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

Re: Fiduciary Duties Regarding Proxy Voting and Shareholder Rights
Notice of Proposed Regulation (RIN 1210-AB91)

Dear Acting Assistant Secretary Wilson:

On behalf of the CtW Investment Group, we are writing to provide comments on the U.S. Department of Labor's notice of proposed rulemaking entitled "Fiduciary Duties Regarding Proxy Voting and Shareholder Rights". The CtW Investment Group works with union-sponsored pension funds to enhance long-term stockholder value through active ownership. The funds the Investment Group works with have over $250 billion in assets under management.

The Department's recently proposed rule regarding proxy voting and the exercise of shareholder rights by ERISA covered plans is a solution in search of a problem. The Department clearly seems to have landed on the changes it wishes to see: either effectively prohibiting ERISA-regulated funds from exercising their rights in corporate elections, or ensuring that they support incumbent management. But it fails to provide any justification for the new regime it seeks to impose on ERISA funds, nor does it demonstrate that its proposed solutions are consistent either with the ERISA statute or with the Constitution. Worse still, despite the clear statutory requirement that regulators proposing new rules objectively consider available evidence concerning the likely impact of such rule changes, the Department completely ignores a vast, decades-long body of research demonstrating the clear and significant positive effects that improved corporate governance has on company performance, as well as the critical role of ERISA-regulated funds in driving corporate reform.

It is only by ignoring this evidence that the Department is able to claim that its proposed rule changes would have benefits exceeding their costs, when in reality it is evident that suppressing the rights of ERISA-funds – or even worse coercing them with unnecessary regulation into rubber-stamping incumbent management – will undermine companies' long-term performance and ERISA-funds' financial stability. We urge the Department to withdraw this rule immediately.

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The Department Cannot Document the Problem it Proposes to Solve

The Department asserts that past guidance on ERISA funds' fiduciary responsibilities have confused some fiduciaries into falsely believing that they are obligated to vote all proxies, that these confused funds expend considerable resources to meet this supposed obligation, and that as a result the financial condition of these ERISA funds is worse than it otherwise would be. But at every step in this process, the Department fails to provide evidence for its assertions, or it provides evidence that directly contradicts them. For instance, the Department provides absolutely no evidence whatsoever that even suggests – let alone demonstrates – the "confusion" it believes has been created by past proxy voting guidance. It does not appear that the Department has made any effort – either through research based on peer- reviewed academic studies, hearings at which ERISA fiduciaries could testify, or surveys of ERISA-fiduciaries – to determine if in fact any ERISA funds have fallen prey to the confusion as the Department imagines. Instead of building up an evidentiary record that would justify a new rulemaking, the Department simply issues the barest of assertions to open its proposal and then hurries into imposing an extensive set of new and cumbersome regulations on ERISA funds.

Beyond the question of whether any ERISA funds have ever believed that they are obligated to vote all their proxies, the Department presents clear evidence that, even if this were the case, the resulting costs to ERISA funds are *de minimus*. According to the Department's own examination of reports filed on Form 5500, there were only 18 reported payments by ERISA funds directly to proxy advisors, and that these payments amounted to only "0.2 basis points" of "the reporting plans assets."[1] It is worth noting that read literally, the Department is reporting that proxy voting costs amount to 0.002% of plan assets, or a total of $20 for every $1 million in plan assets. It staggers belief that the Department would advance a major rule making, entailing significant and costly new obligations for ERISA funds, without being able to document costs that are closer to materiality than this. While the Department goes on to speculate that these reported costs may be only the tip of the iceberg, such speculation cannot form the basis for a rulemaking. The Department should at the very least have undertaken a good-faith fact finding process to determine the current costs ERISA funds incur in voting their proxies rather than summarily concluding – against the available evidence – that the Department's speculations are a sufficient basis on which to impose new costs on fiduciaries.

