IMPAX Asset Management
Adviser to Pax World Funds

Submitted via regulations.gov

September 24, 2020

Joe Canary
Office of Regulations and Interpretations
US Department of Labor
Room N-5655
200 Constitution Avenue NW
Washington, DC 20210

RE: Proposed Rule on Fiduciary Duties Regarding Proxy Voting and Shareholder Rights, RIN 1210-AB91

Dear Mr. Canary,

On behalf of Impax Asset Management LLC, the North American division of Impax Asset Management Group and investment adviser to Pax World Funds, we welcome the opportunity to comment on the Department of Labor Employee Benefits Security Administration's proposed rule on Fiduciary Duties Regarding Proxy Voting and Shareholder Rights, RIN 1210-AB91, 29 CFR Part 2550.

We believe the proposed rule is ill advised for four reasons. First, a foundational principle of ownership of publicly traded stocks is the right to vote on certain corporate matters, and the proxy is an asset that should be treated like stocks or bonds themselves and must be overseen with appropriate care for the creation of value for shareholders. Second, we believe it is inappropriate to view a vote supporting management's recommendations as requiring no justification, as this presumes, incorrectly, that management is always right. Third, empirical evidence shows that shareholder engagement, of which proxy voting is a part, contributes to financial and economic value for companies and shareholders. Fourth, there is no way to determine, when casting a vote, whether that vote will have an impact; many shareholder votes pass or fail by tiny margins.

Proxy voting is an asset of the shareholders

In several places, the proposed rule asserts that proxy voting often has little or no impact and is ineffective in serving shareholders. The same argument, of course, applies to all individual voting in any democratic system, but that rhetoric is not deployed in discussing the reasons for believing in democracy. A vote is a citizen's way of participating in the composition and conduct of government, just as a proxy vote is a shareholder's way of participating in governance and corporate conduct for publicly traded corporations. As Morningstar puts it, "Would you own a business without paying attention to how it's being run and who's running it?"[1] As an asset manager, we believe it is important to use the

[1] Jess Liu, "What is Proxy Voting and Why You Should Care," Morningstar, June 3, 2020. https://www.morningstar.com/articles/986937/what-is-proxy-voting-and-why-you-should-care

resources we have to express our preference for sound governance and good management, because they are the foundations of shareholder value.

The proposed rule's presumptions about the importance of proxy voting also seem out of line with the SEC's position on proxy voting.[2] While the SEC does not necessarily require all shareowners to vote every item on every proxy, it does state, "Investment advisers are fiduciaries that owe each of their clients duties of care and loyalty with respect to services undertaken on the client's behalf, including proxy voting."

We agree with the rule's reiteration that proxies must be voted in ways that comport with the fiduciary duty to clients. Pax World Funds' proxy voting guidelines, which we share with our proxy voting agent, were constructed and are regularly reviewed to assure that we vote in line with the creation of long-term value for shareholders, including voting on shareholder proposals as well as management proposals. Our proxy voting service provider offers advice according to our guidelines, and both the cost and time involved are aligned with providing value to shareholders; the cost of our proxy voting service comes to about 20 cents per item on the approximately 1,000 proxy ballots we vote each year. That cost is well worth it given the importance of this oversight. It *matters* who is on the board, or whether tender offers are fair, or whether performance-based executive pay is really based on performance, or whether a company is adequately addressing the risks of climate change. All these issues affect financial value for shareholders, and we believe ignoring our opportunities to weigh in on them would be compromising our fiduciary duty. This is just as true for pension fund fiduciaries as it is for asset managers.

Voting with management is not necessarily in the best interests of shareholder value

The proposed rule does suggest that a safe harbor for proxy voting, one that need not involve any additional documentation or record-keeping, would be to vote in line with management. Yet the rule provides no empirical justification for the idea that voting in line with management at all times aligns with fiduciary duty or impacts value-creation for shareholders.

It is true that corporate management and boards generally know more about the inner workings of companies than shareholders do. However, knowing more doesn't necessarily result in correct strategic decision-making all the time. As investors, we understand that management and boards are not always right. Proxy voting is one of a small number of shareholder tools—the others being divestment, trimming positions and focused engagement—that allow asset managers and other fiduciaries to let management and directors know when owners disagree.

