UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

OFFICE OF THE
COMMISSIONER

October 5, 2020

Office of Regulations and Interpretations
Employee Benefits Security Administration
U.S. Department of Labor
200 Constitution Avenue NW
Room N-5655
Washington, DC 20210

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

Ladies and Gentlemen:

We submit this comment, on our own behalves and representing our own views,[1] regarding the Department of Labor's (the "Department") proposed rule relating to fiduciary duties regarding proxy voting and shareholder rights (the "Proposed Rule").[2] The Department's Proposed Rule fundamentally changes procedures that ERISA fiduciaries must undertake to determine whether and how to exercise shareholder voting rights. Yet the Department has not provided objective evidence of the problem this Proposed Rule purports to address. We are also concerned that the Proposed Rule may harm the very people the Department intends to help. We therefore urge the Department to exercise prudence by first undertaking a more robust economic analysis of the proxy voting process and then tailoring any regulatory action based on that analysis.

No Objective Evidence of a Problem

First, the Proposed Rule does not provide objective quantitative or qualitative evidence of the problem it is intended to address. The Proposed Rule suggests that the costs of proxy voting exceed the benefits, but does not offer evidence to support that claim. In fact, the Department acknowledges that costs to vote proxies are extremely low and that it lacks evidence to prove otherwise.[3] Similarly, the Department has not sufficiently recognized the multitude of benefits

[1] Our views do not reflect those of the U.S. Securities and Exchange Commission, our fellow Commissioners, or the Staff of the Commission.

[2] Fiduciary Duties Regarding Proxy Voting and Shareholder Rights, 85 Fed. Reg. 95879 (proposed Sept. 4, 2020) [hereinafter *Proxy Voting Proposed Rule*].

[3] *See id* at 55223 ("the Department currently lacks complete data on plans' exercise of their shareholder rights appurtenant to their stock holdings, including proxy voting activities, and on the attendant costs and benefits."); *id* at 55529 ("[a] preliminary examination of all ERISA plan and intermediary fee reports identifies just 18 direct payments to one of the two leading proxy advisory firms, and none to the other. Measured against the reporting plans' total assets, the 18 reported payments averaged 0.2 basis points. The reports additionally identify 46 payments

that shareholder participation in the proxy process provides. Specifically, increased shareholder oversight enhances corporate governance, disclosures, and risk management, which in turn leads to long-term value-enhancing changes to corporate behavior.[4]

For decades, proxy voting has helped shareholders effect significant improvements in corporate governance, including majority vote rules for the election of directors, staggered board terms, limits on poison pills that serve to entrench management, and increased adoption of proxy access bylaws.[5] Shareholder proposals also often highlight the need for important corporate reforms that are later adopted. This was the case, for example, with proposals requesting the expensing of stock options before this was required by GAAP.[6]

Against these proven benefits, the Department focuses on potential but unmeasured costs. The Department's Proposed Rule states that "*some* fiduciaries and proxy advisory firms…*may* be acting in ways that unwittingly allow plan assets to be used to support or pursue proxy proposals for environmental, social, or public policy agendas that have no connection to increasing the value of investments used for the payment of benefits or plan administrative expenses, and in fact *may* have unnecessarily increased plan expenses."[7] Any changes to the calculus for fiduciaries with respect to proxy voting should be grounded in facts and data demonstrating that an actual problem, worthy of regulatory attention, exists.

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to a second service provider known to provide proxy advice, which averaged 0.2 basis points, and 363 payments to a third, which averaged 6.3 basis points….While these reported costs might generally seem small, actual total proxy voting costs *could be* substantially higher for *some* or *many* plans, and even small costs *may not* be justified…. The magnitude of unreported costs is unknown.") (emphasis added). Further, in 2016, the DOL stated that, "[i]n most cases, proxy voting and other shareholder engagement does not involve a significant expenditure of funds by individual plan investors." *See* Interpretative Bulletin Relating to the Exercise of Shareholder Rights and Written Statements of Investment Policy, Including Proxy Voting Policies or Guidelines, 81 Fed. Reg. 95879, 95881 (Dec. 29, 2016).

