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Employee Benefits Security Administration
Room N-5655
U.S. Department of Labor
200 Constitution Avenue NW
Washington, DC 20210
Via: Federal eRulemaking Portal at: https://beta.regulations.gov/commenton/EBSA-2020-0008-0001

Proxy Voting and Shareholder Rights NPRM/RIN 1210-AB91

Dear Officers,

On behalf of more than 500,000 members and supporters of Public Citizen, we offer the following comments on the Department of Labor's (DOL) proposed rulemaking regarding proxy voting and shareholder rights. In brief, we find this a ham-fisted effort to stifle corporate accountability on subjects that management of major corporations find uncomfortable. This is a momentous change, yet the DOL allows the public a mere 30 days for comment, itself an affront to the responsible consideration of such public policy decisions.

Background

Corporations that sell equity stock to the public instead of remaining private take an existential step. Ownership, and therein control, moves from the founders and original owners of an enterprise to any of those who purchase stock. Equity stock means ownership. As any owner of real property understands, whether the property is a house, a car, a farm, or a painting, ownership means control. In a public company where the ownership is spread among hundreds, thousands and sometimes even millions of owners, protocols and law have developed so that the owners may collectively express their control interests. Most commonly, this takes place at an annual meeting where items are subject to a vote. This always includes the election of directors, who serve shareholders to oversee management on a continuing basis; selection of auditors; approval of compensation plans; and issues that shareholders may raise through resolutions typically provided under Rule 14a-8 governed by the Securities and Exchange Commission.

For decades, institutional investors have dominated the stock ownership profiles of the major companies. These institutions are not owners themselves, but agents for individuals who have purchased mutual funds, are beneficiaries of pension plans, or perhaps public sector workers whose deferred compensation includes participation in a state or local pension fund.

As it happens, many of these institutional investors bring a basic conflict. While they manage—in a profitable contract--the savings of individuals, the decision for how this management contract is awarded often rests with corporations who sponsor a specific pension fund. In other words, institutional investors serve two masters.[1] These institutional investors serve investors who might own stock in a corporation, and they serve that same corporation as well.

On shareholder resolutions, which by nature are proposed refinements to corporate governance, or basic management on which the company's officers differ, the institutional investor may be torn between their twin masters.

For many years, some institutional investors opted to vote not at all. Rather than antagonize one master, they stood on the sidelines. This meant that a large portion of the vote was simply not registered. To address this willful indecision, the Department of Labor issued the so-called Avon letter in 1988 under the administration of President George H.W. Bush. Elegantly, the letter declared that proxy votes are material assets and must be managed according to the fiduciary duties of loyalty and care. This guidance was formalized in Interpretive Bulletin 1994-2, and then revised with the addition of cautionary language in Interpretive Bulletin 2008-2. In 2016, the DOL reinstated and updated its original 1994 guidance in Interpretive Bulletin 2016-01. For over three decades, ERISA plans have been prudently voting under this guidance. [2]

The Avon letter helped lead to an increase in shareholder activism. While the overwhelming majority of shareholder resolutions fail to win support among institutional investors (which we worry mean that corporate masters can exact more immediate penalties from wayward institutions for non-compliance than can far flung individual investors who are likely unaware that the institution is voting against their interests), in a few cases, institutions support shareholder reform ideas.[3]

This has led to notable successes. Because of shareholder resolution activists, many companies have named a chair who is not also the CEO. Many have adopted majority voting for directors. These are fundamental advances. Yet the DOL considers these immaterial distractions.

What's known as environmental, social, and governance issues, or ESG, draws scornful dismissal in the DoL proposal. This ignores the material fact that large institutional investors increasingly recognize that ESG disclosures are a critical part of the mix of information they need in order to evaluate the performance of the companies in their portfolio. BlackRock, the world's largest asset manager, has acknowledged the growing trend towards ESG investing. On the company's recent second- quarter earnings call "BlackRock executives said they believe ESG would converge and align with retirement plans' financial plan objectives and that ESG helps identify unpriced risks and opportunities." [4] In fact, BlackRock's CEO, Larry Fink, said that DOL's recent proposed rule on ESG investing "'accelerates'

[1] Paul G. Mahoney, *Manager-Investor Conflicts in Mutual Funds*, AMERICAN ECONOMIC ASSOCIATION (Spring, 2004) https://www.aeaweb.org/articles?id=10.1257/0895330041371231

[2] *Department of Labor Interpretative Bulletin*, SIDLEY (Feb. 23, 2017) https://www.sidley.com/en/insights/newsupdates/2017/02/dol-interpretive-bulletin

