From Shareholder Primacy to Stakeholder Capitalism

A Policy Agenda for Systems Change

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The Shareholder Commons

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Foreword

Our Call to Transform an Unjust, Extractive Economy

Dear Readers, September 7, 2020

Our country stands at a crossroads. With a global pandemic and economic crises affecting all of our communities, we face a choice about how to rebuild. Will we go back to business as usual — opting for an economic recovery that benefits the few — often at the expense of the security and safety of the many? Across party lines, across the private and public sectors, and from the streets to the boardrooms, we must seek a new path, one that sets us on course to fulfill the founding promise of this country — a promise still unrealized for too many. Contained in this policy white paper are bipartisan backed structural reforms that can set us on course to put business to work rebuilding an economy that will work for all of us.

A shift away from shareholder primacy has been gaining momentum. The Business Roundtable's gesture towards this future followed more than a decade of pioneering leadership from social impact entrepreneurs. As Black, Latina/Chicana and White women leaders engaged in providing impact management tools to over 100,000 private sector leaders, our enthusiasm for this shift away from shareholder primacy is rooted in an imperative to close the racial wealth gap and ensure racial and gender equity. Corporate equity ownership is grossly unequal across race and gender. Federal Reserve data shows that as of 2019, 92.1% of corporate equity and mutual fund value was owned by white households. Black households owned 1.5%. Hispanic households owned 1.9%. Beyond being a representation of dismal racial wealth inequality and because shareholder primacy accredits decision-making authority based on accumulated shareholder power at the expense of the consideration of the shared interests of all stakeholders, shareholder primacy perpetuates and *reinforces* structural racism.

The good news is, in addition to overwhelming support for upending shareholder primacy, our organization unites the most credible network of nonpartisan companies and investors already

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practicing benefit governance, also commonly referred to as stakeholder governance, and has a track record of aligning bipartisan support for public policy. Our nonprofit, B Lab, has certified over 3,500 companies across 150 different industries as "B Corps." These companies not only meet a high bar for beneficial impact on workers, communities, and the environment; they change their fiduciary duties to become legally accountable to consider these stakeholders in all decisions. Thus, this change to fiduciary duty creates a critical, albeit incremental, corrective to structural race and gender inequalities. While insufficient to address the racial wealth gap, these changes shift structural power to a fuller set of stakeholders, creating conditions for more inclusive stakeholder participation and decisions.

As B Corps have been successful in both public and private markets, over 10,000 businesses have followed suit by becoming benefit corporations. Over the last decade, these pioneers were enabled by our nonpartisan initiative that passed benefit corporation statutes in 38 states, always with bipartisan support. By setting partisanship aside, we've aligned support for these common sense measures that enable businesses to create value for society by doing right by families and communities, and by not externalizing costs to taxpayers and welfare programs.

The economic impacts of the coronavirus pandemic — including disproportionate harm to Black, Indigenous and Latina/o communities — point to the tremendous need to put business to work to support an inclusive and regenerative economy. A beacon for our path to economic recovery, our network of leaders forged the roadmap that took stakeholder accountability from a niche interest to a tried and successful pathway for resilient and more equitable prosperity. Together we call on bipartisan leadership in Congress to make this pathway an imperative for business and finance in the 21st century. The nonpartisan policy reforms put forward in this white paper are essential tools for ensuring an equitable economic recovery.

We are proud to work alongside the community of private sector leaders offering this roadmap for public policies that can scale and accelerate the shift from shareholder to stakeholder capitalism. As this nation moves forward from this crossroads, whatever your political party or affiliations, we can choose a roadmap that ensures our economy works for all of us and the planet. Join us in putting business to work for an equitable and regenerative economic recovery, and future, for us all.

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Behind the White Paper

B Lab is transforming the global economy to benefit all people, communities, and the planet. A leader in economic systems change, our global network creates standards, policies, and tools for business, and we certify companies — known as B Corps — who are leading the way. To date, our community includes over 3,500 B Corps in 70 countries and 150 industries, and over 100,000 companies manage their impact with the B Impact Assessment and the SDG Action Manager. Learn more at www.bcorporation.net.

The Shareholder Commons is catalyzing systemic change across the capital markets by reorienting asset ownership to prioritize social and environmental impact over a "profit at any cost" approach that has wreaked havoc on the critical systems upon which our economy depends. Through public advocacy and investor engagement, regulation and impact litigation, we seek a playing field for sustainable competition leveled by investor-sanctioned guardrails for all significant companies. Learn more at www.theshareholdercommons.com

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A Call to Action

Transforming an Unjust, Extractive Economy by Replacing Shareholder Primacy with Benefit Governance

In this paper, we outline our original policy proposals for both legislative and regulatory reforms that, if enacted, will end the era of shareholder primacy, and replace it with Stakeholder Capitalism. The policies that we propose ensure that fiduciaries (including pension trustees, investment managers, and corporate directors) account for all of the impacts that corporations have on their shareholders and other stakeholders, including workers, communities, and the environment. **Laws and regulations must be changed to require business and financial institutions to look beyond their own financial returns and take responsibility for the impact they have on the social and ecological systems on which a more just, inclusive, equitable, and prosperous economic system depends. Our policy proposals would require that all companies and institutional investors must adopt *benefit governance*, consisting of revised fiduciary considerations that extend beyond responsibility for financial return, because accountable benefit governance is the foundation of Stakeholder Capitalism.** With the new laws we propose in place, investors will be able to work together to establish ***sustainability guardrails*** that end extractive corporate behavior, re-focusing corporations on real value creation that promotes quality jobs, healthy communities, human dignity, the resilience of our planet, and a more inclusive and just economic system for all.

Benefit Governance: The broad term for a theory of governance recognizes that the fiduciaries who run institutions must account for a broad array of beneficiary, shareholder and stakeholder interests; it can be applied to an individual company, an asset manager, or a pension or similar fund. At companies, it is often called 'Stakeholder Governance'.

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The U.S.economy is fueled by the labor and savings of workers, but the corporate and financial sectors externalize costs onto those same workers, their communities, and the environment in which they live. Under shareholder primacy, individual companies prioritize profits, even when those profits are derived from behaviors that create inequality, environmental damage, and social fragmentation. Not only do such tactics harm societal and worker interests, and accelerate already disproportionate harm to communities most impacted by climate change, they harm the ***human shareholders*** behind retirement savings and represented by institutional investors. As diversified investors, they have more at risk as stakeholders in the well-being of the overall economy, society, and the environment, than as shareholders of individual companies.

The gap between the needs of human shareholders and the behavior of corporate America has created growing inequality; perpetuated the racial wealth-gap; caused stagnant or declining standards of living, job-quality, and well-being for the working and middle classes; and led to an existential ecological crisis. If more evidence were needed, our inability to adequately respond to the COVID-19 pandemic and structural racism prove that current business models provide neither the resilience nor the equitable opportunities we need for an inclusive economy that allows all people to thrive with full human dignity.

The failure of shareholder primacy is being increasingly acknowledged by leaders in business and finance, as well as both major U.S. political parties. The chairman of the world's largest asset manager called for better corporate stewardship of the environment. And just last year, many of the largest and most recognized corporate leaders in the United States released a new Statement on the Purpose of a Corporation, pledging to work for the benefit of all stakeholders — customers, employees, suppliers, communities, and investors — what we are calling Stakeholder Capitalism. This trend is accelerating in the face of the COVID-19 pandemic

Sustainability guardrails: Universal limits that investors would impose on all companies with respect to matters like wages, human rights and emissions, in order to ensure that all companies were competing fairly for profits, rather than earning them through exploitation. For example, investors might decide to remove the directors of any company that did not ensure that its employees and the employees of its suppliers received a living wage.

Human shareholders: The actual beneficiaries represented by institutions like pension funds, endowments, and mutual funds. The financial industry is often so focused on the multiple layers of corporations, asset managers, advisors, and institutions, that it forgets that all of these funds are meant to provide benefits to human beings, and that their decisions should be aimed at benefiting those individuals.

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and a new corporate recognition of racial injustice, with scores of large businesses proclaiming their dedication to remedying injustice and assisting Americans in distress.

But outspoken money managers, heroic CEOs, and corporate contributions to civil rights organizations cannot save us from a system that rewards profits reaped from the exploitation of natural resources and workers, and from the weakening of communities that have been made vulnerable through systemic structures of oppression. It is not simply individual actors that must change, but rather the system itself that must evolve, so that extractive profits are no longer available to companies and investors. Such systemic change requires collective action by investors and companies. But collective action will not materialize unless we change laws to create a shift from shareholder primacy to Stakeholder Capitalism by using benefit governance. By changing the rules that govern fiduciaries, we can create the enabling conditions that would empower the business and finance sectors to work with governments and NGOs to transform the economy so that it is in service to the well-being of our planet and the inclusive and just society we all deserve.

Building From Success: Widespread Bipartisan Adoption of Benefit Corporation Statutes

The successful campaign, led by bipartisan and private sector actors, to enact benefit corporation statutes sets an important precedent for our policy proposals. Behind this effort has been the leadership of our nonpartisan, nonprofit organization, B Lab, which created the B Corp Movement in 2006. We began with a corporate certification, Certified B Corporations (or “B Corps”), a designation for companies that meet the highest standards of social and environmental performance, accountability, and transparency. There are over 3,500 Certified B Corps in 150 industries and 70 countries, a credible community of private sector leaders who are using business as a force for good. Those B Corps helped us shift impact management from a niche interest to the mainstream imperative for business and finance in the 21st century. They have influenced over 100,000 companies to use our freely available B Impact Assessment, a world-class dynamic impact measurement platform, to assess and improve their environmental and social impact.

Most relevant for this policy proposal, B Lab has also led the effort to create the benefit corporation. Benefit corporations are a form of corporate governance and legal structure that enables companies to commit to — and be held accountable for — considering the impacts of their decisions on all stakeholders rather than just their shareholders. In the last decade, these statutes have been enacted in 38 U.S. states and in four other countries, with broad bipartisan support. More than 10,000 benefit corporations now exist.

During that time, benefit corporations have raised more than $3.5 billion in venture capital and private equity, and the market value of the shares of equivalently governed companies in public markets worldwide is over $56B. Three companies have had successful IPOs as benefit corporations, two in the past 90 days (Lemonade and Vital Farms). Benefit corporations are also

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reaching public markets through shareholder votes, including overwhelming recent support for benefit corp governance by the shareholders of Danone, Amalgamated Bank, and Natura.

