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Comment on Employee Benefits Security Administration proposed rule "Fiduciary Duties Regarding Proxy Voting and Shareholder Rights" RIN 1210–AB91

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The Department of Labor's present proceeding to safeguard the retirement future of beneficiaries of pension funds governed by the Employee Retirement Income Security Act of 1974 (ERISA) is a welcome initiative. Parallel to its previous notice of proposed rulemaking "Financial Factors in Selecting Plan Investments" (RIN 1210-AB95),[3] the current proposed rule clarifies the requirements of ERISA in a rapidly changing investment landscape in which both asset managers and the non-financial interests seeking to influence them are in very different positions than in the era when the law was originally passed.

Disappointing Policy Advocates Is the Point

Advocates of various forms of environmental, social, and governance (ESG) investing, or, as the Department has termed them, "environmental, social, or public policy agendas," have, for many years, attempted to use the shareholder resolution and proxy voting process to influence corporate decision-making.[4] Such advocates have been increasingly successful in recent years.[5] The goals of many of these resolutions have been, by definition, outside the realm of financial benefit for shareholders such as

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[3] Financial Factors in Selecting Plan Investments, Federal Register, Vol. 85, No. 126, June 30, 2020, https://www.federalregister.gov/d/2020-13705/p-29.
[4] Kosmas Papadopoulos, "The Long View: US Proxy Voting Trends on E&S Issues from 2000 to 2018," Harvard Law School Forum of Corporate Governance, January 31, 2019, https://corpgov.law.harvard.edu/2019/01/31/the-long-view-us-proxy-voting-trends-on-es-issues-from-2000-to-2018/.
[5] White & Case, LLP, "ESG takes center stage amid economic crisis and social unrest," JD Supra Knowledge Center, August 7, 2020, https://www.jdsupra.com/legalnews/esg-takes-center-stage-amid-economic-10813/.

pension plan beneficiaries. Because both RIN 1210-AB95 and the current rule would arguably, impede that progress, prominent critics have denounced them, claiming that they are, among other things, "part of an unpopular effort to reject climate change."[6]

Such critiques, however, only highlight the need for clearer federal guidance regarding ERISA's requirements. Those requirements have a singular focus: risk-adjusted financial returns for plan beneficiaries. They have been emphatically confirmed over the years, as the Department's current notice of proposed rulemaking points out, by both the U.S. Supreme Court and appellate courts.

ERISA is not concerned with climate change, gender diversity of corporate boards, wage and hour standards of overseas workers, or any other ESG-type issue. If the current system of proxy voting by fund fiduciaries is, in fact, substantially advancing these other goals at the expense of returns to beneficiaries, that alone is reason for the Department to address the issue.

This clarification is especially important, because proponents of the policy agendas advanced by many current shareholder resolutions like to claim that their plans actually *are* consistent with maximizing investment returns. As with ESG investing theory, many shareholder activists insist that their preferred policies are non-concessionary and thus perfectly suitable for entities like pension funds.[7] If that is truly the case, they should have no quarrel with the proposed rule, which only calls for investment managers to "vote proxies in a manner that is in the best interest of the plan" and avoid engaging in the proxy voting process when evaluating a resolution will incur costs but deliver no meaningful benefit. The only way for the rule to interfere with the preferred investment and shareholder engagement strategies of current investment managers is if they are already violating ERISA's fiduciary trust requirements.

The current proposed rule, like "Financial Factors in Selecting Plan Investments" before it, only reinforces what we have always expected from fiduciaries, as is clear both in the plain language of ERISA and the wider history of trust law extending back centuries. Trusts should be administered for the benefit of their formally named beneficiaries, not for the benefit of their managers and certainly not for some vaguely ascertained "good of society" as determined by third-party policy advocates.[8]

Passionate individuals and well-funded activist entities with other goals will likely be chagrined to see one of their potential avenues of influence on corporate management diminished. Their chagrin,

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[6] Kurt N. Schacht, "The Labor Department Is Tearing Down a Landmark of Investor Protection," *Barron's*, September 11, 2020, https://www.barrons.com/articles/the-labor-department-is-tearing-down-a-landmark-of-investor-protection-51599823800.

[7] See comments like "'This [ESG investing] is not in any way concessionary to returns. We actually think it's going to improve returns because it's going to help us select better companies to invest in,' said Cliff Robbins, founder of $2.2 billion hedge fund Blue Harbour Group." Pippa Stevens, "Your complete guide to investing with a conscience, a $30 trillion market just getting started," CNBC, December 14, 2019, https://www.cnbc.com/2019/12/14/your-complete-guide-to-socially-responsible-investing.html.

