October 5, 2020

Office of Regulations and Interpretations
US Department of Labor (ESBA)
Room N-5655
200 Constitution Avenue NW
Washington DC 20210

Submitted electronically via: regulations.gov

Re: Proposed Rule on Fiduciary Duties Regarding Proxy Voting and Shareholder Rights (RIN 1210–AB91)

To whom it may concern:

This letter is written in opposition to the above proposed rule by 16 professionals with more than 400 years of combined experience relating to investment and management of American workers' retirement savings.[1] As experienced professionals and academic experts with extensive backgrounds in pensions and investments, we are concerned that the proposal rule (the "proposal") is based on naïve and outdated early 20th century view of investing that is not fit for the long-term financial interests of American private pension fund participants in the 21st century.

We would not object to a regulatory reminder to private pension fund fiduciaries about existing regulatory guidance that requires them to undertake an evaluation of the costs and benefits associated with exercising proxy voting rights. However, the proposal goes far beyond what is needed, would only create more confusion and exceeds the DoL's regulatory authority. We think it adopts a regulatory approach to risk management that is similar to pre-ERISA statutory "legal lists" of allowed pension investments. The proposal would encourage ERISA fiduciaries to turn a blind eye toward the role that proxy voting and shareholder voice plays in current mainstream investor practices for management of intangible, long-term and systemic financial risks. We see the likely results as being increased compliance costs and transfer of current risks to younger and future fund participants.

Request for Extension of the Comment Period

First, we object to the unreasonably short 30-day deadline for submission of comments on a proposal with major risk management ramifications for pension fund managers, especially during

[1] Signatories to this letter have served as trustees, administrators, advisors and consultants for hundreds of ERISA and other retirement funds, headed the Department of Labor's predecessor to the Employee Benefits Security Administration, taught business law at leading universities, been leaders at global asset management firms and think tanks, served as President of a national pension fund attorneys education association and written hundreds of books and articles on retirement savings, investment, fiduciary duty, corporate governance and the capital markets.

the Coronavirus Crisis. This short comment period has not provided sufficient time for collection of data and a full analysis of the extensive impact that the proposal would have on ERISA plan costs and investment and risk management strategies that make use of investor voice and proxy voting. We note that the Department has typically set longer comment periods in the past for proposed rules with potentially significant impacts, as have the SEC and CFTC.[2] We request that the comment period be extended to at least 60 days to provide adequate time for the public to fully digest and prepare comments on effects of the proposal.

The Proposal ignores data on investor practices and financial materiality of ESG/systemic risks

Like the recent Proposed Rule on Financial Factors in Selecting Plan Investments (RIN1210-AB95), this proposal uses a short-term bias and is based on faulty assumptions about financial materiality of ESG risks. The current proposal states, "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. **It is likely that many of these proposals have little bearing on share value or other relation to plan interests . . .**" [Emphasis added]

As thousands of commenters stated in response to the Proposed Rule on Financial Factors in Selecting Plan Investments, the Department's stated concerns are not well founded. An overwhelming majority of current research on portfolios using investment practices that integrate material ESG (a/k/a sustainability)[3] risk factors into investment analysis has found that they tend to outperform their traditional peers. For example, a 2015 review published in the Journal of Sustainable Finance and Investment that synthesized the results of more than 2200 separate studies of the relationship between ESG and corporate financial performance found that a large majority of those studies reported positive ESG impacts on performance.

More recently, a 2020 Morgan Stanley study concluded that US based sustainable equity funds outperformed their traditional peers in 2019 by a median of 2.8%, and sustainable taxable bond funds outperformed their traditional peers by a median of 0.8%. The same study found that during the first six months of 2020, US sustainable equity funds outperformed their traditional peers by a median of 3.9%, and sustainable taxable bond funds outperformed their traditional peers by a median of 2.3%. This period included initial market reaction to the COVID crisis.

[2] For example, see RIN 1210-AB63 at https://www.dol.gov/newsroom/releases/ebsa/ebsa20160920; SEC proposed rule Releases 33-10814. 34-89290 and IC-33845 at https://www.sec.gov/rules/proposed.shtml#thirdq; CFTC proposed rules 84 FR 70446 and 84 FR 72262 at https://comments.cftc.gov/PublicComments/ReleasesWithComments.aspx?Type=ListAll&Year=2020, accessed September 22, 2020.