The Department's Proposed Solution Imposes Excessive Costs While Violating the Statute

In order to head off the phantom menace of excessive proxy voting costs, the Department paradoxically insists on making proxy voting dramatically more expensive: its proposal would require that any fiduciary examine, apparently on a vote-by-vote basis, whether *any* vote (either in favor or opposed) would increase or reduce plan value, even before determining which way to vote. Moreover, the Department requires that any ERISA fiduciary that determines that a vote would positively affect the plan's financial standing would have to maintain detailed records of its decision making process, again apparently on a case-by-case basis. In so far as an ERISA fiduciary could rely on a set of broad, evidence-based proxy voting policies, these policies would have to be reviewed every two years.

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[1] Federal Register / Vol. 85, No. 173 / Friday, September 4, 2020, pg. 55229

The Department estimates that each such review of a proxy vote, including record-keeping, would entail costs of approximately $535 million across the 34,906 ERISA funds that own stock, amounting to about 89 basis points of plan stock assets, or about 17 basis points of total plan assets. In other words, the Department proposes to increase plan costs by 17 basis points in order to cure a situation in which plans are, according to the Department's own findings, only spending 0.2 basis points. How increasing plan costs by an order of magnitude will result in a reduction of costs is apparently left as an exercise for the reader.

That said, the Department provides two "safe harbors" for ERISA funds: they may adopt a policy of always voting in favor of management, or adopting a policy to never vote proxies. The Department also appears to look favorably on a policy of voting only on certain matters (such as mergers), but it is unclear if voting decisions on such matters would be subject to the stricter evidentiary and record-keeping rules the Department is introducing for ERISA plan proxy voting generally, or if they would be considered under the more lenient "safe harbor" standards.[2] Moreover, the Department evinces a lack of understanding of what matters shareholders are even able to vote on, evinced by its repeated inclusion of share buybacks as a voting matter: they are not subject to such votes (boards approve buybacks plans without any shareholder approval as a routine matter) and the SEC expressly regards shareholder proposals seeking to affect buybacks as impermissible under Rule 14(a)8.

In any event, the Department's proposal, taken as a whole, is clearly coercive: the only way for ERISA funds to avoid a dramatic increase in administrative costs is abdicate their responsibility to act solely in the interests of plan participants and beneficiaries, and instead either never vote or defer to company management's potentially self-interested recommendations. Both "safe harbors" plainly violate the statute's fiduciary requirements: a fiduciary must either ignore the myriad conflicts of interest between shareholder principles and managerial agents – thereby likely causing them to act in the interest of management even when management's interests clearly conflict with those of shareholders, or to potentially forgo the benefits of improved corporate governance (see below) in order to reduce administrative burdens on plan staff (who for these purposes have interests distinct from fund participants and beneficiaries). Either approach puts the interests of some separate party ahead of those of plan participants and beneficiaries, in clear violation of the plain language of the statute.

The Proposal Ignores Benefits From ERISA Fund Proxy Voting

Beyond increasing plan costs and contradicting the statute it purports to be enforcing, the Department's proposal fails to consider if the current proxy voting practices of ERISA funds generate benefits that would be lost if, as the Department clearly anticipates, most ERISA plans either cease voting proxies or automatically vote in favor of management. In particular, the Department ignores a vast literature spanning over two decades that clearly demonstrates the substantial benefits of improved corporate governance that have been secured – in significant part – by the proxy voting activity of ERISA plans.

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[2] It is also unclear why the Department repeatedly cites "share buybacks" as a voting issue. Share buybacks are approved by boards without any shareholder vote, and the SEC has long maintained that shareholder resolutions concerning buybacks cannot be brought under the standard process adumbrated by Rule 14(a)8.