These companies are literally changing the purpose of business by leaving shareholder primacy behind, and putting the well-being of people, communities, and the planet at the center of their work. The state of Delaware, the home of U.S. corporate law, recognized the normalization of benefit governance when its Governor signed legislation on July 16, 2020, removing the final barriers left to converting from a conventional corporation to a benefit corporation.

Systems Change in Action

The case study of the proliferation and success of benefit corporations demonstrates that responsible business can also be successful, mainstream business. However, we maintain that individual company choices are incapable of creating the systemic change needed to end reckless corporate behavior that decreases job quality in the United States, drives ecological collapse, causes disproportionate harm to people of color, and exacerbates income and wealth inequality along racial and gender lines. Further, the policy solution must be comprehensive. Even if all companies were required to consider stakeholder interests, this mandate would be fundamentally misaligned with investment rules and culture that are often understood to require institutional investors to insist that every company in their portfolios optimize its individual return. **Therefore, our proposals include both statutory and regulatory changes that align actors throughout the financial system by requiring all corporations and institutional investors to adopt benefit governance.**

With such a structure in place, the fiduciaries who manage institutional investors and control the equity markets — including pension and sovereign wealth funds, insurance pools, endowments, foundations, and mutual funds — will have the collective motivation and ability to create sustainability guardrails that limit corporate behavior that harms society, the environment, and communities that suffer from the current rules and norms that govern the financial system. These new guardrails will create a level playing field and eliminate the option to profit by exploiting public resources, natural ecosystems, and power imbalances. Instituting common boundaries will direct the operation of the profit motive so that corporate executives must focus on creating value for all stakeholders — creating a Stakeholder Capitalism that allows all of us to be included in and benefit from an equitable and inclusive economic system.

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Executive Summary

Policies That Put Capital Markets to Work for All

Capital Market Policies for the 21st Century

The U.S. capital markets have failed to create an inclusive and equitable economy or durable prosperity because they are built atop policies formulated over the last 150 years that: (1) failed to acknowledge the injustice that accrues in an unregulated free market, and (2) did not account for the planetary boundaries we are now approaching. This paper proposes new legislative and regulatory reforms that promote capital stewardship to embed the markets into a more equitable and inclusive economic system designed to create justice and ecological balance.

The policies we propose will create a foundation for U.S. markets that channel resources toward durable productivity and equity for workers. With these policies in place, investors will have the tools to create sustainability guardrails for company behavior that will distinguish between efficient, innovative profits that benefit us all and profits derived from negative-sum behaviors that put critical systems at risk and continue to exploit communities.

Shareholder Primacy Is at the Root of the Failure of Capital Markets

The laws, regulations, and culture that currently govern U.S. capital markets are designed as if the purpose of business were unrestrained profit, regardless of the damage caused by earning that profit. This design is not accidental and arises from two linked ideas: First, that focusing on the individual company financial return will protect shareholders (“agency theory”); and second, that such focus will optimize the allocation of resources in the economy (the “invisible hand”). The blunt application of these concepts without concern for market failures has created a broad culture of shareholder primacy.

But protecting shareholders and relying on unfettered market forces to create value is not sufficient to create a just, equitable, and inclusive society. In the increasingly financialized economy, markets are decoupled from productivity; as a result, financial success often derives

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from business practices that extract value rather than produce it. This severance of profit from social benefit leads to investing practices that threaten the workforce, the economy, and the environment; and often exacerbate already existing inequalities. We saw this in a pre-COVID-19 economy that produced rising profits but also rising inequality, hopelessness, and ecological breakdown; and that left us unprepared for the foreseeable tragedy of a pandemic.

Replacing Shareholder Primacy

It will not do to simply eliminate shareholder primacy and allow corporate executives unlimited discretion to satisfy the interests of all stakeholders. Investors cannot be expected to provide risk capital without some measure of control through their fiduciaries. Moreover, it would be unwise to rely on management wisdom and good faith to replace the pricing and resource allocation functions of markets and profits. That is why we cannot solve the problem of shareholder primacy by simply eliminating it; we must replace it with better principles that nevertheless address agency concerns and preserve market functions. Such new principles must serve the broad interests of human shareholders and other stakeholders, and corporate control must be wielded to do more than maximize financial returns at individual companies.

This paper proposes policies based on such principles: They are designed to maintain the market mechanism inherent in profit-seeking but correct market failures that allow for profits derived by extracting value from common resources and communities, including workers. Eliminating this inefficiency and unfairness will benefit human shareholders themselves, who rely on a healthy economy, society, and environment in order to support the return on their diversified portfolios and their other interests, including jobs, health, and social stability. These broad interests give human shareholders and the institutional investors who represent them the incentive and broad perspective to follow the lead of the new policies we propose.

Our Proposals Are Built around a Change in the Fiduciary Obligations to the Human Shareholders

The key element of our proposal is a change in the obligation of those who manage the nation's collective investment capital: fund trustees, money managers, and corporate directors and executives. It is essential that they change their focus in order to prioritize protection of the broad interests of their beneficiaries, rather than the returns of individual portfolio companies. This starting point is based upon a realistic understanding of the full set of common interests of the ultimate beneficiaries of the financial system — the 'human shareholders' and workers who rely on pension funds, foundations, endowments, and other institutional investors that own the bulk of shares in publicly traded companies and alternative investments like private equity and venture capital. **Public policy must require business and institutional investors to look beyond individual company financial returns to be responsible for the impact they have on the shared social and natural systems needed for a just, equitable, inclusive, and prosperous economic system. Under our proposal, all companies and institutional investors must adopt benefit governance to enable these broader fiduciary considerations.**

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Because the institutional investors affected by our proposals control the voting stock of a large proportion of corporations, they will have the power to collaborate on sustainability guardrails across the economy, including the behavior of the corporations in which they invest. In turn, because the companies subject to such guardrails will have broad duties to all stakeholders, their directors and officers will have the legal incentive to follow, rather than evade, these restrictions. The proposal thus aligns the legal incentives for corporate and financial intermediaries with the interests of the human shareholders they are supposed to represent.

The remainder of our proposed policy changes involve a series of supportive legislative and regulatory changes necessary to ensure that fiduciaries have the tools to impose sustainability guardrails and protect these broad interests, and that their beneficiaries are able to hold them accountable for doing so. With these interests protected, investors, financial intermediaries, and companies would continue to have the incentive to seek profits and financial return, but on a level and sustainable playing field that produces regenerative profits.

This policy agenda includes the following categories of interventions required for a broad transition to Stakeholder Capitalism.

We have drafted proposed Federal legislative language, “The Stakeholder Capitalism Act,” attached in Exhibit A of this paper, which incorporates each of the ideas below:

Responsible Institutions:
We propose that the trustees of institutional investors be required to consider certain economic, social, and environmental effects of their decisions on the interests of their beneficiaries with respect to stewardship of companies within their portfolios. This clarified understanding of fiduciary duty will ensure that institutional investors use their authority to further the real interests of those beneficiaries who have stakes in all aspects of the economy, environment, and society. These changes can be achieved through an amendment to the Investment Company Act of 1940 (15 U.S.C. 80a) by inserting language after paragraph (54) of Section 2 and after subsection (c) of Section 36.

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Responsible Companies:
Just as trustees of invested funds must expand their notion of the interests of their beneficiaries, the companies in which they invest must also expand the understanding of the interests of the economic owners of their shares, who are more often than not those same beneficiaries. We propose a federal requirement that any corporation or other business entity involved in interstate commerce be formed under a state statute that requires directors and officers to account for the impact of corporate actions not only on financial returns, but also on the viability of the social, natural, and political systems that affect all stakeholders. This change can be achieved through the addition of a new Chapter 2F of Title 15 of the U.S. Code.

Tools for Institutional Accountability:
In order to allow beneficiaries to hold institutional investors accountable for the impact of their stewardship on all the interests of beneficiaries, we propose laws that mandate disclosure as to how they are meeting their responsibility to consider these broad interests, including disclosure of proxy voting and engagement with companies. We propose that the Securities and Exchange Commission should promulgate rules requiring each investment company and each employee benefit plan required to file an annual report under section 103 of the Employee Retirement Income Security Act of 1974.

Tools for Company Accountability:
Corporate and securities laws that govern businesses must also be changed in order to give institutional investors the tools to meet their enhanced responsibilities. This will include requiring large companies to meet new standards for disclosure regarding stakeholder impact as an important element of their accountability. This proposal can be achieved through an amendment added to The Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) after section 13A.

Interim Steps:
We recognize that implementation of these policies may take time, and in the interim we believe that the federal and state governments should create economic benefits through tax, procurement, and other economic development incentives to support accelerated adoption of these new standards by companies and investors. These steps are described in Appendix B.

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Our Proposals Are a Necessary Foundation for Needed Substantive Regulation

Fiduciary rule changes and investor-sanctioned sustainability guardrails are not a panacea, but they do create a clear and level foundation upon which other public policy ideas can be built. Substantive changes to the laws that address the rights of workers; the environment; and that promote equity, inclusion, and justice are needed to ensure fair compensation and representation for workers, a clean environment for every community, and human rights and equal opportunity for all. While those direct regulatory policies are not the focus of this proposal, we emphatically support policies that protect workers, the environment, and create systemic changes that are needed to ensure healthy communities, full human dignity, and a more inclusive and just economy for all people. We also support the reform and use of democratic political processes that rebalance power to ensure appropriate regulation and oversight of business and investment conduct that threatens society and the environment. Finally, we acknowledge that the direct regulation of business, while needed, will not replace the essential role of government and civil society in creating goods and services that are integral to a successful economic system, such as public investments in infrastructure (education, health, transportation, research), or the system of taxation that provides the resources to create these benefits.

The changes discussed in this paper are just as essential as direct regulation and the role of government in creating public goods. Without capital markets reform, a financialized business sector will undermine attempts at regulation by using its resources to profit from regulatory capture, evasion, and arbitrage. Good faith regulatory initiatives will be sabotaged by corporations in search of profits as long as profits remain the only measure of success.

Thus, while direct regulatory policies are not the focus of this proposal, we strongly support the leaders and organizations who pursue specific proposals on such topics. In particular, we support a broader set of policies that protect workers and the environment, and enable fair taxation. We also support policies that promote justice and equality, and protect communities that have been made vulnerable through systemic structures of oppression. Our proposals are thus a necessary but insufficient part of a larger project of systemic restructuring — Stakeholder Capitalism — that will create a just inclusive, equitable, and prosperous economy for decades to come.