Corporations have made countless unfortunate decisions, and perhaps the most dramatic evidence of that is bankruptcy. There were more than 38,000 commercial bankruptcy filings during 2019 (before the COVID-19 pandemic stimulated a new wave of bankruptcies) and while some of them resulted from economic factors that may have been beyond companies' control, some were the result of poor company decision-making, including "liabilities arising from the opioid crisis, fallout from price-fixing,

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[2] Securities and Exchange Commission, "Commission Guidance Regarding Proxy Voting of Investment Advisers," 17 CFR Parts 271 and 276, September 10, 2019. https://www.sec.gov/rules/interp/2019/ia-5325.pdf

and corporate restructuring shenanigans" that are directly attributable to decisions made in the executive suite and the boardroom.[3] Even PG&E's bankruptcy, which on the surface looks like something beyond corporate control, was at least in part attributable to the company's own record of deferred maintenance, which made its equipment more likely to spark fires in a landscape that is increasingly vulnerable to wildfire.[4] As the SEC notes, investors—both bondholders and equity holders—are likely to lose substantial value when companies in their portfolios declare bankruptcy, even if they emerge from it later.[5]

There are countless additional examples of poor corporate decision-making that resulted in loss of shareholder value. Some high-profile examples include Wells Fargo's manipulation of customer accounts, BP's poor safety record, which contributed to the Deepwater Horizon blowout, and Volkswagen's emissions cheating scheme. Bank of America researchers found that controversies can be costly: Companies in the Russell 3000 Index with lower controversy scores consistently outperformed those with rising controversies between 2007 and 2020, and ESG controversies were a particularly useful way to identify higher-risk companies.[6]

While there are thousands of issues on corporate proxies each year that give shareholders the ability to affirm sound judgements made by management and boards, the *presumption* that voting with management is *always* in the interests of pension (or any) fund beneficiaries is simply inappropriate.

Empirical support for the role of engagement, including proxy voting, in creating shareholder value

Along with the presumption that management's recommendations are always in the interests of plan beneficiaries, the proposed rule presumes that voting against management destroys value. While there have been a few event studies that show in some cases, and often using biased samples, there can be abnormal losses over a few days, evidence supporting the idea that shareholder engagements, including proxy voting, destroy value over time periods that are relevant to most pension funds (which often tend to hold securities for years, through index funds) is thin to nonexistent.

To the contrary, there is evidence that shareholder engagement actually creates financial value for shareholders. It is increasingly well established that engagements on sustainability and other issues are often positive for both companies and investors, on issues as varied as corporate governance structures like proxy access, climate risk, and board diversity.

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[3] Charles M. Oellermann and Mark Douglas, "United States: The Year in Bankruptcy: 2019," Monday, February 21, 2020. https://www.mondaq.com/unitedstates/insolvencybankruptcy/896034/the-year-in-bankruptcy-2019

[4] Katherine Blunt and Russell Gold, "PG&E Knew for Years Its Lines Could Spark Wildfires, and Didn't Fix Them," The Wall Street Journal, July 10, 2019. https://www.wsj.com/articles/pg-e-knew-for-years-its-lines-could-spark-wildfires-and-didnt-fix-them-11562768885

[5] Securities and Exchange Commission, "Bankruptcy: What Happens When Public Companies Go Bankrupt," Feb. 3, 2009. https://www.sec.gov/reportspubs/investor-publications/investorpubsbankrupthtm.html

[6] Savita Subramanian, Sameer Chopra, Manish Kabra, Alex Makedon, Jill Carely Hall, Marisa Sullivan, Paula Strzelinska, James Yeo and Lucy Huang, "When Bad News Hits Good Companies," Bank of America Global Research, June 24, 2020.

While the papers described below do not address voting specifically, proxy voting is very much part of the engagement toolkit;[7] it is not separable from other engagement actions, such as dialogue. Moreover, if investors did not have the ability and willingness to vote proxies on these material issues, it is possible that engagements could be less effective. That is because, at times, proxy voting is used as the last action when engagements on material issues have disappointed investors. BlackRock's recent announcement that it voted against management recommendations at 53 companies is a recent example. In the asset manager's view, those companies had not made sufficient progress on addressing climate risks.[8]

Notable papers linking engagement with financial outcomes include the following.