[3] Rosanna Landis Weaver, *Are Fund Managers Asleep at the Wheel,* AS YOU SOW (Feb. 17, 2016)

[4] Leslie P. Norton, *BlackRock's Fink Says U.S. Proposal to Limit ESG Investing Will Only Boost Interest*, BARRON'S (July 17, 2020), https://bit.ly/2CQNtfZ.

interest in ESG, by forcing people to clarify that they're investing in ESG because they're worried about climate and specific risks." [5]

Investment industry analyses confirm the financial materiality of much ESG information. A Bank of America Merrill Lynch study highlighted by the Sustainability Accounting Standards Board found sustainability factors to be "strong indicators of future volatility, earnings risk, price declines, and bankruptcies."[6] Allianz Global Investors produced a research report with similar findings, concluding that the heightened transparency of ESG disclosure lowered companies' cost of capital by reducing the "investment risk premium" that sophisticated investors would require.[7] Nordea Equity Research published an analytic research report concluding that there is "solid evidence that ESG matters, both for operational and share price performance."[8] Goldman Sachs concluded in April of 2018 that "integrating ESG factors allows for greater insight into intangible factors such as culture, operational excellence and risk that can improve investment outcomes."[9]

ESG investments outperform the market, especially in 2020. Research from Morningstar shows that, "when markets were flat (2015) or down (2018), the returns of 57% and 63% of sustainable funds placed in the top half of their categories. When markets were up in 2016, 2017, and 2019, the returns of 55%, 54%, and 65% of sustainable funds placed in the top half of their categories." [10] More recently, additional Morningstar data shows that as market activity decreased due to global reactions to the coronavirus pandemic, 62% of ESG- focused large- cap equity funds performed better than the global tracker.[11] This is just a snapshot of the research that is consistent with academic studies that suggests that there is "no systematic performance penalty associated with sustainable investing and possible avenues for outperformance through reduced risk or added alpha." [12]

Adding to the case for investor interest in ESG risks are trends relating to shareholder proposals on ESG issues. Recent analysis from the Sustainable Investments Institute shows that investors have voted on 172 shareholder resolutions on ESG issues as of July 2020.[13] The number of these proposals filed has increased 12% since 2010, and the average support for the proposals "has steadily increased, from 18.3 percent in 2010 to 26.8 percent so far in 2020." [14] Additionally, "withdrawals have increased in number,

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[5] *Id.*

[6] Bank of American Merrill Lynch, Equity Strategy Focus Point—ESG Part II: A Deeper Dive (June 15, 2017), cited in Sustainability Accounting Standards Board (SASB), The State of Disclosure Report 2017 (December 2017). https://www.sec.gov/rules/petitions/2018/petn4-730.pdf

[7] Allianz Global Investors, *ESG matters, Part 2: Added value or a mere marketing tool? What does ESG mean for investments?*, (June 2017) https://www.sec.gov/rules/petitions/2018/petn4-730.pdf

[8] Nordea Equity Research, Strategy & Quant: Cracking the ESG Code, 5 Sept. 2017, available at: https://nordeamarkets.com/wp-content/uploads/2017/09/Strategy-and-quant_executive-summary_050917.pdf.

[9] Goldman Sachs Equity Research, GS Sustain ESG Series: A Revolution Rising-From Low Chatter to Loud Roar [Redacted], 23 April 2018 (analyzing earnings call transcripts, social media, asset manager initiatives, and rising assets under management utilizing ESG screens to conclude that "the ESG Revolution is just beginning, as the logical, empirical and anecdotal evidence for its importance continue to mount."). https://www.sec.gov/rules/petitions/2018/petn4-730.pdf

[10] *U.S. ESG Funds Outperformed Conventional Funds in 2019,* MORNINGSTAR (April 16, 2020), https://bit.ly/2Dht1EG.

[11] Lynn Strongin Dodds, *ESG equities outshine their conventional peers*, BEST EXECUTION (April 7, 2020), https://bit.ly/3geoaTx.

[12] *U.S. ESG Funds Outperformed Conventional Funds in 2019,* MORNINGSTAR (April 16, 2020), https://bit.ly/2Dht1EG.

[13] *Comparative Impact of Proposed Rule 14a-8: Social and Environmental Policy Shareholder Resolutions*, SUSTAINABLE INVESTMENTS INSTITUTE (July 28, 2020), https://bit.ly/2CUxxcE.

