majorityaction

October 2, 2020

Jeanne Klinefelter Wilson
Acting Assistant Secretary
Employee Benefits Security Administration
Room N-5655
U.S. Department of Labor
200 Constitution Avenue NW
Washington, DC 20210

Re: Proxy Voting and Shareholder Rights NPRM
Fiduciary Duties Regarding Proxy Voting and Shareholder Rights (RIN 1210-AB91)

Dear Acting Assistant Secretary Wilson,

Majority Action is a non-profit, non-partisan organization that empowers shareholders to hold corporations accountable to high standards of corporate governance, social responsibility, and long-term value creation. We have synthesized for an investor audience the growing consensus among academics, economists, investors and regulators that the systemic risks of climate change are material and cannot be mitigated by diversification or hedging. Our most recent report, *Climate in the Boardroom: How Asset Manager Voting Shaped Corporate Climate Action in 2020*, explains the need for shareholders to evaluate corporate climate outcomes as opposed to company-specific climate risks when voting their proxies, and reviews the votes of the 12 largest global asset managers on support for management-backed directors, executive pay plans, and key climate shareholder resolutions during the 2020 U.S. proxy season.

Majority Action strongly opposes the changes to the rules governing fiduciary duties under the Employee Retirement Income Security Act ("ERISA") set forth in the Notice of Proposed Rulemaking ("NPR"; herein, we refer to the proposed changes as the "Proposed Rules"), which would suppress ERISA plan voting by imposing onerous and unjustified cost burdens. At this moment, when we are on the brink of irreversible warming and economic and social catastrophe due to climate change, responsible fiduciaries should not be refraining from voting or reflexively voting with management. Instead, they should use their voting power to protect the value of individual plan assets and their broader portfolios, the stability of the financial system, and the sustainability of the global economy. Accordingly, we urge the Department to withdraw the NPR.

Background

Scientists agree that climate change is accelerating, as evidenced by extreme weather events, wildfires and melting ice sheets, and that we have only a few years to avoid irreversible tipping points and avoid climate catastrophe. Social consequences of climate change could include famine, disease and mass migration, and black swan-type events like widespread food and water shortages and major social upheaval cannot be managed in a traditional risk management framework, which relies on past data and assumes normal distributions.[1] The World Health Organization estimated that failure to adapt to climate change will result in 250,000 excess deaths per year by 2050.[2] Without meaningful action, the economic effects will also be massive: Per capita GDP losses in the U.S. from unchecked greenhouse gas ("GHG") emissions through 2100 could range between 6.7% and 14.39% annually, representing trillions in lost economic output.[3]

The stability of the financial system is also affected by climate change. European Central Bank Executive Board member Isabel Schnabel warned that "[c]limate change is probably the biggest challenge we are facing, much bigger than the [COVID-19] pandemic." She urged that climate risk be integrated into economic policy and expressed concern that markets may not be pricing climate risks properly.[4] The U.S. Commodity Futures Trading Commission recently issued a report cautioning, "A world racked by frequent and devastating shocks from climate change cannot sustain the fundamental conditions supporting our financial system."[5]

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[1] Nahfeez Ahmed, "The UN's Devastating Climate Change Report Was Too Optimistic," Vice (Oct. 15, 2018) (https:// www.vice.com/en_us/article/43e8yp/the-uns-devastatingclimate-change-report-was-too optimistic)

[2] International Actuarial Association, Climate Change and Mortality, at 15 (Nov. 2017) (https://www.actuaries.org/CTTEES_ENVIRO/Papers/REWG_CCandMortality_final_Nov2017.pdf)

[3] The Hamilton Project and the Stanford Institute for Economic Policy Research, Ten Facts about the Economics of Climate Change and Climate Policy (Oct. 2019) (https://siepr.stanford.edu/sites/default/files/publications/Ten-Facts-about-Economics-of-Climate-Change-and-Policy.pdf)

[4] Reuters Staff, "Text: Reuters interview with ECB board member Schnabel," Reuters (Aug. 31, 2020) (https://www.reuters.com/article/us-ecb-policy-schnabel-text/text-reuters-interview-with-ecb-board-member-schnabelidUSKBN25R1OL)

[5] Commodity Futures Trading Commission, Managing Climate Risk in the U.S. Financial System, at 2 & i,
(Sept. 9, 2020)
(https://www.cftc.gov/About/AdvisoryCommittees/MarketRiskAdvisory/MRAC_Reports.

