Subcommittee on Capital Markets Hearing: "Reforming the Proxy Process to Safeguard Investor Interests"

July 13, 2023

Testimony of Nell Minow Vice-Chair, ValueEdge Advisors[1]

I am very grateful for the opportunity to share my thoughts on the proxy process and shareholder resolutions. I welcome your questions and will submit supplemental materials as necessary following this session and the related hearings on ESG and proxy advisors. I am particularly grateful for the opportunity to remind my fellow panelists about the essential elements of transparency and accountability that are the foundation of capitalism and the reason the markets of this country are the strongest, the most robust, and the greatest creators of wealth for investors and employees in the world. I am always disappointed to see the lengths corporate insiders and their service providers will go to insulate themselves from minimal transparency and feedback.

I have worked on behalf of shareholders since 1986 in a series of companies co-founded with Robert A.G. Monks and Rick Bennett, starting with Institutional Shareholder Services, all previous companies profitably sold and doing well. I met Bob Monks when I was at OMB and he was on the staff of then-Vice President George H.W. Bush on President Reagan's Task Force on Regulatory Relief, where we worked with the late Boyden Gray, who was an exemplar of free market economics.

I would like to state for the record that I have included my firm purely for identification. No one is paying me to be here and neither I nor our clients have any financial interest in any legislation or regulatory activity on these matters. I emphasize this because my experience with

[1] I have been following the issues we are here to comment on since 1986, when I was the fourth person hired and the first General Counsel of Institutional Shareholder Services. I met the founder of ISS, Robert A.G. Monks, when I was at OMB and he was working for then Vice President George H.W. Bush. We worked together, with the late Boyden Gray on President Reagan's Commission on Regulatory Relief. Later I was the CEO of ISS, until I left in 1990.

those who comment on these issues is that they often disguise their financial interest in the policies being discussed.[2]
The appendices to this testimony include my recent comment to OMB listing some of the Orwellian names of the fake, dark money front groups that are distorting the legislative and regulatory processes on these issues.

The sole and only reason capitalism works is the ability of investors, the providers of capital, to have some oversight to minimize what economists call agency costs and lawyers like me call conflicts of interest. We would not have capitalism if businesses took money from investors and just said, "Trust me." Markets do not run on money; they run on trust, and in the words of Ronald Reagan, "trust but verify." This is why the US has the most meaningful disclosure requirements in the world, but disclosure is not worth much if shareholders cannot respond to it.

That essential oversight is grounded in shareholder rights, including the ability to buy and sell, limited liability, shareholder litigation, and proxy voting, including votes on management proposals to elect directors, appoint auditors, and approve executive compensation, and advisory proposals from other shareholders on matters that fall within the very narrow requirements of the SEC's rules. For example, that means they cannot pertain to what is classified as "ordinary business," the daily decisions about products and operations. Yet they do have to be relevant, within the control of the company's board and managers. You can submit a shareholder resolution asking a software company to sell brownies, but the SEC will keep it off the proxy card. So the proposal has to be significant enough to be relevant but not central enough to constitute ordinary business. The proponent is limited to 500 words for discussion of the issue, while the company has no limits in its response and full access to the company treasury to fight it.

I am certain I do not need to explain to Members of Congress why it is important to allow affected parties to vote on important issues.

Four key points about shareholder proposals.

1. **Only a small percentage of companies receive proposals from shareholders each year.** The household name companies get several, and many companies get one or two, but most companies get none. The majority of public companies do not receive any shareholder proposals. On average, 13 percent of Russell 3000 companies received a shareholder proposal in a particular year between 2004 and 2017.2 In other words, the average Russell 3000 company can expect to receive a shareholder proposal once every 7.7 years. For companies that receive a shareholder proposal, the median number is one per year. Many of these proposals are withdrawn after conversations with the company. Self-reported, undocumented claims about the costs of reviewing and responding to shareholder proposals are wildly inflated and should be reviewed with skepticism as self-serving.
2. **Even a 100 percent vote in favor of a shareholder proposal is advisory only**[3]. Company executives can and do ignore significant, even majority votes. I am not

[2] For example: https://inequality.org/research/big-money-behind-fight-to-ban-responsible-investing/
[3] There is one small exception, but it is so rarely used, not once in recent memory, that it is not relevant here.

objecting to keeping shareholder proposals non-binding, which is in any event a matter of state law and outside the jurisdiction of Congress. But I emphasize that therefore, any downside risk from a shareholder vote on any topic is negligible, even non-existent. And the benefit of knowing what investors think is enormous; if management disagrees with the vote, at least they will learn that they are not communicating effectively and can do better. Limiting shareholder proposals is killing the messenger. It would be like telling customers they could not complain about products or services. Proposals are one of the very few ways insulated insiders hear honest feedback.