- Beiting Cheng, Ioannis Ioannou and George Serafeim, "Corporate Social Responsibility and Access to Finance," Harvard Business School Working Knowledge, July 22, 2011.[9] "In this paper, we investigate whether superior performance on corporate social responsibility (CSR) strategies leads to better access to finance. We hypothesize that better access to finance can be attributed to reduced agency costs, **due to enhanced stakeholder engagement** through CSR, and reduced informational asymmetries, due to increased transparency through non-financial reporting. Using a large cross-section of firms, we show that firms with better CSR performance face significantly lower capital constraints. The results are confirmed using an instrumental variables and simultaneous equations approach. Finally, we find that the relation is primarily driven by social and environmental performance, rather than corporate governance." (emphasis added)
- Robert G. Eccles, Ioannis Ioannou and George Serafeim, "The Impact of Corporate Culture of Sustainability on Corporate Behavior and Performance," Social Science Research Network, March 2012.[10] "We investigate the effect of a corporate culture of sustainability on multiple facets of corporate behavior and performance outcomes. Using a matched sample of 180 companies, we find that corporations that voluntarily adopted environmental and social policies many years ago—termed as High Sustainability companies—exhibit fundamentally different characteristics from a matched sample of firms that adopted almost none of these policies—termed as Low Sustainability companies. In particular, we find that the boards of directors of these companies are more likely to be responsible for sustainability and top executive incentives are more likely to be a function of sustainability metrics. Moreover, **they are more likely to have organized procedures for stakeholder engagement,** to be more long-term oriented and to exhibit better measurement and disclosure of nonfinancial information. Finally, we provide evidence that High Sustainability companies significantly outperform their counterparts over the long-term, both in terms of stock market and accounting performance." (emphasis added)

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[7] Robert G. Eccles and Svetlana Klimenko, "The Investor Revolution," *Harvard Business Review*, May-June 2019. https://hbr.org/2019/05/the-investor-revolution

[8] S&P Global Market Intelligence, "BlackRock voted against management at 53 companies over climate concerns," 14 July 2020. https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/blackrock-voted-against-management-at-53-companies-over-climate-concerns-59426142

[9] https://hbswk.hbs.edu/item/corporate-social-responsibility-and-access-to-finance

[10] https://hbswk.hbs.edu/item/the-impact-of-corporate-sustainability-on-organizational-process-and-performance#:~:text=Overall%2C%20the%20authors%20argue%20that,values%20and%20beliefs%20that%20underlie

- Brad M. Barber, "Monitoring the Monitor: Evaluating CalPERS' Activism," Social Science Research Network, March 2006.[11] "Many public pension funds engage in institutional activism. These funds use the power of their pooled ownership of publicly traded stocks to affect changes in the corporations they own. I review the theory and empirical evidence underlying the motivation for institutional activism. In theory, the merits of institutional activism hinge critically on two agency costs: (1) the conflicts of interest between corporate managers and shareholders, and (2) the conflicts of interest between portfolio managers and investors. This leads to two types of institutional activism—shareholder activism and social activism. While portfolio managers can use their position to monitor conflicts that might arise between managers and shareholders (shareholder activism), they can also abuse their position by pursuing actions that advance their own moral values or political interests at the expense of investors (social activism). Which of these effects dominates the actions of portfolio managers will determine the value of activism and is an empirical issue. Perhaps the most high-profile activism has been pursued by CalPERS with their annual focus list. I document that CalPERS has pursued reforms at focus list firms that would increase shareholder rights and (imprecisely) **estimate the total wealth creation from this shareholder activism to be $3.1 billion between 1992 and 2005**. Unrelated to the focus list program, CalPERS has also pursued social activism (e.g., the divestment of tobacco stocks). In general, I argue that institutional activism should be limited shareholder activism where there is strong theoretical and empirical evidence indicating the proposed reforms will increase shareholder value. At times, institutions will be forced to engage in social activism and take positions on sensitive issues. In these situations, I argue portfolio managers should pursue the moral values or political interests of their investors rather than themselves." (emphasis added)
- Elroy Dimson, Oğuzhan Karakaş and Xi Li, "Active Ownership," Review of Financial Studies (RFS) Volume 28, Issue 12, 2015.[12] "We analyze an extensive proprietary database of corporate social responsibility engagements with U.S. public companies over 1999–2009. **Engagements address environmental, social and governance concerns. They are followed by a one-year abnormal return that averages +1.8%, comprising +4.4% for successful and zero for unsuccessful engagements**. We document outperformance following environmental/social, as well as governance, engagements. Companies are more likely to be engaged, and success of engagements is more probable, if the target firm is concerned about its reputation and if it has higher capacity to implement changes. After successful engagements, companies experience improvements in operating performance, profitability, efficiency, and governance." (emphasis added)
- Andrew Junkin, "Update to the 'CalPERS Effect' on Targeted Company Share Prices," Wilshire Associates Working Paper, September 24, 2013.[13] "For the three years prior to the 'initiative date,' the engaged companies produced returns that averaged 38.91% below the Russell 1000 Index on a cumulative basis and 36.13% below the respective Russell 1000 sector indices. **For the five years after the 'initiative date,' the average engaged companies produced excess returns of 12.27% above the Russell 1000 Index and 8.90% above the respective Russell 1000 sector indices on a cumulative basis**." (emphasis added)