[4] *See, e.g.*, Kosmas Papadopoulos, The Long View: The Role of Shareholder Proposals in Shaping U.S. Corporate Governance 2000-2018, Harv. L. Sch. F. on Corp. Gov. & Fin. Reg. (Feb. 6, 2019).

[5] *See id.*

[6] *See id.* Shareholder engagement does not just benefit the companies that shareholders own and directly oversee; rather, it can offer market-wide benefits because corporate reforms that are initiated at one company often lead other companies to follow suit. Thus, shareholder engagement by one plan can impact not only the securities held by that plan, but securities held by other plans. *Cf. id.*

[7] *See Proxy Voting Proposed Rule*, *supra* note 2, at 55221 (emphasis added).

Harming the Very People this Rule Purports to Help

Second, this Proposed Rule would make it more burdensome and costly for ERISA fiduciaries to vote shares on behalf of the plans over which they have responsibility. Increasing burdens and raising costs on ERISA fiduciaries would likely have two effects: 1) the increased costs that would be directly borne by fiduciaries could be passed on to plan participants, and 2) fiduciaries would likely be discouraged from proxy voting at an unprecedented scale. The cumulative effect, across all ERISA plans, may be a dramatic decrease in shareholder oversight and effective use of proxy voting to ensure long-term value-enhancing changes to corporate governance, disclosures, and risk management.[8] These deleterious effects would harm not just plan investors – typically middle-class retirement investors who cannot afford to pay higher costs – but also the securities market more generally. As our Agency's mission is centered upon investor protection, we are obliged to call your attention to this risk to ERISA plan participants and all investors.

Specifically, the Department's Proposed Rule imposes a series of prescriptive and complex requirements onto plan fiduciaries regarding whether and how to vote their plan's shares on each proxy proposal. Plan fiduciaries must first determine whether a proposal would have an economic impact on the plan and what that impact would be. In order to make this determination, fiduciaries must undertake what is likely to be an exhaustive economic analysis regarding the expected costs and benefits to the plan, including the corresponding reduction in risk and increase in returns, of voting. Even if plan fiduciaries rely on proxy advisers to aid them in their voting decisions or delegate responsibility for voting proxies to an investment manager, they must independently investigate material facts that form the basis for the recommended vote and monitor and assess proxy recommendations and voting decisions. These requirements will be time-consuming, burdensome, and costly.[9] Those costs will be borne directly by fiduciaries and indirectly by the plans they manage.[10]

Increasing the burdens and costs on plan fiduciaries to vote plan securities under the rule as written is also likely to either incentivize voting with management[11] or disincentivize

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[8] To the extent decreased shareholder oversight or effective use of the proxy process leads to a diminution in value regarding corporate governance, disclosures, or risk management, that would increase the cost of capital, impeding capital formation.

[9] "The Department recognizes that…fiduciaries may need to conduct an analytical process which could in some cases be resource-intensive…and that these activities may often burden fiduciaries out of proportion to any potential benefit to the plan." *See Proxy Voting Proposed Rule*, *supra* note 2, at 55225.

[10] In addition to raising compliance costs, the Proposed Rule could increase plan fiduciaries' exposure to litigation risk, which is not analyzed in the Proposed Rule.

[11] Recognizing the extensive costs and burdens associated with conducting the proposed analysis on a vote-by-vote basis, the Department provides several examples of "permitted practices," voting policies that are "intended to

independent voting by fiduciaries, with the same ultimate result. Plan fiduciaries are likely to interpret the Proposed Rule as creating a presumption that they should not vote for a proxy proposal unless they can point to substantial evidence that a proposal would "have a meaningful bearing on share value or when plan fiduciaries have determined that the interests of the plan are unlikely to be aligned with the positions of a company's management."[12] Proxy proposals that may provide long-term shareholder value, but which are not readily quantifiable or are subject to uncertainty at the time of voting, are likely to face particularly difficult hurdles. And fiduciaries will have to commit considerable time, effort, and resources just to determine whether a vote is advisable or required.