While a comprehensive review of this literature is beyond the scope of this letter, we will briefly note some longstanding highlights that demonstrate the combined importance of corporate governance to company performance (and hence plan returns), shareholder proposals to improved corporate governance, and ERISA plans as proponents and supporters of shareholder proposals. A landmark work in this area, "Corporate Governance and Equity Prices" by Paul A. Gompers, Joy L. Ishii, and Andrew Metrick, developed an index of corporate governance practices such as classified boards, independent directors, and independent board chairs, among other practices that are frequent subjects of proxy votes. Gompers et. al. looked at the performance of 1500 companies during the 1990s, and found that investing in the top decile of companies (with the best corporate governance) while shorting the lowest decile would generate an abnormal return of 8.5% a year.[3]

Subsequent studies have found the causal impact of corporate governance provisions to be in the same direction and of similar magnitudes: Lucien Bebchuk, Alma Cohen, and Allen Ferrel construct an index of corporate entrenchment and like Gompers et. al. find that buying low entrenchment firms and shorting high entrenchment firms would have yielded an abnormal return of 7% a year from 1990-2003.[4] Martijn Cremers and Vinay B. Nair found that even higher abnormal returns were associated with the combination of low entrenchment with active and attentive shareholders, which they proxied by the presence of public pension funds; this combined effect generated abnormal annualized returns of 10%-15%.[5] Both Gompers and Bebchuk have recently studied the effect of dual-class voting provisions on firm performance, and find that this form of insider empowerment has severely negative consequences for shareholder returns, just as one would suspect if proxy voting generally leads to improved performance, but not if proxy voting is typically irrelevant to investor returns.[6]

Furthermore, research shows that the shareholder resolution process is key to driving beneficial changes in corporate governance. Bonnie Buchanan, Jeffrey M. Netter, and Yang zhen Tina found that in the US, shareholder resolutions were closely related to changes in corporate governance, more so than in the UK where regulations make filing resolutions more cumbersome.[7] Peter G. Szilagyi and L. D. R. Renneboog find that shareholder resolutions target underperforming companies with poor governance, and are an effective form of external

[3] Paul A. Gompers, Joy L. Ishii, and Andrew Metrick, "Corporate Governance and Equity Prices" *Quarterly Journal of Economics*, Vol. 118, No. 1, pp. 107-155, February 2003

[4] Lucian A. Bebchuk, Alma Cohen, and Allen Ferrell, "What Matters in Corporate Governance?" *Review of Financial Studies*, Vol. 22, No. 2, pp. 783-827, February 2009

[5] Cremers, K. J. Martijn and Nair, Vinay B., Governance Mechanisms and Equity Prices (August 2003). Available at SSRN: https://ssrn.com/abstract=412140

[6] Bebchuk, Lucian A. and Kastiel, Kobi, The Untenable Case for Perpetual Dual-Class Stock (April 18, 2017). Virginia Law Review, Volume 103, pp. 585-631, June 2017, Harvard Law School John M. Olin Center Discussion Paper No. 905, Harvard Law School Program on Corporate Governance Discussion Paper 2017-6 , Available at SSRN: https://ssrn.com/abstract=2954630 or http://dx.doi.org/10.2139/ssrn.2954630; Gompers, Paul A., Joy Ishii, and Andrew Metrick. "Extreme Governance: An Analysis of Dual-Class Firms in the United States." *Review of Financial Studies* 23, no. 3 (March 2010).

[7] Buchanan, Bonnie & Netter, Jeffry & Tina, Yang. (2010). "Are Shareholder Proposals an Important Corporate Governance Device? Evidence from US and UK Shareholder Proposals." *SSRN Electronic Journal.* 10.2139/ssrn.1572016.

control.[8] Vicente Cunate, Mireia Gine, and Maria Guadalupe examined the use of shareholder proposals to advance Say on Pay practices from 2000-2010, and found that adopting those proposals led to an increase in firm value of 5.4%, as well as increases in profitability and long-term performance.[9] Further discussion of the value of shareholder resolutions in driving material changes to company governance and performance can be found in the footnotes.[10]