3. **While a small number of people are responsible for a large percentage of shareholder proposals, the far more significant number is the level of support those proposals receive**. We already have a system in place to keep proposals that do not get minimum levels of support off the proxy card, and indeed that was the fate of most of the anti-ESG proposals voted on this year. But it does not matter who files the proposals; what matters is whether they get widespread support from a variety of shareholders. If there are votes in favor from large and small funds and individuals, index funds and managed funds, pension funds and foundations, that is the best possible market test, and market tests are what keep companies and the economy strong.
4. **No one is required to purchase the services of a proxy advisory firm**. Many institutional investors do not. Those who do are not obligated to follow their recommendations. Indeed, the data show that while they do follow the advice on routine matters like re-electing directors and approving auditors (over 90 percent of proxy advisor recommendations are to vote with management), their clients review their analyses and then make their own decisions on the more complex and controversial issues like business combinations. ProxyInsight produced a study[4] proving that only 21 percent of investors use the proxy voting policy of a Proxy Voting Advisor and of the 1,086 investors surveyed 70.9 percent vote proxies based on their own policies with a further 8.5 percent delegating to a sub advisor or other asset manager.

   These services are purchased by the most sophisticated financial professionals in the world. Those that choose to work with a proxy advisor can pick a registered investment advisor, one that is a registered NRSRO, or one who is not, one that offers consulting services to corporations or one that does not. Or more than one, to compare their analyses, as some do. While there have been claims over the past few years that there is a "duopoly," that is clearly not the case as anti-ESG fund manager and Presidential candidate Vivek Ramaswamy created an anti-ESG proxy advisory firm[5] this year and it already has at least one major institutional investor client.[6]

   This is exactly how markets are supposed to work and it would be a catastrophic intrusion of the nanny state to interfere with a product that is purchased voluntarily by highly expert customers, just as they purchase many other independent research services to help them with investment decisions.

[4] https://www.proxyinsight.com/research/Proxy Insight PVA Research_151015023727.pdf
[5] https://strive.com/proxy-services/
[6] https://www.pionline.com/governance/pension-fund-nears-deal-anti-esg-firm-strive-proxy-voting-alternative

Further on the subject of proxy advisory firms: Up to 1986, there were no firms providing comprehensive proxy advisory services, just some specialty firms covering what today we would call social issues. In fact, ISS was not created to sell proxy advisory services. But when Bob Monks tried to sell the products we originally planned, no one wanted them. Instead, our prospective clients told us what they did want was independent advice on proxy proposals, which had suddenly become complex and controversial after decades of routine votes to re-elect the board and approve the audit firm.

That was the era of the hostile takeover, made possible by the invention of junk bonds that could finance even the largest acquisitions. And so, it was the era of abuse of investors by both raiders (as we called them in those days) and entrenched management (as we still call them). It was also the era of the rise of the institutional investor, pension funds and mutual funds, for example. And so, two powerful forces collided. For the first time there were widespread attacks on shareholder value and for the first time there were shareholders big enough to act, smart enough to know when it was necessary, and, as fiduciaries, obligated to do so when it was in the best interests of the beneficial holders.

There were some scandals, particularly the "Avon letter" matter, when the Department of Labor stepped in because CEOs were directing their pension funds to vote in favor of poison pills (rather, against shareholder proposals challenging poison pills), not because they were in the interests of the employee pension plan participants for whom the CEOs were acting as fiduciaries, but because they were in the interests of the CEOs themselves. This is the opposite of fiduciary obligation, and that is what the "Avon letter," dated February 23, 1988, addressed. Key points on ESG:

5. **There are no documented cases of ESG-based institutional investor decisions for any reason other than financial returns. But there are many documented cases of institutional investor decisions that favor corporate insiders due to commercial conflicts of interest with portfolio companies.** Big corporations, especially fossil fuel companies, have spent massive amounts of money to fight the E in ESG, with a lot of claims that ESG in general and E in particular leads to investment decisions, including proxy votes, that are not based exclusively on financial returns. And yet, in the many comments filed with the SEC and Labor Department, these commentors have been unable to come up with a single example of a buy-sell-hold or voting decision that is not based, to use the language of ERISA, on "the exclusive benefit" – meaning financial benefit – of the ultimate customer, whether a pension plan participant or mutual fund investor.

   There are many documented cases of decisions by fund managers that are contrary to the interests of beneficial holders. But these are not made for political or "woke" reasons; they are made for business reasons. As Vanguard founder John Bogle wrote many times over many years and as has been documented by studies going back to the 1980s, fund managers will vote proxies on, for example, CEO pay, contrary to the interests of beneficial holders if the portfolio company is a current or potential client of the firm.[7] In one widely reported case, Deutsche Bank switched its vote on a business combination after a side payment from Hewlett Packard, resulting in an enforcement action by the SEC and the promulgation of the rules now requiring that votes be disclosed.[8]

6. **The Executive Branch and Independent Commissions at the federal level and state authorities for state and local funds already have not just the authority but the obligation to identify and bring enforcement actions if any institutional investors make any decisions for other than strictly financial returns, again, "for the exclusive benefit" of the beneficial holders.** That applies to all decisions relating to share ownership including buy-sell-hold, voting, or exercise of other share ownership rights including submitting shareholder proposals, nominating board members, and participating in shareholder litigation. As the "Avon letter" and Deutsche Bank examples cited above show, the government can and does enforce the obligation to act as fiduciaries. There is no evidence that further authority is required, though a reminder, with particular attention to the commercial conflicts issue, may be worth considering.