As the Department previously recognized, absent proxy voting, investors may have no other means to hold management accountable for their actions.[13] However, with this Proposed Rule, the Department is compromising one of the only tools investors have at their disposal to do so, which would shift the balance of power further in favor of corporate management at the expense of investors. Decreasing corporate accountability and increasing costs on plan fiduciaries and investors would harm the very plan participants this Proposed Rule purports to help.

Regulatory Oversight Should Be Evidence-Based

Oversight of the shareholder proposal and voting process should be viewpoint neutral. The Proposed Rule, however, appears to take a view as to the value, efficacy, and wisdom of

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reduce the need for fiduciaries to consider proxy votes that are unlikely to have an economic impact on the plan, thereby allowing plans to focus resources on matters most likely to have an economic impact." *See id* at 55225. One of these permitted practices is following the recommendations of a corporation's management. *See id*. The stated reason for allowing this policy is that it relies on the fiduciary duties that officers and directors owe to a corporation based on state corporate laws. *See Proxy Voting Proposed Rule*, *supra* note 2, at 55225. Inexplicably, the Department has determined that a proxy adviser that is registered as a fiduciary under the Investment Advisers Act does not deserve the same treatment. *See id* at 55229 ("[a] number of stakeholders have questioned whether third-party proxy advice is impartial, sufficiently rigorous, and consistent with ERISA's fiduciary duties, as would be necessary to reliably advance ERISA investors' interests.").

[12] *See id* at 55228 ("[e]ven if the proposal has substantial implications for the company, the cost of voting still may be higher than the potential benefit to the plan, especially if each fiduciary separately must collect and analyze the information necessary to reach an appropriate conclusion.").

[13] *See* Interpretative Bulletin Relating to the Exercise of Shareholder Rights and Written Statements of Investment Policy, Including Proxy Voting Policies or Guidelines, 81 Fed. Reg. at 95881 ("[i]f there is a problem identified with a portfolio company's management, selling the stock and finding a replacement investment may not be a prudent solution for a plan fiduciary. As Vanguard founder John Bogle put it in the context of index funds, 'the only weapon [index funds] have, if we don't like the management, is to get a new management or to force the management to reform.'") (quoting Interview by Christine Benz with John Bogle, Founder, Vanguard (Oct. 10, 2010)).

proxy proposals related to Environmental, Social, and Governance ("ESG") issues.[14] The Department contends, without providing supporting evidence, that, "[i]t is likely that many of these proposals have little bearing on share value or other relation to plan interests."[15] And the Department has exhibited a similar opposition to ESG-oriented investing in the past with a rule proposal to restrict ESG investment by retirement plans.[16] We are concerned about substituting regulatory judgment for that of investors and fiduciaries, and effectively putting a thumb on the scale in this manner.

Such a position would be at odds with investor preferences and best practices that are developing within the asset management industry. Asset managers representing trillions in investments, issuers, lenders, investment advisers, credit rating agencies, analysists, index providers and stock exchanges integrate ESG factors into their capital allocation, pricing and value assessments. In fact, a large number of investors find ESG risks to be as or more important in their decision-making process than financial statements, exceeding traditional metrics like return on equity and earnings volatility.[17] Furthermore, many issues that are the subject of proxy proposals, including executive compensation, board composition and independence, climate risk, and human capital management, also implicate legal, regulatory, and reputational concerns.