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Behind the Policies

Why We Need Policy Changes that Expand the Scope of Capital Stewardship and Fiduciary Duty

Shareholder Primacy, The Myth of Perfect Markets and Modern Portfolio Theory

As in many free market economies, shareholders of U.S.-based corporations generally control the business enterprises that produce most goods and services. As the economy has become more financialized, this control has increasingly been used to enforce shareholder primacy — the idea that the interests of both shareholders and society will be met if individual corporations are managed with the primary goal of increasing financial returns to their shareholders. While shareholder primacy is reinforced by the legal system, it springs from cultural, market, and political forces as well.

In an economist's imaginary perfect market, shareholder primacy would drive optimal performance throughout an economy: As long as shareholders were in control and seeking financial return, then company managers would pursue efficiencies and innovations in order to maximize profits. Moreover, in a frictionless market where all costs were incurred by rational, omniscient, price-taking market participants, this search for profit would benefit society as a whole because its scarce resources would be put to their best use (although these market mechanisms do nothing to address existing inequalities, and may actually exacerbate them). Thus, companies and portfolio managers who beat the return of their peers would be creating value for shareholders and the economy.

In this just-so story of shareholder primacy, the interests of the corporation, its shareholders, and other stakeholders are all aligned so that shareholder primacy serves as an engine of productivity and social welfare (with any consequent inequalities left to be addressed by political action). This is what Milton Friedman meant when he famously said that corporations have a social duty to maximize profit. This dangerous myth continues to captivate the culture that governs the capital markets.

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Current Fiduciary Law Reinforces Shareholder Primacy: Institutional Investors

A very large proportion of the significant financial investments in the economy are made in publicly traded companies, or in privately held companies backed by venture capital and private equity funds. The markets for such investments are dominated by institutional investors like mutual funds and pension plans. Because institutional investors control such a significant portion of the equity of large companies, they are the first link in a chain of control that ultimately decides how resources are allocated and stewarded throughout the economy.

These institutions are managing money on behalf of human beings who are workers, retirees, savers, students, and endowment beneficiaries. Fiduciary obligations require the trustees to manage the funds entrusted to them for the "sole benefit" of these beneficiaries, which is often interpreted as a mandate to generate the highest risk-adjusted returns, and is generally assessed by comparison to the return of similarly risky portfolios. These obligations have sources like the federal law governing certain pensions (ERISA) and state laws that govern public employee pensions and other trust relationships.

This narrow interpretation of the sole beneficiary rule is influenced by the perfect market idea that conceptualizes profits as a measure of real value creation that benefits the entire economy. But the application of this myth leads trustees to encourage financial return maximization at individual portfolio companies, despite broader interests that their beneficiaries might have in a healthy economy, society, and environment.

For example, if a trustee is deciding whether to vote its proxy in favor of decreasing the carbon intensity of a company already in its portfolio, trustees may be advised that the sole beneficiary rule precludes them from considering the effects of climate change on the future of humanity, on the lives of its beneficiaries, or even other companies the beneficiaries own. (Indeed, this was the clear intent of a new regulation proposed by the Department of Labor in June 2020.) Instead, they are often advised that they should act to reduce the carbon intensity of an investment only if it will increase the risk-adjusted return of that same investment; moreover, the advice goes, they cannot divest a company because of its carbon output or vote in favor of a shareholder resolution to lower emissions if doing so would reduce the return on that investment.

These interpretations often mean that institutional investors will engage with a portfolio company on social and environmental issues only if it can be justified as creating financial benefit to that company (ESG integration). This cramped interpretation thus limits the ability of trustees to protect important social and environmental interests, and may actually require them to vote contrary to the best interests — financial and other — of their own beneficiaries. In particular, it may interfere with allocating resources to work with other shareholders to implement sustainability guardrails, which are critical to protecting the broad common interests of beneficiaries in social and environmental issues. As a result, institutional investors hesitate to take the actions that are potentially the most important steps to preserve the long-term value of their portfolios, as critical social and environmental systems are degraded for the purpose of immediate profits.

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Institutional investors exacerbate the focus on individual company returns by following Modern Portfolio Theory (MPT), the investment framework that dominates the capital markets. MPT focuses the investing community on the relative performance of a company or portfolio against peers and not on absolute performance. Under MPT, financial intermediaries consider overall market performance to be outside their control, even though market performance is simply the sum of the performance of all of the companies that their clients collectively own, **and even though overall market performance is responsible for at least 80% of the performance of a properly diversified equity portfolio.** In other words, they have adopted an investing model that rejects the very idea of common sustainability guardrails, which are needed to manage overall market performance, the dominant determinant of an institution's return on stocks.

Current Fiduciary Law Reinforces Shareholder Primacy: Corporations

Corporations include the large commercial enterprises that dominate the global economy; they command large parts of the market for resource extraction, manufacturing, transportation, retailing, and services. Their operations often cross national borders, and their power and wealth allow them to influence public policy around the globe. Ultimately, corporations make the actual decisions as to the allocation of resources within the private economy. Decisions as to whether to pay decent wages, reduce harmful emissions, and price products fairly are made by corporate executives who answer to a board of directors. As a result, the interests that these directors serve will determine the accessibility of equitable and inclusive opportunities in and the health of the economy.

There are cases in Delaware, the leading U.S. jurisdiction for corporate law, that require directors to ignore any interest other than shareholder interests, except to the extent that such interests may relate to shareholder value. In other words, Delaware case law supports the dangerous doctrine of shareholder primacy. Some argue that these cases should be read as only applying to circumstances where control of the corporation is at stake. Others argue that the duty to favor shareholders exists, but is unenforceable, because courts give directors broad discretion, and almost never second guess their decisions. In addition, more than 30 U.S. jurisdictions have adopted "constituency" statutes that give directors more discretion to consider the interests of employees, customers, communities, and other stakeholders.

However, even if shareholder primacy has been eroded through constituency statutes and changing interpretations, **no U.S. jurisdiction requires companies to consider stakeholder interests when making decisions.**[1] In other words, companies are either required or permitted to practice shareholder primacy. And because markets currently focus on a company's financial returns to shareholders, such legal permission becomes a mandate in practice. Only benefit governance can create the **accountability** for stakeholder interests necessary for companies to resist market pressure to always put shareholders first.

1. Of course, there are 38 jurisdictions in the U.S. where corporations can become benefit corporations, in which case such consideration is required, but all of those statutes are optional.

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This combination of market pressure to create financial return and the absence of a legal mandate to consider stakeholder interests drives companies to prioritize financial returns above all else. The practice of shareholder primacy leads to business decisions that create profits for their shareholders, but are unjust and costly for the economy, society, and the environment. These decisions consequently do harm to the broad set of collective interests of the actual human shareholders represented by pension and mutual and by other institutional investors.

Reality: Three Types of Interest

These fiduciary regimes enable shareholder primacy, which is based on the false narrative that maximizing profits will maximize the welfare of both shareholders and stakeholders. The fact is that human shareholders have many interests beyond the comparative financial return of their portfolio and that unchanneled markets do not automatically create social value. Investing models and laws that focus on relative company return ignore the real-world impacts of corporate behavior that externalizes costs, unjustly exerts power, and exploits information gaps and poor choices.

Examples of this mismatch include the aggressive marketing of opioids, continued dependence on carbon-intensive production methods, racial exploitation in banking, massive tax avoidance, and outsourcing to questionable supply chains. Indeed, there is broad consensus that the search for individual company profit led to the brittle supply chains that have deprived the global economy of the tools needed to fight the COVID-19 pandemic, which will weigh on the economy for years to come. All of these business strategies were implemented by corporate managers seeking shareholder return, but they all ultimately imposed significant external costs on society and the environment.

But not only do such tactics harm societal interests and exacerbate inequalities, they harm the human shareholders themselves in most instances, because these beneficiaries are diversified and have more at risk as stakeholders in the economy, social institutions, and the environment than they do as shareholders of an individual company. When businesses earn profits by externalizing costs onto the economy, social institutions, and the environment, those costs can hurt the interests of their own shareholders, and other critical stakeholders as well, in three ways.

Portfolio Interests

External costs generated by business activities can manifest as systemic costs that injure the portfolios of diversified human shareholders, including institutional investors and their beneficiaries. Sometimes the external costs are a matter of an overall business model or particular practice that is extractive and creates more costs than benefits — perhaps a multi-level marketing strategy that provides little real value to consumers or the mining of a high-carbon fuel source. Common sustainability guardrails could end such practices and thus require companies to accept lower returns, but the overall stock market return would increase, because the economy would be more productive. Even if that increased productivity were not enough to make

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up for the loss of profit at the individual company, it would do so at the portfolio level for diversified shareholders, including fund beneficiaries.

In other cases, the external costs generated by businesses may reflect lost productivity at all companies due to collective action issues at the company level. For example, corporate tax avoidance strategies may collectively threaten the public services funded by taxes and subsequently reduce overall productivity. In contrast, if most companies contribute fairly to federal and local tax bases, the government will be able to provide services necessary for an inclusive, equitable, and productive economy, like infrastructure, safety nets, and regulation. This will provide net benefits to companies that pay their fair share. But despite the apparent win-win of tax compliance, in an economy that rewards all profits, any individual company will always seek to increase its own earnings through successful tax avoidance. However, all companies will be better off if investors are able to collectively impose tax avoidance guardrails in order to counter the prisoner's dilemma that the current focus on individual company stock returns alone creates.[2]

The beneficiaries of large asset funds are diversified investors and have an interest in seeing markets as a whole rise, so that trustees have good reason to work together with other shareholders to both root out business models that harm the economy and to enable collective action that avoid practices that lead to a race to the bottom. In contrast, the current perceived duty to allow individual portfolio companies to maximize their own return without regard to broader issues is harmful to beneficiaries and leads to an absurd and dangerous circumstance: the professionals charged with stewarding collective savings are following a theory that encourages companies to ignore their clients' interest in a rising market, and to focus only on relative returns of their clients. Yet MPT itself requires that investors be diversified, and for diversified investors, market return matters much more than the return of individual companies. The net result is that asset managers pursue profit at a single company even when that single-minded focus is costing investors much more in loss of portfolio interests alone, not to mention the citizen and community interests described next.

Individual Interests

A second type of harm from company activity can manifest directly in the work and lives of beneficiaries (and those whom those beneficiaries care about) without necessarily imposing a cost on other investments. For example, a chemical producer may participate in lobbying activity that reduces regulation and thereby reduces corporate cost structures. The limited regulation may increase the profits of businesses overall and thus the stock market, while adversely affecting human health, including the health of those beneficiaries. Other corporate practices may adversely affect the availability of well-paid, dignified work in the U.S., undermining the value of their labor, which is the greatest financial resource of most beneficiaries.

