shareholder-esg-proposals/11160.article.

the SEC's Division of Economic and Risk Analysis.[51][52][53] This change to the proxy resubmission rules created additional barriers to shareholder engagement and disproportionately harmed retail investors, who are traditionally least able to have their views heard.

Section 9 would increase the regulatory requirements for providing recommendations on ESG-related resolutions. This would place an unreasonable burden on a diverse subset of resolutions considering material risks to business performance. Shareholders should not be encumbered in efforts to express their views to management on material issues.

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[51] Ibid.

[52] S.P. Kothari, Comment to SEC File S7-23-19: Procedural Requirements and Resubmission Thresholds under Exchange Act Rule 14a-8, "Analysis of Data Provided by Broadridge Financial Solutions, Inc." (August 14, 2020), available at: https://www.sec.gov/comments/s7-23-19/s72319-7645492-222330.pdf.

[53] U.S. Securities and Exchange Commission, "File No. S7-23-19: Procedural Requirements and Resubmission Thresholds under Exchange Act Rule 14a-8 – Final Rule" (2020), available at: https://www.sec.gov/rules/final/2020/34-89964.pdf.