7. **There is no evidence that ESG-based investment decisions are based on non-financial criteria. On the contrary, ESG is a reflection of the inadequacy of traditional indicators in assessing investment risk and return.** It is not investors, either individual or institutional, who are proposing the weakening of financial measures of performance. The Business Roundtable announced in 2019 that their member corporations had agreed to work for vague "stakeholder"-oriented goals instead of shareholder value.[9]

   We have even seen admissions from corporations themselves that they object to ESG because they are looking for subsidies, not market-based investments. For example, a comment letter filed with the Labor Department by a trade association, The Western Energy Alliance first claimed that they support ESG, which one might think would lead them to conclude that they should be able to attract ESG-oriented investors. On the contrary, though, they then went on to say that they understand what ESG means better than pension fund fiduciaries, among the most sophisticated financial professionals in the world and subject to the strictest standards of care and loyalty our legal system imposes. Again, they failed to come up with a single example of a "wrong" or "non-pecuniary" or "political" investment decision by a pension fiduciary. Here is their real issue: "We have observed how ESG advocacy has negatively affected the industry's access to capital over the last few years." What the industry is saying here is that they want pension funds to subsidize otherwise market-unworthy investments. If ERISA directed plan fiduciaries to act for the exclusive benefit of corporate insiders, that might be worth considering. But an institutional investor fund manager's duty is to

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[7] See for example: "Uncovering Conflict of Interest, As You Sow (https://www.asyousow.org/reports/uncovering-conflict-of-interest), Comment of John C. Bogle on File No. S7-36-02 (https://www.sec.gov/rules/proposed/s73602/jcbogle1.htm)

[8] https://www.sec.gov/news/press/2003-100.htm

[9] I disagreed. https://corpgov.law.harvard.edu/2019/09/02/six-reasons-we-dont-trust-the-new-stakeholder-promise-from-the-business-roundtable/

protect beneficial owners, and that is the opposite of what the Western Energy Alliance and the other critics of ESG are asking for.

In conclusion:

- Shareholder proposals are a very modest way to raise concerns at low cost to investors and to companies. They are submitted to a small fraction of companies but play an essential role in signaling concerns. If they are limited, the only options for shareholders will be far more disruptive and expensive.

- Proxy advisor services are not mandatory and are purchased by sophisticated financial experts. There are no barriers to entry as shown by the new "anti-woke" proxy advisory service, they are not unduly influential (as shown by the votes contrary to proxy advisor recommendations), and they are already adequately regulated.

- ESG indicators are a supplement to traditional financial disclosures, the ones that have repeatedly proven inadequate. Again, no one has to use them and they are purely market-driven. The only participants in these issues who have been driven by non-financial indicators are major corporations (the Business Roundtable's "stakeholder" pledge) and institutional investors (voting proxies to benefit portfolio companies who are clients instead of beneficial holders).

I am happy to provide additional information or answer any questions. And the attached appendices have further information about ESG and the deceptive dark money disinformation behind the opposition.

APPENDIX 1

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COMPLIANCE & ENFORCEMENT

Three Myths About ESG

by Nell Minow

ESG has passed the tipping point. For investors, ESG, which stands for Environmental, Social, and Governance factors, has gone from a nice-to-have to a have-to-have. ESG is the fastest growing area of investment, with every major financial institution and every significant institutional investor having one or more ESG options. U.S. ESG index funds reached over $250 billion in 2020. More significantly, ESG factors are permeating every aspect of even the most traditional investment vehicles. A 2020 survey of 809 institutional asset owners, investment consultants and financial advisers found that 75 percent of them use ESG factors in their investment strategies, up from 70 percent in 2019. Nearly 13 percent of respondents were pension plan sponsors. Corporate executives and board members are scrambling to catch up.

There are two major factors behind the new centrality of ESG. First, there is growing recognition that current financial reporting according to Generally Accepted Accounting Principles (GAAP) is not adequate. The upheavals of the dot-com bubble, the Enron-era accounting scandals, the 2008 financial meltdown, and the failed public offering of WeWork serve as reminders that there is a reason that accounting principles are called “generally accepted” and not “certifiably accurate.” GAAP is fairly good at reporting the value of hard assets and computing present value of future income. It is less reliable in evaluating the worth of today’s key assets like intellectual property and not of much use in informing investors about the asset almost all companies claim is their most valuable: their employees. GAAP is structured to externalize costs off the books as much as possible, driving corporate strategy in that direction. ESG is about the information GAAP leaves out or underweights.

The second major factor is market-driven, based on demographics. Millennials and Generation Z are vastly more concerned with ESG issues like climate and social justice than their parents, harking back more to the boomer generation activism that led to the creation of the Environmental Protection Agency and other regulatory agencies devoted to health and safety concerns. As employees, consumers, and investors, they are insisting on better information and more explicit strategy relating to ESG.

The problem is that the market for ESG is far ahead of the ability to supply it. We are better at understanding the importance of ESG than we are at computing and understanding the data. There is no consensus and a lot of inconsistency in defining what ESG is. That has led to a lot of opportunistic grabs for fees and market share for services and products that are based on what can be counted, not on what counts. It has led to a lot of push-back from corporations and their service providers, as we see in the comments filed with the SEC in response to the Commission's request for feedback on climate change and ESG disclosures. And that includes messaging in support of myths designed to undermine legitimate efforts on ESG. Here are three of the most widely disseminated.