2. In other words, sustainability guardrails can increase a corporation's absolute financial return to its shareholders even if it decreases its return relative to the market. This creates a classic prisoner's dilemma, for which guardrails supply a solution.

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Community Interests

The third type of externality that beneficiaries might want fiduciaries to consider consists of community interests created by the costs borne by those who are not direct trust beneficiaries but to whom the beneficiaries owe an ethical obligation. There is a significant segment of the human population living on less than $2/day who are entirely unaffected by most of the funds in question (although some are arguably within the ambit of foundations and sovereign wealth funds). Suppose that the continued hand-mining of cobalt by children increased profits at some companies and was unlikely to harm performance at other companies or to impact the lives of the vast majority of the beneficiaries of assets under management. Could fiduciaries nevertheless use their collective powers to ensure that such activities were purged from the value chain, even if it had some relatively small cost to portfolio return? It is hard to see how such a decision would satisfy the sole interest rule as in effect today. But it is also hard to believe that most investors want their funds invested in an inhumane manner.

Another example of community interest involves inequality and wage laws. Many companies in the U.S. contribute to trade associations that lobby for rules that limit the rights of workers (by maintaining a low minimum wage or restricting rights to organize, for example). Such rules contribute to growing inequality that may harm the individuals in communities least likely to benefit from the ownership of capital. We believe that many beneficiaries would prefer to protect these communities that have been made vulnerable by systemic structures of oppression, even where the beneficiaries do not directly benefit. For the sake of clarity, we are not suggesting that trustees and other fiduciaries would have to bring an end to such lobbying under our proposal — only that they could consider the interests and preferences of their beneficiaries in deciding whether to do so.

In sum, the unjustified obsession with increasing financial return at an individual company leads to irrational decisions being made for human shareholders and other beneficiaries. Despite this reality, the U.S. legal framework does not provide any clear direction for corporate and capital managers to correct for the imperfection of markets. Instead, it allows and encourages corporate directors and institutional investors to use individual company financial return as the sole measure of success in business. By the same token, the entire investor protection model of the Securities and Exchange Commission is built around this model, and financial industry practices assume its validity. The new rule proposed by the Department of Labor in June 2020 regarding ERISA-regulated pension plans further reinforces this dynamic.

Why Policy Change is Necessary

As mentioned above, many business and financial executives today are calling for a new way of thinking about the purpose of the corporation, as exemplified in the Business Roundtable's (BRT) 2019 Statement of the Purpose of the Corporation and the World Economic Forum's Davos Manifesto for a better, stakeholder-oriented capitalism. The BRT and the World Economic Forum have declared that the purpose of the corporation is to create value for its multiple stakeholders. Changing the culture inside corporate and financial boardrooms is crucial, and we applaud the public leadership of many in the business and financial sectors.

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But simply calling on corporate leaders to lead with purpose in a market system with misaligned responsibilities is not sufficient to the task. We must develop a paradigm that enlists necessary market forces while also preserving precious social and environmental capital. But such a paradigm cannot simply be conjured into existence. We must first develop principles fit to purpose and then embed these principles into policies through law and regulation.

Policy reform (or in some instances, clarification) is a critical step in this transformation. Individual action, no matter how well-intentioned, cannot overturn the shareholder primacy myth or combat the legal doctrine, market forces, and feedback loops that reward all profit equally, regardless of source. In order to level the playing field for responsible actors, we have to incorporate new principles into the market that can relieve the pressure to chase profits at any cost.

Creating Markets that Reflect Reality

Markets are often described as tools to allow individual self-interest to serve the public good: "Private vices are public benefits." And, indeed, by allowing market participants to compete for resources, markets can perform tasks of allocation and induce great efficiency and innovation that command economies have yet to match. But the double-edged flaw of shareholder primacy is that individual company financial return without constraint is a poor heuristic for both the private vice of shareholder self-interest and the public benefit of a productive economy.

Our proposal encourages institutions to work together and engage with portfolio companies to create common sustainability guardrails and similar restraints that limit social and environmental costs. The proposals are anchored in the reality that shareholder interests — their "vice" — extend well beyond simple company-by-company financial return. The beneficiaries behind institutional investors need an equitable and inclusive economy, a just society, and a resilient environment to support their diversified portfolios as well as their other interests as human beings.

Our proposals are designed to ensure that companies and asset managers are first preserving broad market return and other shareholder interests by protecting critical social and environmental systems, and only searching for individual company returns within a financial system that restricts extractive business strategies and enables collective action to preserve and regenerate common resources and public goods.

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The Proposal

Policies to Ensure that Capital is Stewarded to Transform the Economy, Society, and Environment

The U.S. can have a successful market-based economy only if investors, investment managers, and companies turn their attention to protecting the full set of interests shared by shareholders and other stakeholders. Otherwise, market pressure for profits will overcome well-intentioned individual attempts at sustainability and corporate purpose, and businesses will continue to pursue profits derived from behaviors that threaten vital social and environmental systems and continue to exploit populations made vulnerable by systemic structures of oppression.

This section sets out the specifics of our proposal for policy changes that will enable asset owners to apply such parameters along the entire investing chain through to the real economy. Many of these changes can be implemented through the comprehensive federal bill included as Exhibit A, although some changes could, alternatively, be adopted at the state level.

New Fiduciary Duties

The foundation of our proposal is the establishment of new fiduciary obligations throughout the investment chain through adoption of: (1) a uniform federal rule (or adoption at the state and federal levels of similar rules) requiring institutional investors to consider a broader set of beneficiary interests, and (2) a federal requirement that corporations operate under obligations to protect the common interests of shareholders and stakeholders. With respect to the former, institutional relationships with beneficiaries, human savers, comprise a critical first link that establishes the tone for the entire investing chain; as to the latter, it is corporate executives who actually apply the capital in the real economy. Repairing the nature of both relationships is critical to establishing a system of savings and capital allocation that preserves the social and environmental interests of shareholders and other stakeholders.

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Specifically, we propose that the fiduciary duties should be clarified or modified so that trustees and directors must account for the effects of their decisions on the economy, social institutions, and the environment to the full extent that those decisions impact commonly held interests. These interests include overall economic performance and the employment, social, and environmental conditions that human beneficiaries face.

Institutional Investors: Proposal

Our proposed rule clarifies that the obligations of institutional investors to protect beneficiary interests extend to any interest that beneficiaries hold in common. This change clarifies that trustee activity to enhance overall market return by improving economic, social, or environmental conditions is also in the best interests of beneficiaries, and that even if there is not a market effect, such improvements may benefit shareholders as workers, savers, and community members, or by satisfying their ethical concerns. The rule also includes a list of stewardship activities (such as engagement and proxy voting) and goals (such as fair use of limited resources) that can serve the best interests of beneficiaries.

This expansion is largely permissive — there is no requirement that a trustee take action to protect those broader interests. There is, however, one mandatory procedural aspect of the rule: **Trustees must consider whether trust resources should be allocated towards stewarding the assets in a manner that would increase market returns (and thus the return of a properly diversified investor) or protect the common interests that beneficiaries share with respect to their own lives and work.** This means that trustees cannot turn a blind eye to company activity that harms other companies in a diversified portfolio or negatively impacts the lives of its beneficiaries. This rule will encourage investors to work together to impose common sustainability guardrails on companies that allow asset managers and company executives to maximize value, but only in a sustainable manner.

The mandatory element does not extend to security selection. The proposed rule specifically states it is not a breach of the stewardship obligation to purchase or hold companies that degrade common resources, although it may be a breach to fail to adequately consider engaging with such companies or otherwise participating in collective stewardship action to modify their behavior. This divestment element is made explicit to assure trustees that the new rule would not require them to sacrifice portfolio return relative to their peers. To be clear, the proposed rule could enable divestment as a sustainability strategy, but it would not require it.

Similarly, the mandatory element does not extend to community interests. While it is essential that trustees have legal authority (i.e. permission) to respond to legitimate concerns as to the impact that company behavior has on ethical obligations to fellow community members, a legal obligation of such a nature belongs in the regulations regarding companies themselves, not the fiduciaries who represent the owners.

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Table 1 lists the nature of trustees' duties as to different shareholder interests under the new standard.

	STEWARDSHIP	SECURITY SELECTION
INDIVIDUAL COMPANY INTERESTS (ALPHA)	M	M
PORTFOLIO INTERESTS (BETA)	M,G	P,S
CITIZEN INTERESTS	M,G	P,S
COMMUNITY INTERESTS	P,G	P,S

(M)andatory: Trustees must consider this issue to satisfy their duties.
(P)ermissive: It is not a breach trustee duty to consider this issue.
(S)afe Harbor: It is not a breach of duty to fail to consider this issue.
(G)uardrails: Stewardship activity may include joint activity to impose pre-competitive standards on all companies.
**Shaded cells are proposed clarifications/modifications of best interest rule; current law sometimes interpreted to prohibit consideration of these interests.*

We recommend a federal requirement that all trustees be required to address the common interests of their beneficiaries as described in this section. This change would apply to direct federal law regimes including ERISA and Taft-Hartley pension plans, as well as institutions otherwise governed by state law. In the alternative, state laws should be adopted to incorporate these principles. Model language establishing a new federal rule is included in the language set forth in Exhibit A. Alternative model language modifying state law definitions of best interest is included as Exhibit B.

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Institutional Investors: Case Study

Imagine a pension fund for a state's public employees that holds public company stocks through both index funds and through actively managed funds, as well as limited partnerships in private equity funds. Suppose that, through its indexed and actively managed holdings in public companies, it held substantial holdings in an international retailer that paid a low wage to its store employees and paid its CEO annual compensation of $20 million.

Without the clarification included in our proposal, a trustee might be uncertain whether she could or should consider allocating resources to support a shareholder proposal that required a company to pay a living wage or to limit the ratio of CEO pay to median wage unless there was evidence that such a proposal would, holding everything else equal, increase the financial return to shareholders from the company itself.

With the clarification in place, however, the trustee would have to consider supporting the resolution if it were part of a strategy to limit wage inequality at all companies in order to create higher wages for most workers and greater economic growth, thus aiding beneficiaries by raising their wages as well as overall market performances. While this strategy might require the fund to incur administrative costs, and perhaps see a reduced return from the individual company in question, it would be designed to create net financial benefits for its beneficiaries.