Moreover, and contrary to the Department's speculative assertion that voting on "social or political" proxy matters would not be consistent with the fiduciary duties required of ERISA plans, there is voluminous evidence that what are commonly referred to as "ESG" proposals have material, positive effects on firm governance. For instance, a 2015 meta-analysis of over 2,200 published studies found that the majority of studies identified a positive relationship between ESG criteria and company performance, with only 10% of studies finding a negative relationship.[11] A different 2015 study found that successful ESG engagements yielded a cumulative excess return of 7.1% from 1999-2009, while unsuccessful engagements had no negative effect.[12] In a 2019 paper, Caroline Flammer, Bryan Hong, and Dylan Minor studied the use of ESG criteria in setting executive pay, finding the practice has become more common and has been associated with improved long-term financial performance.[13]

Finally, ERISA-covered funds have played and continue to play an outsize role in this proposal-governance-performance cycle. As even conservative commentators have noted, "labor affiliated" funds, which are predominantly union-sponsored private funds covered by ERISA, have historically filed shareholder resolutions much more frequently than other institutions, and have been the driving force behind major corporate governance initiatives.[14] For instance, one of the speediest changes in governance over the past 20 years was the widespread adoption of majority voting for directors.[15] This successful reform effort was led by ERISA-covered, union-sponsored funds, who filed dozens of resolutions calling for directors to submit their resignation to the board if they did not receive a majority of the vote. ERISA-covered funds have similarly played important roles in submitting and supporting shareholder resolutions addressing board independence, poison pills, board declassification, improved disclosure, and increased diversity.

The Department Should Withdraw the Proposal

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[8] Szilagyi, Peter & Renneboog, L.. (2011). "The Role of Shareholder Proposals in Corporate Governance." *Journal of Corporate Finance.* 17. 167-188. 10.1016/j.jcorpfin.2010.10.002.
[9] Vicente Cunate, Mireia Gine, and Maria Guadalupe, "Say Pays! Shareholder Voice and Firm Performance" Upjohn Institute Working Paper No. 13-192, Frebruary 2013.
[10] https://corpgov.law.harvard.edu/2017/07/11/the-value-of-the-shareholder-proposal-process/
[11] Gunnar Friede, Timo Busch & Alexander Bassen (2015) "ESG and financial performance: aggregated evidence from more than 2000 empirical studies", *Journal of Sustainable Finance & Investment*, 5:4, 210-233
[12] https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2154724
[13] Flammer, Caroline and Hong, Bryan and Minor, Dylan, "Corporate Governance and the Rise of Integrating Corporate Social Responsibility Criteria in Executive Compensation: Effectiveness and Implications for Firm Outcomes" (December 27, 2018). Available at SSRN: https://ssrn.com/abstract=2831694 or http://dx.doi.org/10.2139/ssrn.2831694
[14] James R. Copland and Margaret M. O'Keefe, *Corporate Governance and Shareholder Activism*, Proxy Monitor Report, Fall 2013.
[15] Kosmas Papadopoulos, *The Long View: The Role of Shareholder Proposals in Shaping US Corporate Governance (2000-2018)*, ISS Analytics, February 2019, pgs. 7-9.

The proposed rule should be promptly withdrawn. The Department is unable to demonstrate the existence of any problem at all, and must desperately string together unsubstantiated rumor and hearsay in an effort to provide some seemingly legitimate basis for rules whose true motivation we suspect is every bit as distanced from concerns for pension fund participants and beneficiaries as the Department falsely suggests proxy voting practices to be. Indeed, the Department's own calculations show that its proposed cure would increase plan costs by an order of magnitude beyond that status quo ante. Worse still, its proposed solutions plainly require ERISA plans to place an external interest – namely incumbent corporate managers – ahead of the interests of their participants and beneficiaries, in clear violation of the plain language of the statute. The Department should promptly withdraw the proposed rule to spare itself from further embarrassment.

Sincerely,

Dieter Waizenegger, Executive Director