1. **ESG is new**. In the collection of The British Museum is a blue glass jar dating back to the early 19th century. The label identifies the company and the product: East India sugar. And then, in bigger letters, it has an ESG disclosure: "not made by SLAVES." The East India Company distinguished itself from its competition in the West Indies in response to the world's first grass-roots political movement and consumer boycott. This led to the abolition of slavery in the United Kingdom more than 30 years before it took a war to stop it in the United States. ESG is sometimes similarly dismissed as a fad. While fads are very popular in finance and investing, ESG is unlikely to disappear. It will continue to be refined, but it will not disappear. For example, the largest institutional investor in the U.S. is BlackRock, which has announced that 100 percent of its approximately 5,600 active and advisory BlackRock strategies are ESG integrated—covering U.S. $2.7 trillion in assets. Reflecting the demand, BlackRock introduced 93 new sustainable solutions in 2020, helping clients allocate U.S. $39 billion to sustainable investment strategies, which helped increase sustainable assets by 41 percent from December 31, 2019.
2. **ESG is monolithic.** It is critical to remember that ESG encompasses three enormous categories: environment, governance, and a catch-all category referred to as "social." Each is a moving target with constantly evolving ideas about what information is relevant and reliable and each has to be evaluated

separately. “Social” is the wild card in the group. Rising on the list in recent years are #MeToo and #BlackLivesMatter concerns. I predict that there will be increasing attention on political contributions and lobbying expenditures. This scrutiny has been catalyzed by reports from Judd Legum and others about contributions companies have made contrary to their public commitments not to donate to elected officials who supported the January 6 insurrection or who get poor ratings from women’s and racial equity groups.

3. **ESG is “non-pecuniary”—adjacent to or conflicting with financial goals.** This was the explicit underlying assumption in the now-suspended ESG rule pushed through the Department of Labor in the last weeks of the Trump administration, directed at pension fiduciaries. The suspension of the rule as the Biden administration examines the issues is based on two key facts. First, the Department already has not just the enforcement authority but the obligation to use it if a pension fiduciary makes an investment decision for any reason other than “the exclusive benefit of plan participants.” Second, the proponents of the anti-ESG rule failed to come up with a single example of any investment made by any fiduciary for other than purely financial reasons. There is a lot still to be determined about ESG and some arguments to be had over long-and short-term calculations, but it is always financial.

ESG is like the use of the term “organic.” Consumer demand has led to unsupported claims, and it is time for the government to establish clear, consistent, and credible guidelines. In the meantime, companies should increase their disclosures about the procedures they have established for self-evaluation on ESG and what their priorities and goals are, putting some reality into a term with too many myths.

Nell Minow is Vice Chair of ValueEdge Advisors, a corporate governance consulting firm. She was previously General Counsel and President of Institutional Shareholder Services, a principal of the activist LENS Fund, and a partner in GMI Ratings. She writes frequently about corporate governance issues.

APPENDIX 2

We recognize that ESG is still an evolving discipline. But it is not a fad. ESG has passed the tipping point. For investors, it has gone from a nice-to-have to a have-to-have. ESG is the fastest growing area of investment, with every major financial institution and every significant institutional investor having one or more ESG options. US ESG index funds reached over $250 billion in 2020. More significantly, ESG factors are permeating every aspect of even the most traditional investment vehicles. A 2020 survey of 809 institutional asset owners, investment consultants and financial advisers[10] found that 75 percent of them use ESG factors in their investment strategies, up from 70 percent in 2019. Nearly 13 percent of respondents were pension plan sponsors. Corporate executives and board members are scrambling to catch up.

There are two major factors behind the new centrality of ESG. The first is the growing recognition that current financial reporting according to GAAP is not adequate. The upheavals of the dot.com bubble, the Enron-era accounting scandals, the financial meltdown, the failed public offering of WeWork and so much more remind us that there is a reason that accounting principles are called "generally accepted" and not "certifiably accurate." GAAP is fairly good at reporting the value of hard assets and computing present value of future income. It is less reliable in evaluating the worth of today's key assets like intellectual property and not of much use in informing investors about the asset almost all companies claim is their most valuable: their employees. GAAP is structured to externalize costs off the books as much as possible, driving corporate strategy in that direction. ESG is about the information GAAP leaves out or underweights.

The second major factor is market-driven, based on demographics. Millennials and the generation that follows them are vastly more concerned with ESG issues like climate and social justice than their parents, harking back more to the boomer generation activism that led to the creation of the Environmental Protection Agency, OSHA, and other regulatory agencies devoted to health and safety concerns. As employees, consumers, and investors, they are insisting on better information and more explicit strategy relating to ESG.

The problem is that the market for ESG is far ahead of the ability to supply it. We are better at understanding the importance of ESG than we are at computing and understanding the data. There is no consensus and a lot of inconsistency in defining what ESG is. That has led to a lot of opportunistic grabs for fees and market share for services and products that are based on what can be counted, not on what counts. It has led to a lot of push-back from corporations and their service providers, including efforts to distort the market by promoting restrictions on ESG-based assessments. Th answer is not to try to ignore the growing understanding of ESG factors, just to be clear that pension fiduciaries have to evaluate them with the same due diligence they bring to other data about investment risk and return.