The fund could not effectively engage in this strategy independently — no institution has sufficient assets to move the market. Instead, it would have to work with other institutions collectively to impose wage restrictions on companies across the market. Note that in order to prevent privately held companies from continuing the downward pressure on wages, this collective action would have to reach them as well. This could be done by influencing the behavior of private equity sponsors through limited partnership agreements and limited partner committees, and of closely held companies through supply chain management.

In addition, the permissive element of the rule would protect the trustees from a later threat of litigation if they also took into account the positive effect a wage guardrail might have on wages in general, and the consequent benefit to the families of their beneficiaries or on the interests those beneficiaries have in increasing equity, justice, and inclusion in the U.S. The new rule would not require the trustee to consider divesting the retailer, nor would it require the trustee to consider engaging or voting on the wage resolution if it were not part of a strategy to increase market returns or positively impact the beneficiaries themselves. Nevertheless, it would be clear that either action was permissible.

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Corporations: Proposal

We propose a federal requirement that any corporation or other business entity involved in interstate commerce be formed under a state statute that requires directors and officers to account for the impact of corporate actions not only on financial returns, but also on the viability of the social, natural, and political systems that affect all stakeholders.

If the fiduciary rules are changed for asset owners but not for corporate directors, the rules governing these two types of fiduciaries will be misaligned. Asset owners will be frustrated by an inability to invest in companies that are legally structured to respond to the portfolio, individual, and community interests of beneficiaries and other shareholders. A change to the duty of directors is thus needed to fully align the rules of the financial system with the interests of shareholders.

In order to create this alignment, the new fiduciary responsibility of corporate directors would be enforceable solely by the action of shareholders; subject to the standards of the business judgment rule and statutory language limiting nuisance lawsuits. This shift in fiduciary duties does not mandate a certain set of decisions or outcomes, but instead allows directors to respond to the same broad shareholder concerns as are contemplated by the rule for trustees.

While directors would have very broad discretion under this standard in trading off profits and sustainability considerations, most large for-profit enterprises will continue to be controlled by shareholders. If those shareholders are operating under our proposed rule for trustees, and thus protecting the broader interests of their beneficiaries while pursuing profits, then corporations will be able to follow suit under the new corporate fiduciary standard. This is because those interests overlap with the interests of stakeholders in a growing economy, stable social institutions, and a healthy environment.

This alignment of legal interests will permit companies to adhere to sustainability guardrails that, while potentially lowering their own individual profitability, nevertheless contribute to the broad well-being of their shareholders and other stakeholders. The new approach to corporate fiduciary duty could reduce the return for some companies that benefit from exploiting negative externalities, but it will benefit shareholders as a class, along with other stakeholders, because it will lead to a more inclusive and equitably prosperous economy over time. Corporations will not be pressured to compete on the basis of holding down worker wages when it sacrifices inclusion and equitable prosperity and stretches the fragile safety net. They will not have to treat a rising share price as a metric for a company's success while the company simultaneously contributes to climate destruction, or ignore the true cost of their decisions and hope that government or market forces can solve the problems while corporations focus all of their efforts on profit at any cost. **Importantly, these changes will not affect market competition, as long as they are accomplished through common sustainability guardrails that shareholders apply equally to all companies.**

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We recommend a federal requirement that all business entities operate under a benefit corporation standard of fiduciary duties, and that during any transition period, state law barriers to the adoption of benefit corporation governance, including supermajority voting requirements and appraisal rights, be eliminated. The proposed federal law is included in Exhibit A.

Corporations: Case Study

As an example, consider a corporation addressing the climate crisis. Under shareholder primacy, it could find a number of win-win tactics that would improve environmental and social system resiliency, and thus benefit the broad interests of shareholders and stakeholders, while also increasing the present value of its return to shareholders. This is the process of ESG integration, which is consistent with, and indeed mandated by, shareholder primacy.

Thus, under today's regime of shareholder primacy, a company might determine that committing to carbon neutrality by 2040 would increase certain current expenses but prepare the company for likely regulation, decrease energy costs over time, and increase employee morale and consumer preference so as to financially outweigh the up-front costs. At the same time, the company might decide that any quicker pace would cost the company more than it gained in long-term financial return to shareholders. Thus, for that particular company, a 2040 goal might define the beginning of a sustainability frontier, beyond which further increases in sustainability would reduce their individual return compared to its peers. See Figure 1.

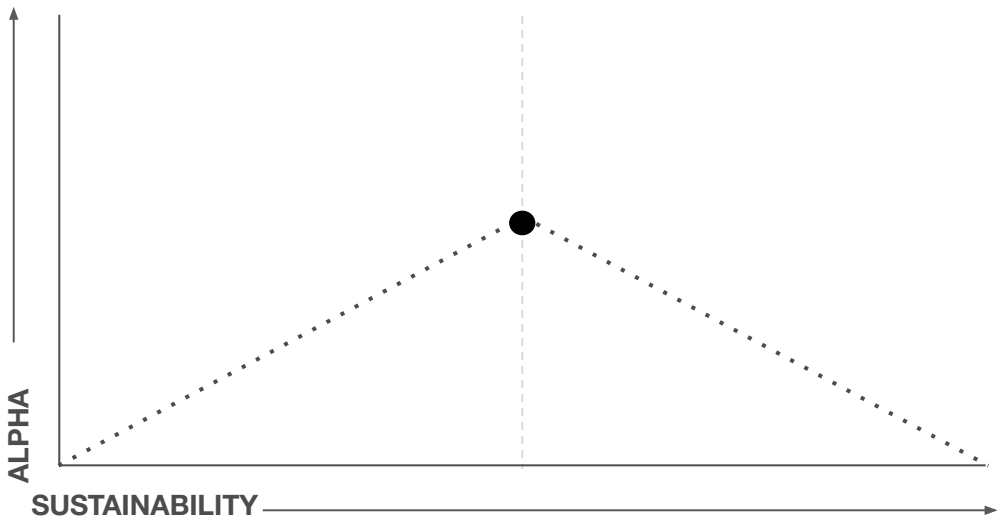

Figure 1: The sustainability frontier. On the left side of a 2040 goal, company financial performance increases as sustainability increases. Past that level of sustainability performance, there is a trade off between alpha and sustainability

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Under a regime created by shareholder primacy, that frontier would limit sustainability performance to the point at which financial performance peaks— in this case, a 2040 net zero goal. Under the proposed standard, however, a corporation could account for (1) the fact that if the corporation and similarly situated companies were to hew to a 2035 target date, the economy as a whole would deliver an improved performance, lifting the return of stock markets overall, and (2) the fact that such a date would also lend itself to a more just transition to a low-carbon economy, improving the lives of shareholders, employees, and communities.

These broader interests could be taken into account by following an investor-sanctioned sustainability guardrail that required all similar corporations to achieve neutrality by 2035. A corporation could participate in this collective action in order to improve the overall return that its shareholders depend upon, even if it could achieve greater individual return by using a goal of 2040.[3] It could also consider additional benefits that shareholders and stakeholders share in an earlier date: more clean energy jobs, an earlier and thus more just transition to a carbon-free economy, and the equity created by preserving underrepresented coastal communities around the globe.

Tools for Accountability

The previous section described a clarified concept of the duties owed by fiduciaries throughout the investment chain. Clarifying these obligations is necessary but will not be sufficient to engender change in the financial system if there is no method to hold fiduciaries accountable. This section addresses tools for holding both asset owners/managers and corporate executives accountable for these broader obligations.

Tools for Accountability: Holding Trustees and Money Managers Accountable

While fiduciary litigation is one avenue of accountability, the balancing of financial, social, and environmental issues required will be difficult to challenge in the courts. However, beneficiaries have varying degrees of voice with respect to who manages their assets and how. For example, a 401(k) investor may choose from the funds made available by her employer, or may have an even broader range of choice if self-management is available. Workers in a pension fund may have little or no direct opportunity for choosing managers, but may have voice through elections, political activity, or grassroots advocacy.

This section describes two proposed rules to make the trustees accountable for the expanded duty that the definition creates.

3. Importantly, the project of requiring all companies to use the 2035 goal may raise the absolute return the company delivers to its shareholders by preserving critical systems in which the corporation is embedded, even though, in isolation, the company could further improve its return by delaying until 2040. This tension between individual motives and systemic outcomes creates a prisoner's dilemma that the guardrails encouraged by these policy proposals can solve.

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Disclosure by Asset Owners and Managers

Significant accountability for the new duties can be established through disclosure requirements. Investment fiduciaries should disclose their efforts to balance these important facets of their responsibilities and should report the details of their proxy voting and engagement efforts on a timely basis. Such disclosure will give beneficiaries opportunities to make their views known and to change trustees or even move assets where such choices are available.

We propose a federal disclosure regime that provides beneficiaries, including pension beneficiaries and the owners of mutual funds, ETFs, interests in private equity and venture capital funds, and other members of the public with information as to how asset owners and managers are allocating capital, voting shares, and otherwise engaging with companies so as to protect the broad stakeholder interests that shareholders have as described in the previous section. A proposed statute authorizing such disclosure regulations is included in the federal legislation in Exhibit A.

Proxy Scorecard: Making Mutual Funds Disclose Proxy Votes Real Time

Approximately half of American households hold shares in mutual funds through 401(k) or other savings plans. Current federal law requires mutual funds (including index funds) to disclose how they have voted proxies in the companies they hold once a year in a hard-to-read HTML format. As a result, a large portion of the American population has little visibility into the voting of their own economic interests on matters that affect their lives as much as political elections. Every year, there are hundreds of shareholder proposals on the ballot at public corporations, and many of these involve environmental, social, and governance issues important to these Americans.

Mutual fund managers who do not hear from beneficiaries may tend to vote those shares in order to earn the approval of the companies themselves, who are often the customers of such funds through the maintenance of employee savings plan. Muting the voice of mutual fund holders leads to proxy votes that do not reflect the broad economic interests of these beneficiaries whose interests are impacted by corporate decisions that erode tax bases, degrade the environment, or continue to create inequality and contribute to the racial wealth gap. Mutual funds report their asset values and other metrics on much shorter than annual bases. For Main Street investors, it is as important to receive information on stewardship questions like proxy voting in real time as it is to receive financial information.

Federal rules should, at a minimum, require that mutual funds immediately report votes cast, and should include some mandatory period before an actual vote for proxies to be filed and reported, to give mutual fund owners time to let fund managers know their opinions. Because funds often defend votes in favor of management by reporting that they "engage" privately with issuers, rules should be adopted that require more transparency with respect to such engagements.

