New America

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RE: RIN 1210-AB91

Attention: Fiduciary Duties Regarding Proxy Voting and Shareholder Rights

To Whom It May Concern:

We are writing in opposition to proposed rule RIN 1210-AB91 - Fiduciary Duties Regarding Proxy Voting and Shareholder Rights. We believe the proposed rule restricts the ability of fiduciaries to perform their duties and is therefore detrimental to the interests of beneficiaries. Below we present our arguments for opposing the proposed rule.

DISCUSSION POINTS

1. **The DOL proposed rule restricts the most fundamental of shareholder rights – the right to vote on issues raised at general shareholder meetings – and potentially harms the ability of pension fund fiduciaries to protect the interests of beneficiaries.** In its most basic form, the proposal introduces requirements that could discourage shareholders from exercising their fundamental right to vote, with potentially harmful impacts on the portfolio. According to the proposal, fiduciaries MUST vote on issues that are deemed to have a material economic impact on the portfolio and MUST NOT vote on issues that may not have a material economic impact. The proposal mentions examples of economically impactful issues, such as mergers or corporate actions, while expressing doubt about the economic basis for other issues such as board diversity, environmental concerns, executive compensation, and social factors.

   The proposed rule does not account for fiduciaries that have developed expertise and carefully considered views on the economic implications of proxy voting issues that the DOL holds in doubt. It ignores the vast body of academic evidence supporting the pecuniary impact of issues it deems to be non-economic, such as environmental concerns, and makes no mention of market trends showing real-world evidence of the impact these issues can have on portfolio values. Instructing pension fund fiduciaries NOT to vote on select issues

that they may consider to be important to the long-term prospects of the portfolio interferes with their duty to manage risks and returns, to communicate their views on essential matters to portfolio company managements, and to protect the interests of beneficiaries.
The proposed rule does offer fiduciaries a way out – by documenting and explaining the specific economic basis for each proxy vote taken – but this is a false choice that could have a chilling effect on fiduciary voting outcomes. Even if they believe an issue has economic impact on the portfolio, fiduciaries may not want to bear the expense and risk of justifying their vote on issues that are deemed to be non-economic by the DOL.

It is beyond the scope of this comment to lay out the economic basis for all the issues that the DOL has cast doubt upon, but we note that there is ample academic evidence supporting such views. For example, a seminal study published by Harvard Business School found that companies scoring highly on environmental, social and governance factors material to their business outperformed peers that scored poorly on the same metrics by more than 300 basis points per annum[1]. An award-winning paper from the University of Augsburg and Queens University, published by the Federal Reserve Bank of San Francisco, shows that the transition from a high-carbon to a low-carbon economy, as we are experiencing today, significantly impacts company valuations and risk profiles.[2] Another study, by the University of Zurich and Harvard Kennedy School, provides clear evidence that firms' climate-related performance affects their stock market valuations.[3]

Market trends also demonstrate the economic implications of environmental concerns that are dismissed in the proposed rule. For example, traditional oil and gas stock prices are down 50% on average in 2020 year to date, while renewable energy stock prices are up by 50%, providing enormous swings in value and risk for beneficiaries. Despite assertions to the contrary by the DOL, investment trends clearly indicate that fiduciaries have an economic basis to vote on issues related to renewable energy and other environmental concerns. To properly protect the economic interests of beneficiaries, fiduciaries need to consider such factors in their portfolios and exercise their right to vote on them. Moreover, from a governance perspective, fiduciaries have a right and an obligation to object to high levels of compensation for company executives at underperforming companies and it is surprising that the DOL would object to fiduciaries voting on such matters.

In legal terms, the proposal imposes *ex ante* qualitative and quantitative requirements on fiduciaries in relation to the consequences of voting. This is equivalent to requiring citizens, prior to voting, to be aware that they must justify their vote for a candidate, especially if it is

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[1] Khan, Mozaffar N., George Serafeim, and Aaron Yoon. "Corporate Sustainability: First Evidence on Materiality." Harvard Business School Working Paper, No. 15-073, March 2015. http://nrs.harvard.edu/urn-3:HUL.InstRepos:14369106