ESG is nothing new. In the collection of The British Museum is a blue glass jar dating back to the early 19th century. The label identifies the company and the product: East India sugar. And then, in bigger letters, it has an ESG disclosure: "not made by SLAVES." The East India Company distinguished itself from its competition in the West Indies in response to the world's first grass-roots political movement and consumer boycott. This led to the abolition of slavery in the United

[10] https://www.pionline.com/esg/esg-integration-grows-globally-does-gap-between-us-and-others-survey

Kingdom more than 30 years before it took a war to stop it in the United States. ESG is sometimes similarly dismissed as a fad. While fads are very popular in finance and investing, ESG is unlikely to disappear. It will continue to be refined, and its influence will increase. For example, the largest institutional investor in the US is Black Rock, which has announced that 100 percent of its approximately 5,600 active and advisory BlackRock strategies are ESG integrated – covering U.S. $2.7 trillion in assets. Reflecting the demand, BlackRock introduced 93 new sustainable solutions in 2020, helping clients allocate U.S. $39 billion to sustainable investment strategies, which helped increase sustainable assets by 41 percent from December 31, 2019. As it consistently has throughout its history, EBSA's assessment of pension fiduciaries making ESG investments should be based on process and due diligence rather than results.

ESG is not monolithic. It is critical to remember that ESG encompasses three enormous categories: environment, governance, and a catch-all category we call social. Each is a moving target with constantly evolving ideas about what information is relevant and reliable and each has to be evaluated separately. "Social" is the wild card in the group. Rising on the list in recent years are #metoo and #blacklivesmatter concerns, plus increasing attention on political contributions and lobbying expenditures following news stories from Judd Legum[11] and others about contributions contrary to public statements about ending funding for elected officials who supported the January 6 insurrection or to those who get poor ratings from women's groups and racial equity groups. EBSA should be careful to make sure that its rules promote rather than restrict the development of ESG metrics.[12]

ESG is never "non-pecuniary" – adjacent to or conflicting with financial goals. None of the corporate executive and trade associations have documented a single example of a pension fiduciary making any financial trade-off in ESG-qualified investments. Quite the contrary. It is a reflection of the increasing recognition, following the dot.com collapse, the Enron era accounting failures, the security analyst corruption scandal, the financial meltdown, and many other examples, showing the inadequacy of GAAP in estimating investment risks and returns. GAAP is still based in 19th century notions and is better at estimating the value of property, equipment, and other hard assets than it is at valuing what most corporations claim is their most important asset, human capital. ESG can provide significant data about employee turnover, the resources devoted to employee development and education as well as information about compliance with regulatory risk relating to climate change and other E, S, and G issues.

To provide some context for these concerns, here are just a few of the extensive and compelling developments and evidence on ESG as a meaningful risk factor, many from the Trump administration, that not only can but must be a part of any fiduciary's responsibility to evaluate and act on:

1. The Environmental Protection Agency[13] published a 150-page document about coping with the debris from natural disasters across the country, which said, "Start planning for the fact that climate change is going to make these catastrophes worse. This is an essential issue for every element of

[11] https://popular.info

[12] https://www.responsible-investor.com/articles/i-want-to-make-an-official-request-of-regulators-and-the-esg-community-stop-it

[13] https://www.epa.gov/homeland-security-waste/guidance-about-planning-natural-disaster-debris

corporate strategy, from supply chain issues to core operations and risk management." EPA also has a sustainability initiative[14] on better disclosure of investment risk.

2. A study published in *Sustainability Accounting, Management and Policy Journal* by Michael Magnan and Hani Tadros[15] found that better disclosure of environmental performance correlated with better performance at the 78 companies in environmentally sensitive industries that they examined.

> In this paper, we aim to bridge the gap in the literature about the association between environmental disclosure and environmental performance by analyzing the motivation of firms with high or low environmental performance to disclose proprietary environmental information that could compromise the firm's competitive position or have direct impact on its cash flow. Consistent with some prior research, we argue that economic- and legitimacy-based incentives both drive a firm's environmental disclosure. However, revisiting prior research, we put forward the view that a firm's environmental performance (either high or low) moderates the effects of these incentives on environmental disclosure in a differential fashion.

Of course, you do not have to be an economist to conclude that companies will be more transparent when there is good news to report. What matters here is what investors can conclude from the level of transparency in these disclosures, and what it means about the potential – or necessity – for engagement. We point the Committee to the work of Tensie Whelan of NYU Stern Center for Sustainable Business on ESG data as a key indicator of supply chain risk, relating to the State Department release cited below.

3. The Bank of England takes note of climate-related investment risk:

> [A] speech by Sarah Breeden,[16] head of international banks supervision, suggests...that time is running out to prevent catastrophic climate change and previous efforts to combat the problem have been nowhere near vigorous enough.
>
> Breeden's message to the financial sector was that they need to incorporate climate change into their corporate governance, their risk management analysis, their forward planning and their disclosure policies or face the prospect of losing a heck of a lot of money.
>
> The financial markets have a term for a sudden drop in assets prices known as a Minsky moment (after the economist Hyman Minsky). Breeden said a climate Minsky moment was possible, in which losses could be as high as $20tn (£15.3tn).

If the Bank of England is calling on companies to address the risks of climate change, then the Department of Labor should recognize that pension fund managers' similar assessment of risk is consistent with their obligation as fiduciaries.