[3] BlackRock defines the relationship between ESG and sustainability as, "ESG is often conflated or used interchangeably with the term "sustainable investing." We see sustainable investing as the umbrella and ESG as a data toolkit for identifying and informing our solutions. ESG data is most often categorised as "non-accounting" information because it captures components important for valuations that are not traditionally reported. The valuation of companies has become more complex, with a growing portion tied up in intangible assets. ESG metrics provide insights into these intangibles, such as brand value and reputation, by measuring decisions taken by company management that affect operational efficiency and future strategic directions."

Other studies suggest that high performing ESG companies create value disproportionate to their peers: "ESG links to cash flow in five important ways: (1) facilitating top-line growth, (2) reducing costs, (3) minimizing regulatory and legal interventions, (4) increasing employee productivity, and (5) optimizing investment and capital expenditures."[4] ESG affects not only the equity of those companies, but also their debt. In addition, ESG performance correlates with material events and credit risk, as measured by bankruptcies and credit spreads, which has major implications for credit markets and bond investors.[5]

The integration of material ESG factors into investment analysis is far more common amongst mainstream investors than was recognized by the proposal. For example, 73 percent of global investors surveyed by the CFA Institute in 2015 said they take ESG factors into account in their investment analysis and decisions.

Rather than repeat the voluminous references to current research in the thousands of comments on materiality of ESG factors that were submitted in response to the Proposed Rule on Financial Factors in Selecting Plan Investments, we incorporate them in this submission by reference. Those comments provide data which also demonstrates that the cost-benefit analysis for this proposal are based on erroneous and outdated assumptions about financial materiality of ESG factors and the risk management value of proxy voting and expression of shareholder voice. Research cited as a basis for the Proposal is generally either produced by conflicted special interest groups, not limited to more recently evolved investment approaches which integrate material ESG factors into investment analysis, are focused on short-term returns or fail to address long-term and systemic risk exposures.

The proposal is inconsistent with the global direction of investment practices

We note that the approach taken in the Proposal is directly contrary to the evolution of regulation in other markets and the evolution of the capital markets themselves. Jurisdictions around the world are mandating requirements exactly oppositional to the direction of the Department of Labor's proposed regulation. As the European Commission wrote explaining its recent decision to consult about strengthening ESG disclosures: "Users of this information, mainly investors and civil society organisations, are demanding more and better information from companies about their social and environmental performance and impacts. To this end, the Commission committed to review the Non-Financial Reporting Directive in 2020 as part of the strategy to strengthen the foundations for sustainable investment."

Consideration and management of ESG risk factors has become a de facto standard for asset managers in the EU and other developed nations, where regulators clearly believe such an investment lens drives greater risk/return efficiency and provides more transparency. In the

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[4] Witold Henisz, Tim Koller, and Robin Nuttall. "Five ways that ESG creates value," McKinsey Quarterly, Nov 2019.

[5] Bank of America reports that investors could have avoided 90% of S&P 500 bankruptcies during 2005-2015 if they had screened out firms with below average environmental and social rankings 5 years earlier; companies with better ESG performance enjoy lower costs of capital. These are the kinds of systemic issues with real financial impacts to which many ESG shareholder resolutions are targeted.

United Kingdom, the new Stewardship 2020 Code requires a statement from asset managers on how they are dealing with systemic risk.

Perhaps more importantly, the global capital markets are also signaling that ESG investing is mainstream. The capital markets understand the numbers: Considering ESG risks and opportunities improves rather than hinders the risk/return profile of investments. Therefore, some $40 trillion in assets under management globally now is managed using an ESG focus.[6] The worlds' largest asset manager, Blackrock, has called for more ESG disclosure and for making climate change central to its investment philosophy. The world's largest pension fund, GPIF in Japan, has adopted ESG as a core investment philosophy and is adopting ESG benchmarks against which to measure its performance.

The proposal is arbitrary and capricious under Supreme Court precedent

The DoL is dead wrong in assuming sing the proposal on the assumption that ESG proxy votes have little bearing on share value or other relation to plan interests. In *Little Sisters of the Poor and Paul Home v. Pennsylvania* the U.S. Supreme Court recently addressed a similarly deficient regulatory proposal. The Court said, "Our precedents require final rules to "articulate a satisfactory explanation for [the] action including a rational connection between the facts found and the choice made." This requirement allows courts to assess whether the agency has promulgated an arbitrary and capricious rule by "entirely fail[ing] to consider an important aspect of the problem [or] offer[ing] an explanation for its decision that runs counter to the evidence before [it]." Under this legal standard it is not clear that the proposal would survive a legal challenge.