[8] W. Scott Simon, "Fiduciaries, Look to the Law of Trusts as Your Guide," May 4, 2017, https://www.morningstar.com/articles/837376/fiduciaries-look-to-the-law-of-trusts-as-your-guide.

however, no more weakens a fiduciary's duty to his beneficiaries than a window shopper's covetous gaze weakens the duty of a store security guard to her employer. Quite the opposite, in fact.

Understanding Marginal Benefits of Proxy Engagement

The proposed rule also implicitly incorporates important concepts too infrequently embraced in federal policy making, namely cost-benefit analysis and marginal cost calculation. The Department's notice makes note of the perverse result of previous guidance, under which plan investment managers operated under the impression that they were required to vet and vote on *every* proxy measure, regardless of its materiality or relevance. This takes prioritization and discretion out of the hands of managers and potentially saddles them with a massive and inefficient paperwork burden that ill serves their beneficiaries.

Alternately, the current framework can also put investment managers in an awkward, though generally undisclosed, difficulty. The perceived need to vote every proxy measure, coupled with limited staff resources with which to conduct reliable analyses, means that managers are tempted to outsource their decision-making to one of two major proxy advisor firms (themselves beset with potential conflicts of interest), in effect outsourcing their fiduciary duties as well. [9] This path, coming along as it does with comprehensively auto-populated, fill-in-the-blank software, is more of an abdication of responsibility than seriously analyzing a handful of the most relevant proxy measures and simply declining to vote on the rest.

Even Beneficial Rules Must Be Deregulatory

The Competitive Enterprise Institute has long been an advocate of deregulation and regulatory reform, regarding both agency proposals and legislation to update the process by which regulations are issued, approved, and repealed. We frequently testify and file comments opposing the implementation of new rules that would create additional burdens on private regulated entities. As the Department's notice concedes, it is unclear at this point whether the net effect of the current proposed rule will end up being deregulatory or not.

Clarifying that investment managers are not required to analyze or vote on every proxy proposal should reduce compliance burdens and give greater discretion to managers regarding the proxy voting process. However, other requirements of the proposed rule will likely increase reporting requirements for managers keen to avoid running afoul of any final rule. We therefore urge the Department to err on the side of imposing the least cost and liability while still strengthening protections for ERISA beneficiaries.

Similar to our comment on "Financial Factors in Selecting Plan Investments," we commend the Department's notice of proposed rulemaking for its well-placed concern for the potential paperwork

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[9] Tao Li, "Outsourcing Corporate Governance: Conflicts of Interest within the Proxy Advisory Industry," *Management Science*, Volume 64, Issue 6, June 2018, https://pubsonline.informs.org/doi/abs/10.1287/mnsc.2016.2652.

burden the rule could create.[10] But we nevertheless urge the staff of the Employee Benefits Security Administration to exercise caution about *any* additional compliance burdens and redouble their efforts to consistently impose not just a positive cost/benefit ratio, but the least possible additional cost on regulated entities in order to achieve the rule's intended purpose. Departments and agencies should consider the cumulative total burden that regulated entities are already working under, how any proposed rule would increase it, and the dynamic effects of that increased total.

Fund managers and financial institutions are already working under a heavy burden of federal and state regulation, and are simultaneously subject to the general regulations that apply to every employer. That accumulated burden has significant economic effects on individual firms, particular industries and sectors, and the U.S. economy as a whole. The Competitive Enterprise Institute's Wayne Crews estimates that the current total cost burden of U.S. federal regulation comes to $1.9 trillion per year, roughly $14,000 per household—a large burden by any measure.[11]

That accumulated burden also harms innovation and slows economic growth, resulting in a smaller economy and lower investment returns—exactly the topic of the current proposed rule.[12] Non-material proxy resolutions that dilute or impede maximizing shareholder returns are a disservice to pension fund beneficiaries—but so is an undue regulatory burden than throttles overall economic growth. The need to slow the growth of accumulated regulatory costs is so important that even a rule such as this—intended to financially protect and benefit individual Americans—should still be subjected to the closest scrutiny when it comes to placing new compliance burdens on private entities.

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[10] Richard Morrison, "Comment on Employee Benefits Security Administration Proposed Rule 'Financial Factors in Selecting Plan Investments' (RIN 1210-AB95)," Competitive Enterprise Institute, July 29, 2020, https://cei.org/content/comment-employee-benefits-security-administration-proposed-rule-financial-factors-selecting.

[11] Wayne Crews*, 10,000 Commandments 2020: An Annual Snapshot of the Federal Regulatory State*, Competitive Enterprise Institute, May 27, 2020, https://cei.org/sites/default/files/Ten_Thousand_Commandments_2020.pdf.

[12] Patrick A. McLaughlin, Nita Ghei, and Michael Wilt, "Regulatory Accumulation and Its Costs: An Overview," *Policy Brief*, Mercatus Center, November 2018, https://www.mercatus.org/publications/regulation/regulatory-accumulation-and-its-costs.