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Tools for Accountability: Asset Owners and Managers and Other Shareholders Holding Companies Accountable

Just as beneficiaries need tools to hold institutional investors accountable, those institutions and other diversified shareholders need tools to push that flexibility and accountability further down the links in the investing chain to companies. This section proposes a number of tools to accomplish this.

Benefit Board Leadership

It is important that clear accountability for ensuring compliance with the new standard is located within the board leadership, even though the entire board will be bound by the new fiduciary standards. In order to operationalize compliance with the board's fiduciary duties, boards should have clear mechanisms to evaluate and report on board and corporate behavior in line with the new standard. This evaluation process is intimately tied to compensation of executives and employees. Large corporations should be required to delegate leadership on the expanded stakeholder duties and employee compensation to the committee responsible for executive compensation.

We recommend that, for large companies, federal rules require that the compensation committee be charged with ensuring that the company incorporates consideration of stakeholder concerns into its decision-making process, and that the company's compensation scheme for senior employees is reflective of stakeholder considerations.

New Business Disclosure Responsibilities

There will be no effective accountability under the new fiduciary standards if there is no public reporting. To enable better market decisions, credible stakeholder consideration requires commensurate disclosure of stakeholder impact. Disclosure provides information not only to shareholders but to other stakeholders to help them understand the true cost and impact of dealing with the businesses in question.

For example, a company's Scope 3 emissions might have a limited effect on its financial performance but contribute disproportionately to atmospheric carbon concentration. Institutional investors might want to use this information to protect their diversified portfolios and human beneficiaries from the negative impacts of climate change, and workers and consumers might want this information to help decide whether they would prefer to pursue their careers with or purchase goods or services from companies with low carbon profits.

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Markets — whether for goods and services or for capital — only work when there is adequate information for market participants to make decisions. The current disclosure regime offers up a very limited slice of that information, only requiring information directly material to the individual financial return that the company provides to its shareholders. It does not mandate any information as to how a corporate decision might affect critical systems that other stakeholders rely upon.

Moreover, because most disclosure requirements are based on a company's status as publicly traded, privately held companies do not provide even the limited information provided by public companies. This leaves consumers, workers, and other stakeholders without critical information, and unfairly disadvantages public companies. This in turn could create an unintended consequence of incentivizing public companies to go private or for private companies to stay private, weakening an important part of the capital market ecosystem and reducing wealth creation opportunities for most Americans, who are non-accredited investors and unable to invest in private companies.

We recommend that current SEC disclosure requirements in its investor protection regime be expanded to address not just matters material to a company's financial performance, but also information relevant to systemic risk and the impact of the company on all of the interests of its shareholders and stakeholders. We also recommend that disclosure requirements should be applied to all companies with revenues greater than $1 billion, rather than basing disclosure requirements on a company's listing status. A proposed statute authorizing such disclosure regulations is included in the federal legislation in Exhibit A.

Discourage Compensation Based Solely on Equity Performance

As we emphasize throughout this proposal, the single-minded focus on financial performance is at the root of deep problems like inequality, the racial wealth gap, and climate risk. We believe that compensation in shares or options at the company level, or based on the return of an individual company alone at the trustee or asset manager level, can exacerbate this problem by incentivizing executives and managers to sacrifice broad shareholder or stakeholder interests in order to increase the share price or portfolio performance. Just as it is important to align the legal obligations of trustees and executives with the broad interests of shareholders and stakeholders, it is necessary to ensure that compensation schemes are also aligned.

Accordingly, we propose that tax and other laws should be designed to ensure that such incentive payments do not vest unless important social and environmental impact metrics are met. Compensation structured in such a fashion will still rely on markets and the profit motive to incentivize executives, but in a manner that accounts for the true cost and impact of generating those profits.

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Similarly, we believe that tax and or regulatory policy should be designed to discourage asset manager compensation based on portfolio performance that does not account for the systemic effects of such performance.

We recommend that tax laws and financial regulations be designed to discourage compensation based on equity or portfolio value that does not account for systemic effects of assets under management.

Shareholder Proposals

Shareholder rights at a company should not be restricted to matters material to the financial returns of that company. As discussed throughout this paper, shareholders have many interests in a company's performance that extend beyond the narrow bounds of financial materiality. Rule 14a-8 is a primary example of this issue.

Under Rule 14a-8, the SEC monitors a process that gives the shareholders of publicly traded companies the right to have proposals for shareholder action included in the company's annual proxy statement. This gives shareholders the ability to bring matters of concern to their fellow shareholders and management. There is a fairly complex set of rules and procedures that establish the types of proposals that may be brought, and companies can often exclude certain proposals without concern that the SEC will challenge them.

For example, proposals cannot concern ordinary business matters; under this exception, matters must not be overly "complex," and must be legal to implement. Under the second exception, the matters must be "economically relevant" to the corporation. These exceptions, along with a series of letters and guidance from the SEC, create uncertainty as to whether proposals that concern the interests of shareholders outside a company's financial return can be excluded. Some social and environmental issues involve complex questions of measurement, while others focus more on the economic effects on portfolios and beneficiaries than the individual companies. Thus, proposals on environmental and social matters that are critical to diversified shareholders may be excluded under these exceptions.

For the indexed and quasi-indexed shareholders participating in the public markets today, one of the most important issues is managing the effect that issuers have on the critical systems that those shareholders and stakeholders alike rely upon. Rule 14a-8 should be amended to clarify that proposals that mandate social and environmental standards are proper matters for shareholder action, and not excludable.

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We recommend the following actions:

- **Amend Rule 14a-8 to provide clarity that Rules 14a-8(i)(7) and Rule 14a-8(i)(5) cannot be used to exclude proposals relevant to the interests of institutional investors consistent with responsible capitalism and the proposed expanded fiduciary duties.**

- **Reverse any adoption of currently proposed new SEC rules to make it more difficult for shareholders to bring proposals, including increase in required voting thresholds for repeat proposals.**

Support Shareholder Collective Action

As we have emphasized, for most shareholders the preservation of critical environmental and social systems is more important — both to their financial health and broader experience — than increasing financial returns at any one company. Maintaining those systems may require collective action at the shareholder level to avoid prisoners' dilemmas by facilitating pre-competitive action at the company level. For example, shareholders may want to adopt a sustainability guardrail requiring that manufacturers meet certain benchmarks regarding freshwater depletion in order to ensure that the water system does not collapse.

There is a risk that such efforts might be attacked as anticompetitive, on the basis that coordination to restrict environmental abuses constitutes collusive behavior that will raise consumer prices. Such a potential is illustrated by the recent announcement that the Justice Department was investigating action among carmakers to voluntarily improve fuel standards. In July of 2020, an energy industry lawyer and former White House counsel claimed that activist investors seeking to curb abuse of the environment were engaging in illegal activity. Such attacks falsely conflate consumer prices and consumer well-being. In the long run, consumers are not served if companies compete on prices and increase profits in the short term but ultimately degrade the vital systems necessary for an inclusive and equitable economy. The Department of Justice and Federal Trade Commission must adopt "safety zones" of conduct that are presumed not to be anticompetitive to ameliorate this concern.

Similarly, there is some risk that collective action among shareholders could trigger heightened filing requirements under the Williams Act provisions that require certain shareholders to file Forms 13D and 13G with the SEC. These public filing requirements are intended to inform the public when there is a potential for a change in control at a publicly traded company. Thus, the rules should not be triggered by engagement activity in which shareholders merely seek to exercise the rights that they already have. Nevertheless, the fear of expanded filing requirements could discourage institutional shareholders from participating in collective action necessary to meet their enhanced fiduciary obligations. The SEC should be able to provide guidance through an approved list of shareholder engagement activities that are not considered to involve questions of corporate control, or adopt regulatory safe harbors for engagement with respect to sustainability guardrails and similar restrictions on portfolio company conduct.

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While specific policy recommendations in these areas require further study, safe harbors protecting shareholder engagement should be established through guidance, regulation or legislation.

We recommend that the Department of Justice and the Federal Trade Commission establish a process to determine whether there is a need to create a Safety Zone for coordinated shareholder action in pursuit of sustainability guardrails or similar restrictions on corporate behavior with a goal of preserving economic justice, environmental systems, and social institutions and otherwise protecting the common interests of corporate shareholders and stakeholders. In addition, the SEC should study the adoption of an approved list or similar guidance or regulation to ensure that such activities do not trigger heightened filing requirements under the Williams Act.

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Conclusion

Towards a More Just, Inclusive, Equitable and Prosperous Economic System

Adoption of this proposal will ensure that the U.S. financial system accounts for the need to ensure the resilience of economic, social, and environmental systems. Despite the profound changes the new policies entail, they pragmatically build on the current competitive market system while cutting dated rules created for a much different economy that did not prioritize justice, equity, and inclusion for all people or face the threat to planetary boundaries and depleted resources we face today.

If our proposals become law, the institutional shareholders who control the equity markets will widen their aperture of responsibility and begin to consider a broad array of the interests of the beneficiaries they represent, including their interests in a thriving job market that offers economic security and full human dignity, and an interest in a just, inclusive and equitable economy that works for everyone in a manner sustainable for future generations.

In order to exercise this responsibility, these shareholders will have to engage with the companies that dominate the markets in order to create common sustainability guardrails that provide a baseline of support for social institutions and a limit on the exploitation of common resources and communities made vulnerable by systemic structures of oppression. This interaction will preserve the competitive dynamic so important to the economic growth of the U.S. economy, while channeling that competition to innovations that improve the lives of all Americans, and not just the wealthiest among us.

Now is the time to make these changes. The richest economy in the world failed to prepare for an inevitable pandemic, and the reason lies in corporations' unending pursuit of individual advantage. This same pursuit has continued to exacerbate inequality and racial wealth gaps, an environment teetering on collapse, and the unraveling of civil society.

Our proposals can put an end to markets that pressure executives to hold down worker wages, thus endangering the productivity of the national workforce. The proposals will create accountability so that ever-rising share prices do not excuse responsibility for climate destruction

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that imperils the future of the economy and society. If adopted, they would remove any excuse that the hands of directors and other fiduciaries are tied, and that all they can do is to hope that someone else will solve the problem caused by their own profit-driven decisions. The policies we describe are necessary to transform our system from shareholder primacy to Stakeholder Capitalism so that it can fulfill its promise to create a just, inclusive, equitable and prosperous economy that will endure long into the future.