The proposal fails to consider the impact of risk on investment decisions

Finance has two main purposes: to provide adequate risk-adjusted returns to individuals and to direct capital to where it is needed in the economy. ERISA investor fiduciaries, like other institutional investors, seek to provide a competitive financial return while managing the risk inherent in investing. That is a single function, not two, because risk and return are two equally important sides of the coin. Asset managers attempt to either reduce the risks of investing, or increase the returns, or both.

Unfortunately, the proposal gives little attention to the risk side of that equation. Because many of the proxy voting topics treated as financially immaterial under the proposal have demonstrated risk ramifications for investors with long-term pension obligations, that oversight is a fatal flaw. The proposal essentially places risk management blinders on investor fiduciaries by excessively discounting the value of proxy voting and shareholder voice as an accepted risk mitigation technique.

[6] Sophie Baker, "Global ESG-data driven assets hit $40.5 trillion", Pensions & Investments, July 2, 2020,

Governance agency risk and proxy voting

Failure of the Proposal to consider agency risk is problematic and renders the cost-benefit analysis inadequate. A recent Harvard Business Law Review analysis of governance risk and proxy voting describes proxy voting as a means for protecting investors (and pension fund participants) from the longstanding agency problem between managers and shareholders in widely held public corporations.[7]

> "Shareholder voting, more broadly, serves as an important vehicle for shareholders to communicate their preferences to the board. While companies do not always take immediate action in response to a shareholder vote, a large body of empirical research suggests that corporate directors pay attention to voting outcomes and, in many cases, incorporate the results of the vote in future decisions. . . . if a shareholder vote on a matter is sufficiently important, then the incentives of market participants to pursue voters increases, resulting in market-based allocation of the value of the costs associated with lobbying for votes. The competition for votes also creates several positive "spill-over" effects on other areas of corporate governance. Specifically, the competition for votes likely: first, improves the overall information levels in the market; second, improves the ex ante incentives of management and challengers to be more attentive to the concerns of voting shareholders; and third, increases the impact of reputation on the various actors' behavior. Simply put, a competition for votes provides management and challengers with incentives to take actions that in themselves could benefit the company and shareholders' interests."

Managing exposure to systemic market risk and return

Innumerable studies (notably Brinson, Hood and Beerbower, *Financial Analysts Journal*, 1986) show that beta (overall exposure to systemic market risk and return) affects investment returns by a far greater amount than an investor's skill in picking securities or constructing diversified portfolios (commonly thought of as "alpha"). Beta is by far the largest source of both risks and return. Generations of rigorous studies have proven that the risk/return profile of the market dominates the final risk/return experienced by all investors, no matter what style of investing is used. Accepted academic literature shows that 75-95% of variability in return is caused by non-diversifiable systematic factors.[8]

Alpha (commonly thought of as incremental risk/return due to security selection and portfolio construction) and beta are not distinct, but inextricably linked. For example, idiosyncratic factors that investors might consider in their pursuit of alpha become systemic risk exposures as increasing numbers of market participants identify characteristics such as size, style, quality,

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[7] Corporate managers, due to their limited ownership stake in the corporation, do not fully realize the gains in equity as a result of their success; conversely, they also do not directly suffer the losses as a result of their mistakes to the extent that the remaining shareholders do. This creates a divergence in interests called "agency risk."

[8] See Gary P. Brinson, Randolf Hood and Gilbert Beerbower, "Determinants of Portfolio Performance", Financial Analysts Journal, Vol 42, No 4, July/August 1986, 39-44., also Roger G. Ibbotson, "The Importance of Asset Allocation," Financial Analysts Journal, Vol 86, No 2, 2010, 18-20.

ESG and other intangible factors, etc. Disaggregating individual security return into these and other "exposures" has led to the rise of "smart beta." The very terms are illustrative of the links between alpha and beta.