[2] Görgen, Maximilian, Andrea Jacob, Martin Nerlinger, Ryan Riordan, Martin Rohleder, Marco Wilkens. "Carbon Risk." University of Augsburg, Queen's University. first version: 10-Mar-17, current draft: 24-Jun-19, https://www.frbsf.org/economic-research/events/2019/november/economics-of-climate-change/files/Paper-6-2019-11-8-Riordan-1PM-2nd-paper.pdf

[3] Ramelli, Stefano, Alexander F. Wagner, Richard J. Zeckhauser, Alexandre Ziegler. "Investor Rewards to Climate Responsibility: Evidence from the 2016 Climate Policy Shock." University of Zurich, John F Kennedy School of Government, Harvard university. https://www.nber.org/papers/w25310

different than what has been recommended by their company management or their local council. Just as it is a constitutional right of a citizen to vote for the candidate of her or his choice without consequence, it is the 'constitutional' right of a shareholder to vote on any given issue, as agreed upon in the formation of legal entities.

That a fiduciary must apply best knowledge and experience in exercising shareholder voting rights is a qualitative requirement that should be imposed under specific regulations applicable to the pension industry. However, such qualitative requirements should never interfere with the most fundamental of property or ownership rights – the right to vote.

2. **The proposed rule instructs fiduciaries to vote in line with recommendations made by investee company managements, a clear violation of the basic rules of corporate governance.** The proposal advises fiduciaries to vote in-line with management recommendations on issues deemed non-economic or non-impactful. This is bizarre – instructing or inducing fiduciaries to concur with the opinions of management of investee companies is potentially harmful to all stakeholders and a violation of basic ownership rights. In legal terms, the proposal undermines the system of checks and balances that is at the heart of corporate governance – the separation of ownership and control.[4]

   An example of how this could be a problem would be a vote to amend the articles of association of an entity. Per the proposed rule, a fiduciary might be reluctant to vote due to the requirement to prove economic impact. However, in the context of fiduciary duties, not voting on such an issue could be incompatible with the protection of beneficiary interests. Note that the DOL proposal suggests a minimal shareholding threshold for voting, proposing either a dollar value or a percentage of portfolio assets. However, we reject this concept as it ignores the fact that shareholder votes are cumulative and that even in the case of a small shareholding, all votes need to be counted to arrive at a representative outcome.

3. **The DOL proposal misinterprets SEC recent rulings on proxy voting to justify the imposition of restrictions on fiduciary voting rights**. The DOL indicates in the proposed rule that it believes SEC guidance on proxy voting may be used to address some of the Department's concerns about ERISA fiduciaries properly discharging their duties with respect to proxy voting activities. In effect, the DOL expresses its objective to extend SEC guidance to entities over which the DOL has jurisdiction, in a similar and consistent fashion. However, this is misleading in our view, as the SEC guidance in no way restricts the right to vote nor dictates what can and cannot be voted on.

   In Guidance Regarding Proxy Voting Responsibilities of Investment Advisers[5] – a rule issued by the SEC on August 10, 2019 - the commission addresses proxy voting concerns by imposing standards on the process for evaluating proxy voting issues, rather than by

[4] Adolf A. Berle and Gardiner C. Means, The Modern Corporation and Private Property, 1933. https://archive.org/stream/in.ernet.dli.2015.216028/2015.216028.The-Modern#page/n5/mode/2up
[5] Commission Guidance Regarding Proxy Voting Responsibilities of Investment Advisers. https://www.federalregister.gov/documents/2019/09/10/2019-18342/commission-guidance-regarding-proxy-voting-responsibilities-of-investment-advisers

imposing any direct or indirect restrictions on actual voting. The SEC rule emphasizes that "for an investment adviser to form a reasonable belief that its voting determinations are in the best interest of the client, it should conduct an investigation reasonably designed to ensure that the voting determination is not based on materially inaccurate or incomplete information."

In other words, the SEC guidance on proxy voting indicates that the interest of beneficiaries should be protected not through restrictions on voting rights, but rather by enhancing the diligence of the process and above all, granting fiduciaries the authority to decide what exactly is in the best interests of their beneficiaries when it comes to exercising their right to vote. The SEC does NOT issue guidance on the economic basis for proxy votes, and it does NOT suggest that voting on any proxy issues should be restricted. Yet, this is exactly what is proposed in the new rule by the DOL.