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[14] https://www.epa.gov/sites/default/files/2019-12/documents/esgmetricsreportingtemplate_pam_lacey.pdf
[15] https://www.emerald.com/insight/content/doi/10.1108/SAMPJ-05-2018-0125/full/html
[16] https://www.bankofengland.co.uk/-/media/boe/files/speech/2019/avoiding-the-storm-climate-change-and-the-financial-system-speech-by-sarah-breeden.pdf

4. A July 2020 report from GAO[17] documents the financial/"pecuniary" priority of institutional investors use of ESG factors in calculating investment risk. We incorporate that entire report by reference in this document. An excerpt:

> Institutional investors with whom we spoke generally agreed that *ESG issues can have a substantial effect on a company's long-term financial performance*. All seven private asset managers and representatives at five of seven public pension funds said they seek ESG information *to enhance their understanding of risks* that could affect companies' value over time. Representatives at the other two pension funds said that they generally do not consider ESG information relevant to assessing companies' financial performance. While investors with whom we spoke primarily used ESG information to assess companies' long-term value, other investors also use ESG information to promote social goals. A 2018 US SIF survey found that private asset managers and other investors, representing over $3.1 trillion (of the $46.6 trillion in total U.S. assets under professional management), said they consider ESG issues as part of their mission or in order to produce benefits for society....
>
> These investors added that they use ESG disclosures to monitor companies' management of ESG risks, inform their vote at shareholder meetings, or make stock purchasing decisions. Most of these institutional investors noted that they seek additional ESG disclosures to address gaps and inconsistencies in companies' disclosures that limit their usefulness. [emphasis added, footnotes omitted]

Not one of the investors surveyed made any "pecuniary" trade-offs and the overwhelming majority look at ESG exclusively in financial terms.

5. Pensions and Investments[18] reported on an ISS study:

A link exists between a company's ESG performance and its financial performance, according to a study published from ISS ESG, the responsible investment arm of Institutional Shareholder Services.

Firms with high or favorable ISS ESG corporate ratings tend to be more profitable through an economic value-added lens, the study found.

> While one can argue that the relationship between ESG and financial performance is perhaps due to the fact that more profitable firms have the resources to invest in areas that positively influence ESG, it could also be that profitability rises as a result of a company better managing its material ESG risks, or it could be a little bit of both," the study said. "If it is a little bit of both, then this means that good-ESG initiatives drive up financial performance, which then provides the monetary resources to invest to be an even better ESG firm, which then drives up performance again, and so on.

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[17] https://www.gao.gov/assets/710/707949.pdf

[18] https://www.pionline.com/esg/iss-study-links-esg-performance-profitability

Moreover, companies with better ESG ratings are also less volatile, noted Anthony Campagna, global head of fundamental research at ISS EVA.

6. Corporations are increasingly providing ESG disclosures[19] to respond to investor demand and to assist in their own strategic planning, and those that do tend to outperform. Whether that is cause or effect is not clear, but for investment risk assessment purposes, that makes little difference.

Since July 2017, following the release of the Task Force on Climate Related Disclosure (TCFD) guidelines, more than 500 large businesses, investors and industry groups have signed on to provide this type of forward-looking financial disclosure. Companies in the financial services industry are leading the way in their support of the TCFD recommendations, including BlackRock, State Street and S&P Global, along with the Association of Chartered Certified Accountants.

It is not limited to the financial services industry. Other sectors are signing on, including Statoil and Shell in the energy sector, consumer product companies such as H&M and Nestlé, materials companies such as BASF and DowDuPont, as well as industrial companies such as Saint-Gobain and Ingersoll Rand.

7. On July 1, 2020 the U.S. Department of State, along with the U.S. Department of the Treasury, the U.S. Department of Commerce, and the U.S. Department of Homeland Security issued a business advisory to caution businesses about the risks of supply chain links to entities that engage in human rights abuses, including forced labor, in the Xinjiang Uyghur Autonomous Region (Xinjiang) and elsewhere in China. DOL/EBSA should not issue a rule that fundamentally undermines this critical policy advisory from four other Departments. EBSA should coordinate with the other federal agencies to ensure that pension fiduciaries are not discouraged from making the appropriate calculations about supply chain risk.

8. A new global alliance of financial institutions, investors and businesses,[20] is launching a new central source for accessible, digital, corporate sustainability information in support of the 10 principles of the UN's Global Compact.[21]

9. President Biden's wide-ranging initiatives on ESG issues include an Executive Order on Climate-Related Financial Risk.[22] As the Department is aware, it will impose new obligations and create new opportunities for assessing investment risk based on climate and other ESG factors.

> It is therefore the policy of my Administration to advance consistent, clear, intelligible, comparable, and accurate disclosure of climate-related financial risk (consistent with Executive Order 13707 of September 15, 2015 (Using Behavioral Science Insights to Better Serve the American People)), including both physical and transition risks; act to mitigate that risk and its drivers, while accounting for and addressing disparate impacts on

[19] https://www.greenbiz.com/report/2019-state-green-business-report
[20] https://www.ft.com/content/304f9a1f-cb31-4c83-81bd-d814aa211c26
[21] https://www.unglobalcompact.org
[22] https://www.whitehouse.gov/briefing-room/presidential-actions/2021/05/20/executive-order-on-climate-related-financial-risk/

disadvantaged communities and communities of color (consistent with Executive Order 13985 of January 20, 2021 (Advancing Racial Equity and Support for Underserved Communities Through the Federal Government)) and spurring the creation of well-paying jobs; and achieve our target of a net-zero emissions economy by no later than 2050. This policy will marshal the creativity, courage, and capital of the United States necessary to bolster the resilience of our rural and urban communities, States, Tribes, territories, and financial institutions in the face of the climate crisis, rather than exacerbate its causes, and position the United States to lead the global economy to a more prosperous and sustainable future.