Mainstream investors have recognized this dynamic and are now trying to mitigate systematic risks, from climate change to lack of gender diversity to political risk – something that the proposal fails to recognize.[9] Because many of these sources of risk are also a major socio-political issue, they are often viewed through that lens as "one-off" actions at individual companies to pursue non-financial goals. But viewed through a widely diversified long-term investor lens, rather than being a series of isolated incidents or politically motivated initiatives, these real-world actions form a coherent risk management strategy that affects more forms of risk than are addressable simply through diversification. Proxy voting and shareholder voice are major components of this risk management process and information disclosure is often a prerequisite.

As an example, consider the Boardroom Accountability Project ("BAP") undertaken by the New York City Comptroller, on behalf of the New York City retirement systems, in 2014. Comptroller Scott Stringer announced that he would seek to create a "proxy access" rule at 75 companies through private ordering following a convoluted history of the SEC attempting to create such a rule only to be precluded by the courts. The mere announcement caused a 53 basis point excess return, according to three academics, including one from the SEC. Based on the 53 basis points of excess return, the BAP created some $266 million in excess return for the City's pension funds. The actual impact on total market value over time, as 600 companies have adopted proxy access, is even greater. While the academic study noted that results likely would have been greater had a proxy access standard been market-wide and set by regulation, even just using the 53 basis points as the effect, extending the attempt to install proxy access across every listed company at the time of Stringer's announcement would have resulted in an increased market value of some $132.5 billion.

Recognizing the ability to mitigate systematic risk changes almost everything. It means both that improving the marketplace overall is more powerful than beating the market through security selection (a zero-sum game) and that it is possible to do so. A corollary is that much of today's focus on relative performance ("benchmarking") is myopic, because focusing on system health (which cannot be benchmarked on a relative basis) over the long term will have greater impact

[9] For example, BlackRock's 2020 report on investment stewardship explains its deployment of proxy voting and corporate engagement as a risk management tool. "Our efforts around sustainability, as with all our investment stewardship activities, seek to promote governance practices that help create long-term shareholder value for our clients, the vast majority of whom are investing for long-term goals such as retirement. This reflects our approach to sustainability across BlackRock's investment processes, in which we use Environmental, Social, and Governance factors in order to provide clients with better risk-adjusted returns, in keeping with both our fiduciary duty and the range of regulatory requirements around the world. As a result, we have a responsibility to our clients to make sure companies are adequately managing and disclosing sustainability-related risks, and to hold them accountable if they are not. While we have been speaking with companies for years on sustainability issues, our investment stewardship team has intensified its focus and dialogue this year with companies facing material sustainability-related risks. Our approach on climate issues, in particular, is to focus our efforts on sectors and companies where climate change poses the greatest material risk to our clients' investments. 'Climate risk' may include a company's ability to compete in a world that has transitioned to a low-carbon economy (transition risk), for example, or the way climate change could impact its physical assets or the areas where it operates (physical climate risk).

on financial returns. And it foreshadows a powerful new force in the fight against global warming, income inequality, gender discrimination and other systematic risks that threaten to depress returns.

Impact of the proposal on the roles that proxy voting plays in mitigating investor exposure to systemic risk and agency risk merits a robust DoL analysis. Unfortunately, these aggregated long-term risk and return dynamics have been ignored. As a result, the cost-benefit analysis misses a major component of the proposal's effect on pension plan participants if ERISA plan participants were forced to forfeit their shareholder voice on these issues to other investors that might not be aligned with the investment and risk management strategies of long-term investors.

The Proposal is inconsistent with ERISA fiduciary duties

Duty of impartiality

The proposal fails to acknowledge that ERISA imposes a fiduciary duty of impartiality. Impartiality requires fiduciaries to recognize that different classes or groups of plan participants often have interests which may conflict or diverge from each other. Fiduciaries must undertake good faith efforts to identify and reasonably balance those differences. For example, younger and older participants are likely to have differing investment risk tolerances, income generation needs and long-term capital growth expectations.

By defaulting to a short-term bias and discouraging recognition of the role that proxy voting can play in risk management over the long term, the proposal would encourage transfer of current risks from older to younger plan participants. This is a fatal flaw.

The US Supreme Court recognized that the duty of impartiality applies to ERISA fiduciaries in *Varity v. Howe,* 516 U.S. 489 (1996). It said, "The common law of trusts [made applicable to ERISA §§404, 409] recognizes the need to preserve assets to satisfy future, as well as present, claims and requires a trustee to take impartial account of the interests of all beneficiaries. See Restatement (Second) of Trusts § 183 (discussing duty of impartiality); *id.,* § 232 (same)."