In our view, the DOL proposed rule should actually follow the protocol of the SEC - introduce and apply qualitative standards that can be regulated and evaluated based on the soundness of the process through which voting decisions are made, rather than on the soundness of the substance or content of the decisions. We believe the DOL proposed rule on proxy voting does not take the right approach to this issue.

4. **The rushed timing of the DOL proposed rule on proxy voting undermines the integrity of the rule making and commentary process.** The current proposed rule on proxy voting was introduced prior to the finalization of another recently proposed rule change by the DOL regarding Financial Factors in Selecting Plan Investments (RIN 1210-AB95).[6]

   The previous proposed rule on financial factors, mainly regarding restricting pension fund fiduciaries from considering ESG in the investment process, is closely connected to the current proposed rule on proxy voting, focused mainly on restricting fiduciaries from voting on non-economic, principally ESG-related issues, as defined by the DOL.

   Market participants reasonably expect that following the completion of the consultative process, including review and deliberation on the approximately 8,500 comments that were submitted, the text of the proposed rule on financial factors is likely to be revised. This should have a direct bearing on the context of the current proposal on proxy voting.

   By introducing the current proposed rule prior to completing the process on the previous rule proposal, and providing only thirty days for commentary, the DOL is rushing ahead with its agenda, leading to speculation that they are not acting in good faith and are not giving the public review process proper consideration. This undermines public trust in the regulatory process and shows disdain for the outpouring of public commentary in response to actions proposed by the DOL. We note that the views and arguments expressed in our

[6] Notice of Proposed Rulemaking on Financial Factors in Selecting Plan Investments Amending "Investment duties" Regulation at 29 CFR 2550.404a-1. https://www.dol.gov/agencies/ebsa/about-ebsa/our-activities/resource-center/fact-sheets/financial-factors-in-selecting-plan-investments

comments on the Financial Factors proposal[7] have direct relevance to the current proposal on proxy voting, and we fully expect they will be properly reviewed and considered, as should all other comments submitted in the consultative process.

5. **The Proposed rule prioritizes the interests of investee company managements, potentially increases costs for pension funds and undermines the shareholder voting process.** The proposed rule not only strips checks-and-balances created by constituting documents from the voting process, the heart of corporate governance law separating the powers of ownership and management, it also by default validates management's recommendations on critical issues as compliant with fiduciary standards. By directing pension fund fiduciaries to invest in line with management recommendations, the proposed rule prioritizes the interests of investee company managements over the interests of shareholders, potentially promoting conflicts of interest. Leveraging the voting power of investee management begs the question: should shareholders simply accept that the decisions of investee company managements are always sound, that they do not need to be checked and that they are in compliance with fiduciary standards?

   The DOL suggests that the proposed rule will save time and lower costs for pension funds, as they will no longer need to waste effort on spurious voting matters, but this is an odd claim. It is hard to see how the removal of a fundamental ownership right like voting, and the prioritization of investee company management decisions over shareholder views, can be justified on the basis of improved efficiencies. Moreover, the proposal could have the opposite effect. Fiduciaries that choose to vote on issues that could be deemed non-economic, could very well face increased costs due to the requirement to document the reasoning for their vote and potentially to defend their actions against regulatory scrutiny.

   An unintended consequence of the proposed rule is that by restricting fiduciary voting rights, the DOL could encourage fiduciaries to divest portfolio holdings, especially if they feel they have no other way to protect the interests of beneficiaries. While the proposed rule makes clear that the DOL does not want fiduciaries to vote on ESG-related issues based on non-pecuniary factors, such as ethical or moral beliefs, it fails to take into account voting by fiduciaries on ESG-related matters driven by economic assumptions. For example, in the case of oil and coal companies, a fiduciary may reason that the long-term outlook for fossil fuels is poor, expecting that over time renewable energy will replace traditional fuel sources. In this case, engaging with management through proxy voting to encourage investment in new, cleaner technologies could prove to be beneficial and preferable to divestment.

   A good example is Glencore, Australia's biggest coal miner, which announced it would cap production in 2019. Announcing its new policy, Glencore stated, "We must invest in assets that will be resilient to regulatory, physical and operational risks related to climate change," and it specifically cited engagement by investors as a motivating factor.[8]

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[7] Comment 0726 New America 07302020. https://www.regulations.gov/document?D=EBSA-2020-0004-0720

[8] https://www.reutersevents.com/sustainability/divestment-isnt-badge-honour-its-failure-engagement