Another Executive Order focuses on creating opportunities for clean energy[23] that will affect the investment risk assessment in many sectors.

10. "ESG: Shareholder Engagement and Downside Risk"[24] finds that "successful engagement [on ESG factors] reduces the firm's exposure to a downside-risk factor."

11. In the Harvard Business Review article, An ESG Reckoning is Coming[25], Michael O'Leary and Warren Valdmanis write that companies have been better at promising to meet ESG goals than delivering on them, which underscores the vital importance of shareholder oversight to protect loss of shareholder value.

12. The SEC's Asset Management Advisory Committee recommended meaningful, consistent, and comparable disclosure of material environmental, social, and governance ESG disclosures earlier this year.[26] Increasing adoption of TCFD[27] and SASB[28] disclosure standards will provide critical information for all investors, including pension fiduciaries, to factor into their assessments of investment risk.

13. In Fortune Magazine, Professor Jeffrey Sonnenfeld and Steven Tian extensively document the superior performance of ESG-enhanced funds over the anti-ESG funds.[29]

14. If you shorted the companies led by the top ten most over-paid CEOs, you would outperform the market.[30] That's one of the most important elements in the G of ESG.

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23 https://www.whitehouse.gov/briefing-room/presidential-actions/2021/12/08/executive-order-on-catalyzing-clean-energy-industries-and-jobs-through-federal-sustainability/

24 https://www.researchgate.net/profile/Xiaoyan-Zhou-7/publication/318002428_ESG_Shareholder_Engagement_and_Downside_Risk/links/5e6769ce299bf1744f6f12f6/ESG-Shareholder-Engagement-and-Downside-Risk.pdf

25 https://hbp.az1.qualtrics.com/CP/File.php?F=F_e4XeHWSIIMVXsRo

26 https://www.sec.gov/files/amac-recommendations-esg-subcommittee-070721.pdf

27 https://www.fsb-tcfd.org

28 https://www.sasb.org

29 https://fortune.com/2023/06/05/alt-right-economy-is-failing-real-performance-of-anti-woke-entrepreneurs-business-politics-sonnenfeld/

30 https://www.asyousow.org/reports/the-100-most-overpaid-ceos-2023

15. Even Vivek Ramaswamy, the Presidential candidate who has devoted his entire career to opposing “woke” investments and ESG puts his own money into ESG-friendly companies.[31] The founder of the anti-ESG Strive fund does not puts his own money where his mouth is.

[31] https://www.nytimes.com/2023/07/07/us/politics/vivek-ramaswamy-wealth-plane.html

APPENDIX 3

May 17, 2023

Hon. Richard Revesz
Administrator
Office of Information and Regulatory Affairs
U.S. Office of Management and Budget
725 17th St NW
Washington, D.C. 20053

Re: OMB–2022–0014

Dear Administrator Revesz:

I am an OIRA alum. I was there almost from the beginning, arriving in 1981, when Jim Miller was heading the office. I had come from EPA, where I learned a lot about notice-and-comment regulation, including the conflicts that arose from failure to coordinate between agencies. I recall there was one toxic substance that was regulated separately and often inconsistently depending on whether it was being transported on the highways, transported by trains, exposed to people in the workplace, exposed to people at home through consumer products, or being left in garbage dumps. I also saw the wide disparity in application of cost-benefit analysis and access to the best examples in categories like performance standards vs. design standards, failure to comply with the Paperwork Reduction Act, and lack of consistency in trying to find a balance between clarity and flexibility.

Working at a regulatory agency and then at OIRA gave me both a trees and forest look at domestic rulemaking and notice and comment proceedings. OIRA was one of the greatest experiences of my professional life, helping to make essential, life-improving regulations work better – and get rid of ones that were outdated. I have the greatest respect for the diligence, expertise, and integrity of the agency employees who develop regulations, but the role OIRA plays as clearinghouse and providing coordination and oversight is essential.

When I arrived at OIRA, desk officers did not even have desktop computers; we worked on electric typewriters. It has come a long way. It has been a deep source of satisfaction to see the office play a vital and broadly welcomed role in the regulatory process, through many different administrations.

I was very glad to see these proposed guidelines, which are very much in line with what I know of OIRA's perspective and function. I would like to raise an additional question, based on my experience since I left OIRA in participating in about a dozen rulemakings at different agencies through comments and testimony, always sharing my own views, as I do in this letter, with my employer only as identification, never on behalf of a client.

In recent years, I have increasingly been struck by the problem of dark money-funded "astroturf" (fake grassroots), fake "public policy" thinktanks[32], fishy" comments[33], sock puppets,[34] and advocacy masquerading as scholarship that are seriously undermining the integrity of the notice and comment system.