The risk blind and myopic approach taken by the proposal mischaracterizes the duties of ERISA fiduciaries by failing to even mention this legal obligation. In discouraging consideration of the risk management benefits of voting proxies on material ESG factors (many of which have long-term financial consequences over time), the proposed rule would likely favor the interests of older plan participants, who have more limited exposure to long-term risks than younger participants. An unreasoned cross-generational transfer of risks that sacrifices the long-term economic interests of younger fund participants while holding older participants harmless, would seem to violate ERISA fiduciary duties of impartiality established by the Supreme Court. By promoting such violations, the proposal goes beyond authority of the Department.

Corporate director standards are less stringent than the ERISA fiduciary duties

The proposal includes a safe harbor for proxy voting policies that defer to the judgment of corporate managers on proxy voting decisions – with no apparent realization that this would be

breach ERISA fiduciary duty statutes. The proposal explains, "a fiduciary may, consistent with its obligations set forth in ERISA section 404(a)(1)(A) and (B), maintain a proxy voting policy that relies on the fiduciary duties that officers and directors owe to a corporation based on state corporate laws. On that basis, the proxy voting policy may state that the responsible plan fiduciary, if it so determines, ordinarily will follow the recommendations of a corporation's management."

What the proposal ignores is that corporate managers and directors are subject to a lower fiduciary standard of care than set by statute for ERISA fiduciaries. For example, corporate officers and directors, due to their limited ownership stake in the corporation, may not fully realize the gains in equity as a result of their successes and do not directly suffer the losses that result from their mistakes to the same extent that the remaining shareholders do.[10] In addition, Delaware corporate law authorizes companies to waive director liability for breaches of the duty of care, a protection that is not available to ERISA fiduciaries.[11] Corporate conflicts of interest with the company may also be waived upon approval of non-interested directors, while ERISA fiduciaries have no comparable opportunity to engage in conflicted personal transactions.[12]

The proposal appropriately notes that "ERISA mandates that fiduciaries discharge their duties 'solely in the interest' and 'for the exclusive purpose' of providing benefits to participants and their beneficiaries." It also stresses that "the Supreme Court has described this duty as requiring that fiduciaries act with an 'eye single' to the interests of participants and beneficiaries, and that appellate courts have described ERISA's fiduciary duties as 'the highest known to the law.'" However, it is troubling that the proposal fails to recognize that corporate officers and directors in most states are authorized to take the interests of stakeholders other than shareholders into consideration under state corporate law constituency statutes when exercising their discretionary judgment.

Consequently, any regulatory delegation of ERISA fund proxy voting decisions to third parties who are explicitly authorized to favor other corporate stakeholders and have no commitment to act with an eye single to the interests of ERISA plan participants or apply the highest fiduciary duties know to the law is simply beyond the powers that have been granted to the Department.

In addition, the Business Judgment Rule, which typically covers decisions of corporate officers and directors, provides greater discretion in making corporate decisions than do the fiduciary duty standards applicable to ERISA fiduciaries. For example, the Business Judgment Rule protects "well-meaning directors who are misinformed, misguided, and honestly mistaken" from judicial second-guessing, except in rare case where "a transaction may be so egregious on its face that board approval cannot meet the test of business judgment." FDIC v. Castetter, 184 F.3d 1040, 1046 (9th Cir. 1999). Compare that to judicial application of the pension fund fiduciary

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[10] Nili, Yaron and Kastiel, Kobi, Competing for Votes (August 26, 2020). 10 Harvard Business Law Review 287 (2020), Univ. of Wisconsin Legal Studies Research Paper No. 1605, Available at SSRN: https://ssrn.com/abstract=3681541.

[11] 8 Del. C § 102(b)(7) (2019).

[12] 8 Del. C § 144 (2109).

standard where the court said in *Donovan v. Cunningham*, "a pure heart and an empty head are not defenses to a claim of the breach of one's fiduciary duties."[13]

Corporate fiduciary duties are significantly less stringent than the standards set for ERISA fiduciaries. Any delegation of proxy voting decision authority to management at the company involved would not only raise conflict of interest questions but also result in dilution of the ERISA statutory duty of loyalty.