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Appendix A: Policy Agenda Text

Fiduciary Duties for Institutional Investors

We propose changes to current state and federal laws to require investment fiduciaries to consider a broad array of beneficiary interests that extend beyond the financial return provided by individual companies.

The Stakeholder Capitalism Act included as Exhibit A does this all with a federal law that preempts contrary state laws and includes provisions that amend the fiduciary duties applicable to retirement plans governed by ERISA and investment companies. The SCA broadly defines "investment companies" for these limited purposes to eliminate exemptions for private equity, venture capital and hedge funds, and also expands the definition to include state law governed investment fiduciaries such as state and municipal pension plans, foundations and endowments.

As an alternative to the latter, Exhibit B provides for a model state law provision that redefines the "bests interests" of beneficiaries.

Corporate Fiduciary Duties: Model Corporate Fiduciary Requirement.

We propose a federal policy that changes current state and federal laws to require corporate fiduciaries consider the interests of stakeholders as well as shareholders.

The SCA included as Exhibit A includes a provision that requires companies engaged in interstate commerce to incorporate under state laws and with governing document provisions that require corporate fiduciaries to account for stakeholder interests.

Asset Owner/Manager Disclosure

We propose a federal disclosure regime that provides beneficiaries — including the owners of mutual funds and ETFs — and other members of the public with information as to how asset owners and managers are allocating capital, voting shares and otherwise engaging with companies so as to protect the broad stakeholder interests that shareholders have as described in the previous section.

The SCA included as Exhibit A authorizes the establishment of a regulatory regime to create such disclosure requirements.

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We also propose that federal rules should, at a minimum, require that mutual funds immediately report votes cast, and should also include some mandatory period before an actual vote for proxies to be filed and reported, to give mutual fund owners time to let fund managers know their opinions. Because funds often defend votes in favor of management by reporting that they "engage" privately with issuers, rules should be adopted that require more transparency with respect to such engagements.

Benefit Board Leadership

We recommend that, for large companies, federal rules require that the compensation committee be charged with ensuring that the company incorporates consideration of stakeholder concerns into its decision-making process, and that the company's compensation scheme for senior employees is reflective of stakeholder considerations.

Company Disclosure

We recommend that current SEC disclosure requirements in its investor protection regime be expanded to address not just matters material to a company's financial performance, but also information relevant to systemic risk and the impact of the company on all of the interests of its shareholders and stakeholders. We also recommend that disclosure requirements should be applied to all companies over a certain size threshold at the federal level, rather than basing disclosure requirements on a company's listing status.

The SCA included as Exhibit A authorizes the establishment of a regulatory regime to create such disclosure requirements.

Compensation

We recommend that tax laws and financial regulations be designed to discourage compensation based on equity or portfolio value that does not account for systemic effects of assets under management.

Shareholder Proposals

We recommend the following actions:

- Amend Rule 14a-8 to provide clarity that Rules 14a-8(i)(7) and Rule 14a-8(i)(5) cannot be used to exclude proposals relevant to the interests of institutional investors consistent with responsible capitalism and the proposed expanded fiduciary duties.

- Reverse any adoption of currently proposed new SEC rules to make it more difficult for shareholders to bring proposals, including increase in required voting thresholds for repeat proposals.

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Support Shareholder Collective Action

We recommend the the Department of Justice and the Federal Trade Commission establish a process to determine whether there is a need to create a safety zone for coordinated shareholder action in pursuit of sustainability guardrails or similar restrictions on corporate behavior with a goal of preserving economic justice, environmental systems and social institutions and otherwise protecting the common interests of corporate shareholders and stakeholders. We believe that the SEC should study the adoption of an approved list or similar guidance or regulation to ensure that such activities do not trigger heightened filing requirements under the Williams Act.

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Appendix B: Interim Tax & Procurement Policy

Fiduciary Duties for Institutional Investors Benefit Board Leadership

Implementation of these policies may take time and in the interim, we believe that the federal and state governments should create economic benefits through tax, procurement and other economic development incentives to support accelerated adoption of these new standards by companies.

Publicly created economic incentives are an important component of public policy, which can serve as a policy bridge until the time when comprehensive policies can become law after they are enacted. Economic incentives — whether expressed through tax or procurement policy — can be structured to support companies that voluntarily adopt new fiduciary duties, board leadership, and disclosure regimes voluntarily.

Tax policy is a common mechanism used to incentivize or reward socially productive behavior that is not required by the letter of the law. Corporate tax incentives can be structured as credits or deductions, and can incentivize companies to spend their own funds with the knowledge that their tax burden will be reduced.

Procurement preferences can be expressed at the local, state, and federal level. The federal government's procurement power is broad: in 2019, the federal government spent $4.45 trillion.[4] Previous examples have included Executive Orders passed to raise wages and benefits, improve worker safety, and reduce discrimination.

Before new fiduciary duty and disclosure regimes become required for all companies and investors, policymakers can offer economic incentives to companies and investors that choose to adopt them voluntarily. Once such a requirement is effective, policymakers can further use economic incentives to encourage substantive high performance by offering incentives to companies and investors whose performance is verified by a third party on an issue important to policymakers and/or on overall performance that creates a certain level of value for all stakeholders. We propose that all government contracts and investment should only support businesses and investors that adopt new standards of fiduciary duty and disclosure regimes. The spending of the public's money should require recipients to be accountable to serve the public interest and to be transparent about the extent to which those interests are being served.

4. See USAspending.gov for details on federal procurement spending.

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Exhibit A: The Stakeholder Capitalism Act

A Bill

To ensure that directors, trustees and other fiduciaries with the responsibility for overseeing the wealth of American citizens have the obligation and ability to act for the common good of those beneficiaries, including their interests in successful American and global economies in which citizens seek dignified, well-paying jobs and save for long-term goals through diversified portfolios; in an environment and social institutions that support the well-being of all citizens; and in knowing their capital is not being used to undermine American values; and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE; TABLE OF CONTENTS.

(a) SHORT TITLE.—This Act may be cited as the "The Stakeholder Capitalism Act of 2020".

(b) TABLE OF CONTENTS.—The table of contents for this Act is as follows:
Section 1. Short title; table of contents.

TITLE I—REQUIRING BUSINESS TO WORK FOR THE COMMON GOOD OF CITIZENS AND SHAREHOLDERS

Sec. 101. Fiduciary Duties.
Sec. 102. Disclosure Requirements for Large Businesses.

TITLE II—REQUIRING INVESTMENT COMPANIES (INCLUDING INSTITUTIONAL INVESTORS) TO WORK FOR THE COMMON GOOD OF CITIZENS AND BENEFICIARIES

Sec. 201. Fiduciary Duties.
Sec. 202. Disclosure Obligations.

TITLE I— REQUIRING BUSINESS TO WORK FOR THE COMMON GOOD OF CITIZENS AND SHAREHOLDERS

SEC. 101. FIDUCIARY DUTIES FOR BUSINESSES.

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(a) IN GENERAL.—A new Chapter 2F of Title 15 of the U.S. Code is hereby adopted to read in its entirety as follows:

SEC. 80d. CORPORATE FIDUCIARY DUTIES

(a) DEFINITION.—In this section:

“(1) a “qualifying corporation” is any corporation, limited liability company, business trust, limited or general partnership, including any limited liability limited partnership, or any other business entity engaged in interstate commerce and incorporated or formed in the United States;

“(2) a “manager” is any person with the discretion to make decisions on behalf of a qualifying corporation, including directors, officers and managers;

“(3) a “shareholder” shall mean any holder of an equity security, including, without limitation, common stock, preferred stock, membership interests and partnership interests, whether general or limited and beneficial interests in business trusts;

“(4) “common equity” shall mean interests of a shareholder entitled to payment in dissolution after the satisfaction of all liabilities.”

“(b) IN GENERAL--No qualifying corporation shall engage in interstate commerce unless, pursuant to the laws under which it is formed:

“(1) such corporation is governed by fiduciary duties or other rules that, in either case, require its managers to account in their decisions not only for financial returns, but also for their impacts on all stakeholders, including on the social and natural systems on which a just and prosperous future depend;

“(2) such corporation’s shareholders are entitled to bring legal action for injunctive relief to enforce the fiduciary duties described in subsection (a) and the laws applicable to any qualifying corporation do not require that such actions be brought by the holders of more than 2% of a corporation's common equity or, in the case of any publicly traded corporation, $2,000,000 worth of shares, as measured on the day such action is initiated.”

“(c) SAFE HARBOR-- Any corporation formed pursuant to a statute that establishes fiduciary duties of managers and corporate purpose consistent with the provisions of [The Model Benefit Corporation Law, the Delaware Public Benefit Corporation Statute or Chapter 18 of the Model Business Corporation Act] shall be deemed to satisfy subsection 1(a) of this provision.”

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"(b) RULEMAKING.—Not later than 2 years after the enactment of this section, the Securities and Exchange Commission shall promulgate rules setting forth the procedures to ensure that entities subject to Section 80d are in compliance, including filing requirements, safe harbors and procedures for determining compliance."

(C) EFFECTIVE DATE.— This section shall take effect upon enactment, except that Section 80d of Title 15, shall take effect 3 years following such enactment.

SEC. 102. DISCLOSURE REQUIREMENTS FOR LARGE BUSINESSES.

(a) IN GENERAL.—The Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) is amended by inserting after section 13A the following:

"SEC. 13B. ANNUAL REPORTS ON MATTERS RELATING TO THE COMMON GOOD FOR LARGE BUSINESSES.

"(a) DEFINITION.—In this section:

"(1) IN GENERAL.—The term 'large business' means an entity that—

"(A) is organized under the laws of a State or territory of or the United States as a corporation, partnership, limited liability company, limited liability partnership, trust, or other legal entity;

"(B) engages in interstate commerce; and

"(C) in a taxable year, according to information provided by the entity to the Internal Revenue Service, has more than $1,000,000,000 in gross receipts.

"(2) AGGREGATION RULES.—All entities treated as a single employer under subsection (a) or (b) of section 52 of the Internal Revenue Code of 1986, or subsection (m) or (o) of section 414 of such Code, shall be treated as 1 entity for the purposes of paragraph (1).

"(b) REPORTING OBLIGATIONS FOR LARGE BUSINESSES.—

"(1) IN GENERAL.—Every large business shall file annually with the Commission, in accordance with such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest, such information about its impact on its employees and other workers whose labor it contracts for or who are in its supply chain, communities it impacts, other stakeholders, the environment and other matters of common interest to citizens and relevant the social and natural systems on which a just and prosperous future depend as the Commission shall require by regulation.