Until a few years ago, I believed that the notice and comment process worked remarkably well, giving government agencies and independent commissions a chance to be guided by the experts who must comply with regulations and minimizing the problem of unintended consequences. It has been less effective in preventing regulatory capture, but overall it has struck a good balance by making the interactions between the regulators and the regulated transparent.

That is no longer true. Corporations and billionaires have set up dozens, maybe hundreds of fake groups with generic names that file comments without disclosing their sources of funding. They cite each other without disclosing their connections, not just their funders but often their executives as well. They have even gone so far as to submit comments with forged signatures, purportedly from individuals but in reality drafted by K Street "communications" firms. These firms have created fake "news" websites and fake social media profiles. For one of the rulemakings I commented on, at the SEC, they even posted a YouTube video,[35] again not disclosing that it was paid advocacy, warning viewers (falsely) that if a proposed SEC regulation on proxy advisory firms did not go final it would usher in open borders, gun control, and abortion. There are many, many more examples, and I would be happy to meet with staff (and have that meeting added to the record of this rulemaking) if it would be useful.

Without disclosure about the sources of the comments, the entire system is distorted. The clients and funders are essential for assessing the credibility of the comment. They know that, and that is why these dark money-funded fake front groups are created specifically to hide the money behind them. If a "study" is done by the industry or by an advocacy group, it should be viewed differently than if it is done by a non-partisan independent organization or an academic who does not receive funding from an affected party. They know it matters; that is why they hide it. You do not have to be an economist to understand that incentives make a difference. A comment from a group that tries to hide its funders should be viewed with skepticism.

The rules that apply in so many other areas of communication to prevent misleading and outright fraudulent information are not in force here. The generically-named Texas Public Policy Foundation, which cherry-picks data to pretend climate change is not a problem, does not mention that its funders include energy companies Chevron, ExxonMobil, and other fossil fuel interests.[36]

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[32] https://www.nytimes.com/2020/11/11/climate/fti-consulting.html

[33] https://www.bloomberg.com/news/articles/2019-11-19/sec-chairman-cites-fishy-letters-in-support-of-policy-change

[34] https://valueedgeadvisors.com/2018/11/06/more-useless-sock-puppet-bluster-from-fake-front-group-main-street-investor-coalition/ and note the overlap in the comments between groups with the same members/funders like the Business Roundtable and the World Business Council.

[35] https://valueedgeadvisors.com/2020/01/10/republican-operative-holly-turner-posts-appallingly-deceptive-video-in-support-of-anti-shareholder-proposal-from-the-sec/

[36] Their use of the inaccurate and inapposite term "cartel" to describe the proxy contest at ExxonMobil is a hint of their lack of credibility as well. One would think that they might conclude the successful election of three dissident

The FreedomWorks comment is especially misleading because it is "signed" by a long list of anonymous individuals (last names omitted), but fails to disclose that the group is funded by major corporations and groups related to the ultra-wealthy, anti-regulation Scaife and Koch families. These are material omissions because basic law and economics make clear that knowing who is paying for a source is necessary to evaluate its purpose and objectivity.

The fix is easy, and the cost is negligible. All it would take is the addition of language like this in any notice of proposed rulemaking:

> We encourage commenters to state clearly whether they are receiving payment or subsidies, directly or indirectly, for submission of the comment and any financial ties they have to those who are likely to be affected by the rule. These disclosures are not required but failure to include them will be a factor in determining the credibility of the comments.

I also ask that before agreeing to any meeting OIRA staff or political appointees have with outside groups to discuss pending regulatory proposals, the group or representative be asked to state for the record their funders or clients. As you know, groups like Donors Trust (that calls itself "the community foundation for liberty" but is called by critics the Koch-funded "ATM for the far right") hide behind names that are intentionally vague, blandly institutional, and faintly patriotic. They often represent the opposite of what their names suggest. For example: Judicial Education Project, The Fairness Center, Americans for Prosperity Foundation, Committee for a Constructive Tomorrow, Commonwealth Foundation for Public Policy Alternatives, Franklin Center for Government and Public Integrity, Independent Women's Forum, Heartland Institute, National Center for Public Policy Research, Consumers' Research, Institute for Humane Studies, etc. etc. I am not aware of any similarly obfuscatory efforts from progressive/liberal sources, but should there be, of course my concerns apply equally to them as well or any group that fails to disclose their direct and indirect sources of funding.

I met with just one such group when I was an OIRA desk officer, represented by a man who insisted that he was just working on his own for his love of animals. He was so specific about the LD50 tests that I questioned him further. He turned out to be funded by pharma companies trying to reduce animal testing requirements. Since then, efforts like these have grown to overtake Executive Branch and independent agency rulemaking. They have permeated and undermined the notice and comment process and the federal and state level. I urge OIRA, as the quality control on the conveyer belt of federal regulation, to address this issue to minimize the damage these fake front groups are causing.

I note that at this writing, the REIN legislation is included in the debt ceiling bill passed by the House. I do not think it will pass the Senate. But it is still worthwhile to express my concern that if it ever did become law, it would create chaos for the administrative and independent agencies. I trust that the White House legislative affairs office is raising these concerns.

My thanks to you and the staff for an excellent proposal, reflecting OIRA's outstanding professionalism. If I can be of any assistance, please do not hesitate to call on me.

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directors was an indicator of investor frustration at the inadequacy of the company's communications about climate change (as well as its $22 billion loss last year).