[14] *Id.*

up 35 percent since 2010, generally because of a growing likelihood companies will agree to investor requests for more disclosure."[15]

Current Rulemaking

Comes now the DOL's effort to eviscerate the Avon letter. The Employee Benefits Security Administration of the DOL has published a proposed rule regarding proxy voting and the exercise of shareholder rights by private sector retirement plans that are covered by the Employee Retirement Income Security Act of 1974 ("ERISA"):[16] Instead of the simple Avon letter declaration, the DOL now requires that managers governed by ERISA perform an economic analysis of each vote at a company shareholder meeting. This analysis must conclude that the vote will be important. This economic analysis will be cumbersome and expensive, which the DoL acknowledges. To avoid this expense, the DOL permits three safe harbors: An ERISA-governed manager may avoid the expensive analysis and fulfill fiduciary duty if the fund either 1. Votes with management and against the shareholder proponent; 2. Does not vote on shareholder resolutions; or 3. Only votes where the fund controls a substantial amount of the company, or where the investment represents a substantial part of the fund.

In short, vote with management, or the government will come after you.

Alone, these so-called safe harbors are laughable bubble wrap for corporate managers who don't want to be second guessed by the legal owners of the property they are entrusted to manage. The DOL should be embarrassed to adopt one of the Chamber of Commerce's most craven fantasies.[17] After all, this is the Department of Labor, the administrative arm charged with advancing the interests of working men and women. By statute, as provided in 29 USC 551, "The purpose of the Department of Labor shall be to foster, promote, and develop the welfare of the wage earners of the United States, to improve their working conditions, and to advance their opportunities for profitable employment."[18] The Department of Labor is not the Department of Commerce

Beyond this, the safe harbor of voting with management may lead institutional investors to violate their fiduciary duty of loyalty to their plan beneficiaries. While management may be wise, and directors may themselves be bound by duties of loyalty to corporate interests, corporate management and directors are also protected by the business judgement rule. This state law concept means that managers may make bad decisions, those that ultimately harm the interests of the company and its shareholders, provided that they do not violate the duties of loyalty and care. In the case of Enron, when shareholders sought stricter governance ahead of the company's ultimate meltdown, it would clearly have been a fiduciary failure for institutional managers to vote with management, the same management responsible for massive fraud on investors. While this may be an extreme case, the same circumstances hold where investors seek better environment reporting, where the entire planet—let alone a single corporation--is at risk of a meltdown.

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[15] *Id.*

[16] Fiduciary Duties Regarding Proxy Voting and Shareholder Rights (RIN 1210-AB91) – https://www.dol.gov/sites/dolgov/files/ebsa/temporarypostings/fiduciary-duties-regarding-proxy-voting-and-shareholder-rights.pdf

[17] Billy Nauman, *Big investors battle SEC on shareholder resolution changes*, FINANCIAL TIMES (Feb. 3, 2020) https://www.ft.com/content/868e7aa5-ead5-43f2-8617-b184648288eb

[18] See Title 29 of the United States Code, Section 551, FEDERAL REGISTER (website viewed Sept. 25, 2020) https://www.govinfo.gov/content/pkg/USCODE-2018-title29/html/USCODE-2018-title29-chap12-sec551.htm

Yet by siding with management, major institutions that effectively control corporations can escape penalty from the Department of Labor.

ERISA code requires institutional investors that are plan fiduciaries must discharge their duties "with the care, skill, prudence, and diligence" of an expert acting in a like capacity.[19] ERISA plans hire experienced investment managers to comply with these prudence requirements. And they hare provision proxy advisory firms to fulfill their duty on voting. Again, this current rulemaking will render institutional investors in violation of ERISA code.

Conclusion:

This rulemaking did not emerge from years of frustration by American working men and women whose retirement savings managers the DOL oversees. Instead, it stems from the playbook of corporate America's leading trade associations.[20] Across this presidential administration, this playbook is being codified in rules that harm workers for the benefit of corporate managers. The DOL will allow high risk speculators to use savers funds in a previous rulemaking. The Securities and Exchange Commission (SEC) has just disenfranchised small investors in the shareholder resolution process governed by Rule 14a-8. The SEC also introduced a chilling censorship scheme for proxy advisory firms. All these steps serve to insulate corporate management from accountability to their owners. These are all damaging moves and will license and even invite managements who are unfocussed on mission, self-dealing, and engage in misconduct.

The DOL must withdraw this proposal.

For questions, please contact Bartlett Naylor at bnaylor@citizen.org, and/or Rachel Curley at rcurley@citizen.org.

Sincerely,

Public Citizen

[19] 29 CFR § 2550.404a-1

[20] *Modern Regulatory Systems and Reasonable Systemic Risk Regulation*, CHAMBER OF COMMERCE (website visited September 30, 2020) https://www.centerforcapitalmarkets.com/resources/studies-and-publications/