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[14] "The Department's concerns about plans' voting costs sometimes exceeding attendant benefits has been amplified by the recent increase in the number of environmental and social shareholder proposals introduced." *Proxy Voting Proposed Rule*, *supra* note 2, at 55229.
[15] *Id*.
[16] *See* Financial Factors in Selecting Plan Investment, 85 Fed. Reg. 39113 (proposed on June 30, 2020).
[17] *See* Emirhan Ilhan, Philipp Krueger, Zacharias Sautner, & Laura T. Starks, Institutional Investors' Views and Preferences on Climate Risk Disclosure, (European Corp. Governance Inst., Finance Working Paper No. 661/2020); Savita Subramanian Et Al., Bank of America Merrill Lynch, Equity Strategy Focus Point ESG Part II: A Deeper Dive (June 15, 2017).

These issues are clearly material to long-term performance and risk[18] and shareholders are increasingly using their vote to hold companies accountable for addressing these issues.[19]

Indeed, an advisory committee to the CFTC recently released a comprehensive report finding that climate change poses major risks not just to individual businesses, but "to the stability of the U.S. financial system and to its ability to sustain the American economy."[20] Shareholder engagement and oversight, including proxy voting by plan fiduciaries can focus the attention of corporate managers and drive valuable and needed change on this and many other critical issues. Regulators should be wary of stifling this kind of engagement.

Before proposing rules that essentially favor or oppose a particular proxy proposal or class of proposals, there should be an objective, evidence-based record to support such a change. Here, the record is notably lacking such evidence. Indeed the prevailing evidence demonstrates that ESG-related issues have been widely incorporated into traditional financial models and analyses, and form the basis for a wide array of investment preferences, in the asset management industry. We therefore urge the Department to exercise prudence by first undertaking a more robust economic analysis of the proxy voting process and then tailoring any regulatory action based on that analysis.

[18] Institutional investors are increasingly stating that ESG risks are material and demanding that corporations disclose and address such risks. *See* Larry Fink, BlackRock, A Fundamental Reshaping of Finance, (Jan. 14, 2020) (open letter to CEOs declaring "that all investors, along with regulators, insurers, and the public, need a clearer picture of how companies are managing sustainability-related questions."); Cyrus Taraporevala, State Street Global Advisors, A Letter to Corporate Board Members (Jan. 28, 2020) [hereinafter *State Street Letter*] ("[w]e believe that addressing material ESG issues is good business practice and essential to a company's long-term financial performance—*a matter of value, not values.*"). The Sustainability Accounting Standards Board (SASB), which focuses on improving the effectiveness of corporate issuer reporting, highlighted, in a 2017 report, several large institutional investors, among others, that found sustainability factors to be important to their investment strategies. *See* Sustainability Accounting Standards Board, The State of Disclosure, at 2 (2017). In addition, in June 2017, a Bank of America Merrill Lynch report concluded that ESG investing would help investors avoid bankruptcies and that ESG attributes "have been a better signal of future earnings volatility than any other measure [it has] found." *See* Subramanian Et Al., *supra* note 17. Thus, it is no longer the case that ESG proposals are widely viewed as having "only an attenuated connection to shareholder value and generally not issues material to a company's business." *Cf.* Business Roundtable, Responsible Shareholder Engagement & Long-Term Value Creation, (Oct. 2016).

[19] In a recent publication BlackRock reported that it is using its shareholder vote to hold companies, and directors, that fail to address ESG risks accountable. *See* BlackRock, Our Approach to Sustainability at 9-10 (July 2020). The CEO of State Street Global Advisors issued a letter to board members stating the firm would use its "proxy vote to press companies that are falling behind and failing to engage" on issues that affect long-term performance, including ESG issues. *See* State Street Letter, *supra* note 18.

[20] *See* Climate-Related Market Risk Subcommittee of the Market Risk Advisory Committee at the U.S. Commodity Futures Trading Comm'n, Managing Climate Risk in the U.S. Financial System Managing Climate (Sept. 9, 2020).

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Thank you for your consideration.

Respectfully,

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