Climate change imposes undiversifiable, portfolio-wide risks to long-term and institutional investors with broad market exposure. Already, extreme weather events such as hurricanes, flooding and wildfires have caused losses of more than $460 billion in just the last three years.[6] No sector or asset class is safe from its effects. A report by the Cambridge Centre for Risk Studies found that portfolio-wide risks from climate change would be "unhedgeable."[7] The study predicted losses for a portfolio with 40% equity allocation of more than 25% within five years after a financial tipping point has been reached, and over 45% losses for a portfolio holding 60% equities.[8]

Investors are mobilizing to hold the largest GHG emitters and their enablers accountable to implement immediate and concrete decarbonization plans in order to protect the value of their portfolios, the stability of financial markets and the health of the global economy. For example, in the 2020 proxy season, a group of public pension funds, state treasurers and shareholder advocates pressed for board reforms at JPMorgan Chase, the world's largest fossil fuel financier. Specifically, they urged shareholders not to re-elect director Lee Raymond, the former ExxonMobil CEO and architect of its decades-long campaign of climate change denial who had served for nearly two decades as JPMorgan Chase's lead independent director. Holders of over 15% of shares opposed Raymond's re-election, and the company announced in the middle of the campaign that he would step down as lead director.[9]

Voting on director elections at systematically important carbon emitters is the single most direct and effective action long-term investors with broad market exposure can take to influence corporate decision making and protect the value of their portfolio as a whole. Although shareholder proposals and dialogue have produced improvements, the urgency of the current crisis requires a more direct approach, especially at companies that have not responded to other approaches. To that end, investors have begun exploring proxy voting guidelines that would hold

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6 NOAA National Center for Environmental Information, "Billion-Dollar Weather and Climate Disasters: SummaryStats," accessed September 14, 2020 (https://www.ncdc.noaa.gov/billions/summary-stats).

7 Cambridge Centre for Risk Studies, Unhedgeable Risk: How Climate Change Sentiment Impacts Investment, at 2 (Dec. 2015) (https://www.jbs.cam.ac.uk/wp-content/uploads/2020/08/crs-unhedgeable-risk.pdf)

8 Cambridge Centre for Risk Studies, Unhedgeable Risk: How Climate Change Sentiment Impacts Investment, at 4 (Dec. 2015) (https://www.jbs.cam.ac.uk/wp-content/uploads/2020/08/crs-unhedgeable-risk.pdf)

9 See Majority Action, "Climate in the Boardroom: How Asset Manager Voting Shaped Corporate Climate Action in 2020," at 21 (2020) (https://static1.squarespace.com/static/5d4df99c531b6d0001b48264/t/5f698600bdf79a75853d431c/1600751130906/ClimateintheBoardroom_MA_2020)

directors accountable for companies' failure to decarbonize. In this context, the Department's erection of barriers to proxy voting by ERISA fiduciaries is not only wrongheaded, but hazardous to plans' portfolios.

Justification for the Proposed Rules is Lacking

The NPR does not support its central claim that fiduciaries misunderstand their duties under ERISA relating to proxy voting. Periodic guidance in the over three decades since the Avon Letter was issued has reinforced that fiduciaries must take into account costs and benefits to the plan when determining whether and how to vote proxies. The Department has produced no data, which it could have obtained through its audit and enforcement activities, showing that fiduciaries misunderstand their duties or that they are voting all proxies regardless of economic impact. In sum, the Department's assertions in this regard are purely speculative.