"(2) APPLICABILITY.—This subsection shall apply regardless of whether the entity is subject to the reporting requirements of section 13(a) or section 15(d) of this Act.

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"(c) RULEMAKING.—

(1) IN GENERAL.—Not later than 3 years after the enactment of this section, the Commission shall, in consultation with the Department of Labor, the Department of Commerce, and the Environmental Protection Agency, promulgate rules setting forth the required content and format of the filings made under subsection (a).

(2) CONSIDERATIONS.—In promulgating the rules required under this subsection, the Commission shall seek to ensure reasonably standardized presentation of the information reported and consider—

"(A) the interests of investors, workers, consumers, and other stakeholders;

"(B) the compensation, benefits, and working conditions of the business' workers and the workers in its supply chain, including whether it uses substitute forms of contracted labor, and if so, the compensation, benefits, working conditions, and rights of those workers in comparison to employees;

"(C) the interests of the communities in which the business has material operations or which it otherwise impacts, directly or indirectly;

"(D) the protection and regeneration of the environment, including the interests of the business' stakeholders and society in mitigating the economic and other harm caused by climate change; and

"(E) the interests of society as a whole, including the preservation and regeneration of the social and natural systems on which a just and prosperous future depend.

"(d) FALSE OR MISLEADING STATEMENTS.—

"(1) IN GENERAL.—Except as provided in paragraph (2), it shall be unlawful for any person, in any report or document filed under this section, to make or cause to be made any untrue statement of a material fact or omit to state a material fact required to be stated in the report or document or necessary to make the statements made, in light of the circumstances under which they were made, not misleading.

"(2) DEFENSE.—A person shall not be liable under paragraph (1) if the person shows that the person had, after reasonable investigation, reasonable ground to believe and did believe, at the time the statements were made, that the statements were true and that there was no omission to state a material fact necessary to make the statements made, in light of the circumstances under which they were made, not misleading.

"(3) NO PRIVATE RIGHT OF ACTION.—Nothing in this subsection shall be construed as creating a private right of action."

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(b) EFFECTIVE DATE.—This section and the amendments made by this section shall take effect on the date of the enactment of this Act, except that section 13B(b) of the Securities Exchange Act of 1934, as amended by this section, shall take effect on the date that the rules promulgated by the Commission under subsection (c) of that section take effect.

TITLE II— REQUIRING INVESTMENT COMPANIES (INCLUDING INSTITUTIONAL INVESTORS) TO WORK FOR THE COMMON GOOD OF CITIZENS BENEFICIARIES

SEC. 201. FIDUCIARY DUTIES.

(a) INVESTMENT COMPANIES.— the Investment Company Act of 1940 (15 U.S.C. 80a) is amended by—
(1) Inserting after paragraph (54) of Section 2 the following:

"(55) "guardrails" shall mean parameters that, if broadly adopted by businesses, have the potential to promote economic, environmental and social well-being, equity and a just and prosperous future and other common interests of investors throughout our nation, including requirements that subject businesses:

"(A) fairly account for the well-being of their stakeholders,

"(B) use equitable and proportionate shares of available natural and other resources,

"(C) contribute fair and proportional amounts to the public good, including through tax payments, and

"(D) fairly share gains with workers and other stakeholders;"

"(56) "stewardship" shall mean participation in engagement and proxy activities, policy advocacy and similar actions, including actions in support of guardrails."

"(57) "sustainability" shall mean maintaining the health and equity of the economy, social institutions and the environment to the extent such maintenance promotes common interests."

"(58) "common interests" shall mean interests held generally in common by beneficiaries and the persons and communities served by such beneficiaries, including interests in (A) securities market performance, (B) the effect of economic, social and environmental systems on beneficiaries and the persons and communities served by such beneficiaries and (C) the effect of such systems on the welfare of communities of which such beneficiaries and the persons and communities served by such beneficiaries are a part."

(2) inserting after subsection (c) of Section 36 the following:

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"(d) A person subject to subsection (a) of this section who acts for a the investment company shall be deemed to have a fiduciary duty--

"(1) that permits consideration of common interests in addition to the return of the fund;

"(2) that permits allocation of resources to stewardship or other matters and engagement in security selection in order to protect the common interests;

"(3) that requires consideration of the allocation of investment company resources to stewardship in support of guardrails to the extent such action by the investment company and other securityholders and stakeholders has the potential to affect the common interests in the matters listed in Section 2 (58) (A) and (B);

"(4) that permits engagement in security selection in order to advance the common interests but provides that failure to consider divesting or not acquiring a security shall not be deemed a violation of such duties."

"Notwithstanding the fiduciary obligations prescribed by this subsection, the law of the jurisdiction of formation of an investment company and the documents governing such investment company (to the extent permitted by such laws) may limit or eliminate monetary liability for persons subject to the obligations of this subsection (d) but shall not otherwise impose unreasonable limits on private rights of action brought by beneficiaries to enforce such obligations."

(b) EMPLOYEE BENEFIT PLANS.—Section 404(a) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1104(a)) is amended by inserting after paragraph (2) the following:

"(3) Notwithstanding any other provision in this Act, in exercising a plan's voting power or undertaking any other stewardship activities as to plan assets, a fiduciary shall—

"(A) be permitted to consider the common interests, as defined in Section 2(58) of the Investment Company Act of 1940, of the plan participants in addition to the return of the fund;

"(B) be permitted to allocate resources to stewardship, as defined in Section 2(54) of the Investment Company Act of 1940, or other matters and engage in security selection in order to protect the common interests of fund beneficiaries;

"(C) be required to consider the allocation of fund resources to stewardship, as defined in Section 2(56) of the Investment Company Act of 1940, in support of guardrails, as defined in Section 2(55) of the Investment Company Act of 1940 to the extent such action by the fund and other securityholders and stakeholders has the potential to affect the common interests of plan participants in the matters listed in Section 2(58) (A) and (B) of the Investment Company Act of 1940;

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"(D) be permitted to engage in security selection in order to advance the common interests of plan participants, but failure to consider divesting or not acquiring a security shall not be deemed a violation of this Section."

(c) EFFECTIVE DATE.— This section shall take effect on the date that is 3 years after the enactment of this Act; provided that no person who is a fiduciary described in this Section shall be deemed to have breached such person's fiduciary duty for acting in accordance with the provisions of this Section on a date prior to such third anniversary.

SEC. 202. DISCLOSURE OBLIGATIONS.

(a) INVESTMENT COMPANIES AND EMPLOYEE BENEFIT PLANS.—

(1) IN GENERAL.—Not later than 3 years after the enactment of this section, the Securities and Exchange Commission shall, in consultation with the Department of Labor, the Department of Commerce, and the Environmental Protection Agency, promulgate rules requiring each investment company and each employee benefit plan required to file an annual report under section 103 of the Employee Retirement Income Security Act of 1974 to file annually with the Commission information explaining how the investment company's or employee benefits plan's voting policies and other stewardship practices—

(A) ensure the faithful discharge of the fiduciary duties imposed by section 201(a) or 201(b), respectively of this Act and the amendments made thereunder;

(B) address the matters required to be disclosed by section 101 of this Act and the amendments made and rules promulgated thereunder with respect to the investment company or employee benefit plan;

(C) address the specific objectives and interests of the investment company's investors or the employee benefit plan's participants, including—

(i) saving for the long-term purpose of retirement in the case of and employees benefits plan and any investment company that holds retirement funds;

(ii) saving for the long-term purpose of paying for college tuition in the case of any investment company that holds college-savings funds; and

(iii) using sustainable strategies reflecting the diversified nature of investors as a class and effect of negative externalities generated by some portfolio companies on market returns overall;

(iv) avoiding business strategies that shift costs to citizens including avoidance of taxes and reliance on practices that create negative externalities including the shift costs onto society and the government; and

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(D) ensure that any proxy voting research, analysis, ratings, or recommendations from a third party, reflect the specific objectives and interests of the investment company's or employee benefit plan's participants and beneficiaries.

(2) EXEMPTIVE AUTHORITY.—

(a) The Securities and Exchange Commission may exempt from the rules promulgated under this subsection any investment company or class of investment companies for whose investors the Commission determines that the costs of disclosure outweigh the benefits.

(b) The Secretary of Labor may exempt from the rules promulgated under this subsection any employee benefit plan or class of plans for whose participants and beneficiaries the Secretary determines that the costs of disclosure outweigh the benefits.

(c) APPLICABILITY.—Solely for the purposes of this Title II, "investment company"

(1) shall include any entity otherwise exempted from such definition pursuant to Section 3(c)(1) or 3(c)(7) of the Act, and

(2) need not be an issuer, such that any entity, including pension plans not subject to ERISA, endowments, foundations and any other entity investing in securities for the benefit of other persons shall be subject to the requirements of this title II, subject to the exemptive authority established in subsection (c)(2).

(d) EFFECTIVE DATE.—This section shall take effect on the date of the enactment of this Act.

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Exhibit B: Model State Best Interests Definition

SECTION __: Best Interests Includes Common Interests; Protection of Common Interests Permissible; Mandatory Consideration of Guardrails.

a. In addition to the return of the fund, a trustee considering the "best interests" of fund beneficiaries may consider other common interests of the beneficiaries.
b. Trustees may allocate resources to stewardship or other matters and engage in security selection in order to protect the best interests of fund beneficiaries.
c. Trustees shall consider the allocation of fund resources to stewardship in support of guardrails to the extent such action by the fund and other securityholders and stakeholders has the potential to affect the common interest of fund beneficiaries by increasing the overall return of securities markets.
d. Trustees may engage in security selection in order to advance the common interests of their beneficiaries, but failure to consider divesting or not acquiring a security shall not be deemed a violation of this Section __.
e. For the purpose of this Section __:
    i. "common interests" shall mean interests held generally in common by beneficiaries, including an interest in sustainability;
    ii. "guardrails" shall mean parameters that, if broadly adopted by businesses, have the potential to promote sustainability, including requirements that subject businesses:
        A. fairly account for the well-being of their stakeholders,
        B. use equitable and proportionate shares of available natural and other resources,
        C. contribute fair and proportional amounts to the public good, including through through tax payments, and
        D. fairly share gains with workers and other stakeholders;
    iii. "stewardship" shall mean participation in engagement and proxy activities, policy advocacy and similar actions, including actions in support of guardrails;
    iv. (iv) "sustainability" shall mean maintaining the health and viability of the economy, social institutions and the environment to the extent such maintenance promotes common interests and a just and prosperous future.

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