[11] https://papers.ssrn.com/sol3/papers.cfm?abstract_id=890321
[12] https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2154724
[13] https://www.sristudies.org/junkin2013

- Tamas Barko, Martijn Cremers and Luc Renneboog, "Activism on Corporate Social Responsibility," European Corporate Governance Institute (ECGI) Finance Working Paper No. 509/2017, TILEC Discussion Paper No. DP 2017-021, May 2017.[14] The study covers environmental, social and governance (ESG) improvements using a proprietary dataset covering 660 companies globally over 2005-2014. "Targets have a higher market share, analyst coverage, stock returns, and liquidity. The engagements lead to significant ESG rating adjustments. Activism is more likely to succeed for companies with a good ex ante ESG track record and with lower ownership concentration and growth. **Successful engagements positively affect sales growth, without changing profitability. Targets outperform matched firms by 2.7% over 6 months post-engagement, while the (ex ante) lowest ESG quartile earns an extra 7.5% over 1 year**." (emphasis added)
- S. Lakshmi Naaraayanan, Kunal Sachdeva and Varun Sharma, "The Real Effects of Environmental Activist Investing," Social Science Research Network, December 2019.[15] "Using a socially motivated activist campaign by a large pension fund, we measure the real effects of activist investing on pollution and the environment. **Targeted firms reduced their total toxic chemical releases, production-related emissions, cancer-causing pollution, environmental accidents and legal risks. These effects do not come at the expense of lower financial performance or returns**. We rule out natural alternative hypotheses while also presenting evidence supporting the external validity of socially motivated activism. These findings suggest that shareholders can delegate their pro-social preferences onto firms to maximize their total value between their financial and non-pecuniary benefits." (emphasis added)
- Andreas G. F. Hoepner, Ioannis Oikonomou, Zacharias Sautner, Laura T. Starks, and Xiaoyan Zhou, "ESG Shareholder Engagement and Downside Risk," European Corporate Governance Institute Finance Working Paper No. 671/2020, June 3, 2020.[16] "We examine whether engagement on environmental, social and governance (ESG) issues can benefit shareholders by reducing firms' downside risk, measured using the lower partial moment and value at risk. Using a proprietary database, we provide evidence supporting this hypothesis. We further find that the measured risk effects vary across engagement success and engagement themes. Engagement appears most effective in lowering downside risk when addressing environmental topics (primarily climate change). **We find corroborating evidence in that successful engagement reduces the firm's exposure to a downside-risk factor**." (emphasis added)

There is no way to determine whether a vote will have impact when it is cast

The proposed rule also suggests that when holdings are small, it may not be in the economic interests of the plan to vote at all, even when voting costs are small, because it would have little or no impact. But there is no way to know, when a proxy vote is cast, whether the vote will matter. While many issues on a proxy ballot typically pass by large margins, there are many others that have far smaller margins, and

[14] https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2977219

[15] https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3483692&dgcid=ejournal_htmlemail_corporate:governance:finance:ejournal_abstractlink

[16] https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2874252

there is evidence that company management, in cases where the votes are close, uses a variety of methods to manipulate the vote counts to ensure a favorable result.[17] Especially given the possibility that management will take steps to turn close votes into non-majority votes, the importance of voting by smaller equity holders takes on even more importance. But at the time that funds and fiduciaries cast votes, the outcomes of the voting are simply not known. Presuming that smaller holdings do not matter is inappropriate.

We appreciate the opportunity to comment on the proposed rule. In summary, we believe the rule is unnecessary and ill advised, and could harm the interests of plan beneficiaries.

Sincerely,

Joseph F. Keefe
President
Impax Asset Management LLC

Julie Fox Gorte
SVP for Sustainable Investing
Impax Asset Management LLC

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[17] See, for example, Ilona Bavenko, Goeun Choi, and Rik Sen, "Management (of) Proposals," School of Banking and Finance, University of new South Wales, American Economic Association, December 19, 2018, https://www.aeaweb.org/conference/2019/preliminary/paper/iyRtSrGk; and Laurent Bach & Daniel Metzger, "Are Shareholder Votes Rigged?" Harvard Law School Forum on Corporate Governance, January 4, 2017, https://corpgov.law.harvard.edu/2017/01/04/are-shareholder-votes-rigged/.