The Department urges that as a result of fiduciaries' confusion, they are likely voting on "environmental and social" shareholder proposals that "have little bearing on share value or other relation to plan interests."[10] Dismissing the link between environmental and social concerns and the value of plan assets reflects an outdated view of investing; as we discussed above, investors ignore climate change risks at their peril, and many other environmental and social factors, such as board and workforce diversity, also have strong links to firm performance.[11]

The Department also justifies the need for the Proposed Rules by claiming that research on the value of shareholder voting is "mixed." Presumably, since the NPR would impose a new standard, the Department's assertion should be read to mean that the evidence has become mixed or perhaps more mixed since the Department issued subregulatory guidance in 1988, 1994, 2008, 2016 and 2018. But the evidence has not become more unfavorable to shareholder voting; if anything, more recent studies show greater value from voting and the kinds of environmental, social and governance changes shareholder voting spurs.

Only two of the studies the Department cites in support of this contention actually analyze studies on shareholder voting, and neither depicts a growing trend of unfavorable research. Both papers describe studies showing positive and negative

[10] NPR, at 40.

[11] See, e.g., https://newsroom.bankofamerica.com/system/files/2019_Environmental_Social_Governance.pdf; Credit Suisse, "Does Gender Diversity Improve Performance?" Jul. 31, 2012 (https://www.credit-suisse.com/us/en/about-us/research/research-institute/news-and-videos/articles/news-and-expertise/2012/07/en/does-gender-diversity-improve-performance.html).

effects on firm performance from various kinds of shareholder voting. Denes et al.[12] found that more recent studies showed a positive relationship between shareholder proposals and firm value than older ones did, and Yermack[13] noted that studies examining the impact of director withhold campaigns, a more recent activist tactic, show positive outcomes. (The remaining studies cited in the NPR did not address the value of shareholder voting, but instead focused on ancillary topics like proxy advisors.)

The NPR ignores substantial literature supporting the value of proxy voting. For example, passage of a corporate social responsibility shareholder proposal was found in a 2020 study to generate positive abnormal returns.[14] A 2012 Journal of Finance study estimated that the passage of a governance proposal causes a positive 2.8% cumulative abnormal return.[15]

Empirical research indicates that director voting serves a valuable disciplining function. In one 2008 study, researchers found that "vote-no" campaigns, in which shareholders are urged to withhold support from directors' election, lead to operating performance improvements and more disciplinary CEO turnover.[16] Another 2008 study by Cai et al. of 13,384 director elections from 2003 to 2005 found that lower votes for directors on the compensation committee at companies where CEOs receive positive abnormal compensation were followed by lower abnormal pay the next year.[17] In addition, lower voting support for independent directors was associated with a greater likelihood of CEO turnover.[18]

In a more recent study, researchers calculated the average "years to election"—the average number of years from a given year to the next election a director faces-- in a sample of director elections between 2001 and 2010.[19] They found that greater proximity to the next election was associated with higher sensitivity of CEO turnover to firm performance, and that the effect was most

[12] Matthew R. Denes et al., "Thirty Years of Shareholder Activism: A Survey of Empirical Research," 44 J. Corp. Fin. 405 (2017) (https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2608085).
[13] David Yermack, "Shareholder Voting and Corporate Governance" (2010) (https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1523562&download=yes).
[14] Fernando Martins, "Corporate Social Responsibility, Shareholder Value, and Competition," at 3 (Aug. 14, 2020) (https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3651240&download=yes).
[15] See Vicente Cuñat, Mireia Gine, & Maria Guadalupe, "The Vote Is Cast: The Effect of Corporate Governance on Shareholder Value," 67 J. Fin. 1943 (2012) (https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1555961)
[16] Diane Del Guercio et al., "Do Boards Pay Attention When Institutional Investor Activists 'Just Vote No'?", at 3-4 (2008) (https://www.readcube.com/articles/10.2139%2Fssrn.575242).
[17] Jie Cai et al., "Electing Directors," at 20-21 (Nov. 2008) (https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1101924&download=yes)
[18] Cai et al., at 22.
[19] Vyacheslav Fos et al., "Do Director Elections Matter?" at 2-3 (2017) (https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2609815&download=yes)

pronounced for board chairs and members of the nominating/governance committee. Additional tests supported a conclusion that the relationship was causal. [20]

The NPR Omits Mention of Costs Associated with Reduced Accountability

The NPR focuses a great deal of attention on the direct costs the Proposed Rules would impose, which are substantial, but do not discuss or even mention the impact on plan portfolios of reduced accountability resulting from fiduciaries not voting plans' shares or voting them in accordance with management's recommendations. Shareholder voting serves a key function in our system of corporate governance, helping to keep management and the board focused on long-term value creation and to prevent opportunistic behavior such as excessive executive pay and self-dealing transactions.

To the Department's way of thinking, shareholder voting, at least on management proposals, is pretty pro forma--the NPR notes that "nearly all management proposals are approved with little opposition."[21] That generally high level of support, though, may well reflect companies' tailoring of proposals to ensure passage. Absent the possibility of meaningful opposition, less value-enhancing proposals may well be submitted, which would represent a loss for shareholders. As well, the director voting studies we discuss above show that shareholders can effect change through their votes against director elections.

We can estimate the impact of reduced accountability by reference to the large literature on the relationship between shareholder rights and firm performance. After all, nearly all shareholder rights included in academic studies involve shareholders' ability to use their votes to elect board members, initiate bylaw amendments, and approve (or disapprove) transactions and charter amendments. That literature overwhelmingly finds that greater shareholder rights are associated with higher returns and operational performance (and vice versa).[22] The Department's refusal to discuss these studies or grapple with the impact of reduced accountability undermines the strength of its case.

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[20] Fos et al., at 3-4.

[21] NPR, at 26.

[22] E.g., Paul Gompers et al., "Corporate Governance and Equity Prices," Quarterly J. of Econ. 118(1), 107-155 (2003) (https://papers.ssrn.com/sol3/papers.cfm?abstract_id=278920); Martijn Cremers & Allen Ferrell, "Thirty Years of Shareholder Rights and Firm Valuation" (2013) (https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1413133); Olubunmi Faleye, "Classified Boards, Firm Value, and Managerial Entrenchment," 83 J. F. Econ. 501 (2007) (https://papers.ssrn.com/sol3/papers.cfm?abstract_id=877216).

The Department's Conception of Economic Impact is too Narrow

The NPR indicates that fiduciaries analyzing economic impact should focus on the individual company whose shares the fiduciary is considering voting. For example, the NPR states that a fiduciary should "consider the likely impact on the investment performance of the plan based on such factors as the size of the plan's holdings in the issuer relative to the total investment assets of the plan [and] the plan's percentage ownership of the issuer."[23]

Such a narrow approach to analyzing economic impact would hobble responsible fiduciaries trying to grapple with complex issues like climate change. Consider a fiduciary that is considering how to vote on directors at an electric utility that has not made a meaningful, time-bound commitment to reduce its emissions. Making such a commitment would allow the utility to adapt its business strategy to flourish in a more carbon-constrained world and in that way could directly benefit that firm.

But even if making that commitment imposed short-term costs on the utility, perhaps depressing its share price for a time, our fiduciary could determine that the overall impact on the plan's portfolio favored supporting the commitment. Limiting emissions could benefit other equities the plan owns by, for example, preventing water shortages, and it could also positively affect the value of assets in other asset classes such as real estate. On the largest scale, mitigating the impacts of climate change can limit harm to GDP and promote stability in the financial markets. Fiduciaries should be permitted to consider all of these factors when determining economic impact.

Columbia Professor John Coffee recently made a forceful case that diversified investors have no incentive under modern portfolio theory to try to reduce unsystematic risk. Instead, he urged, it is rational for such investors to focus on reducing systematic risks that affect the value of all stocks. He asserted that climate change is the "clearest example" of such systematic risk and stated that "[diversified investors] may want to take action (either by voting, litigation, or persuasion) to induce change that reduces [climate change] risk (even if it causes losses to some companies in their portfolio, so long as the action taken implies greater gains than losses to the portfolio)."[24]

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[23] NPR, at 91.

[24] John C. Coffee, "The Future of Ownership: ESG, Common Ownership, and Systematic Risk," at 10-13 (Sept. 2020) (https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3678197&download=yes).

For the reasons set forth above, Majority Action urges the Department to withdraw NPR. Thank you for the opportunity to share our views. For further conversation and follow up, please feel free to contact Lisa Lindsley lisa@majorityact.org.

Yours Sincerely,

Eli Kasargod-Staub
Executive Director