Evolution of investment and proxy voting practices

When Congress enacted ERISA, it chose to "apply rules and remedies similar to those under traditional trust law to govern the conduct of fiduciaries."[14] The *Restatement of Trusts,* is the leading authority on that trust law. In 1992 the *Restatement of Trusts* was amended in response to decades of debate over the investment industry's transition toward adoption of Modern Portfolio Theory. The *Restatement of Trusts (Third)* summarizes the trust law principle that informed resolution of that debate. "Trust investment law should reflect and accommodate current knowledge and concepts. It should also avoid repeating the mistake of freezing its rules against future learning and developments."[15]

The Proposal violates this fundamental legal principle by failing to recognize the ongoing evolution of risk management and proxy voting practices. For example, Morningstar reported that support for ESG-related shareholder resolutions at the 50 largest families in 2019 hit 46%, up from 27% five years earlier.

The proposal also ignores current investment industry knowledge about the financial materiality of ESG factors and disregards changes in mainstream investment practices. A recent McKinsey study found that 83 percent of C-suite leaders and investment professionals say they expect that ESG programs will contribute more shareholder value in five years than today. They also indicated that they would be willing to pay about a 10 percent median premium to acquire a company with a positive record for ESG issues over one with a negative record.

By taking a backward- rather than forward-looking view of investment industry developments and risk management knowledge, the proposal would place ERISA fund beneficiaries at a disadvantage to peers in the competition for risk-adjusted returns in the marketplace. That runs counter to the ERISA's purpose and has serious ramifications for American workers who participate in ERISA plans.

Use of pre-ERISA investment theory

The proposal alternates between referencing a single proxy vote's effect on the plan and, especially when describing the new safe harbor for following management's recommendations,

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[13] Donovan v. Cunningham, 716 F.2d 1455, 1467 (5th Cir. 1983)

[14] Conference Report on HR 2, Pension Reform, HR Rep. No. 93-1280, 93d Cong., 2d Sess. 295, reprinted in 3 Legislative History of the Employee Retirement Income Security Act of 1974, 94th Cong., 2d Sess. 4277, 4562 (1976).

[15] RESTATEMENT (THIRD) OF TRUSTS ch. 17, intro. note (AM. LAW INST. 1992).

referencing its effect on the particular company. In one section, the proposal says that "a fiduciary may adopt a policy of voting proxies in accordance with the voting recommendations of a corporation's management on proposals or types of proposals that the fiduciary has prudently determined are unlikely to have a significant impact on the value of the **plan's investment**." [Emphasis added] Elsewhere, the proposal states, "A plan fiduciary must vote any proxy where the fiduciary prudently determines that the matter being voted upon would have an economic impact on **the plan**. [Emphasis added]

The latter approach was endorsed by ERISA. The US Court of Appeals (5th Circuit) has explained why.

> "In general, the regulations provide that the fiduciary shall be required to act as a prudent investment manager under the modern portfolio theory **rather than under the common law of trusts standard which examined each investment with an eye toward its individual riskiness. . . . a fiduciary's investment duties under 29 U.S.C. § 1104(a)(1)(B) are satisfied if he has given appropriate consideration to** facts he knows or should know to be relevant to the particular investment or investment course of action involved, "including **the role the investment or investment course of action plays in that portion of the plan's investment portfolio with respect to which the fiduciary has investment duties**" and has acted accordingly. 29 C.F.R. § 2550.404a-1(b)(1)(i)-(ii). For these purposes, **"appropriate consideration" includes determining that the investment or investment course of action "is reasonably designed, as part of the portfolio** (or, where applicable, that portion of the plan portfolio with respect to which the fiduciary has investment duties), **to further the purposes of the plan, taking into consideration the risk of loss and the opportunity for gain (or other return) associated with the investment or investment course of action** . . ." [Emphasis added][16]

The transition from evaluating investments on a stand-alone basis to application of Modern Portfolio Theory principles which are focused on the role that an investment or course of action plays in the context of the overall portfolio strategy was a major transition in trust and pension investment law. The proposal overlooks this critical difference, which should have been discussed in the proposal if the difference was intentional.

The roles that proxy voting and shareholder voice play in current portfolio risk management practices should be evaluated in the context of the long-term and portfolio-wide strategy, with consideration of the aggregate effects of shareholder votes and voice. By attempting to mandate application of only a single company evaluation of individual proxy voting issue materiality, the proposal appears to step beyond its authority.

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[16] *Laborers National Pension Fund v. Northern Trust Quantitative Advisors* 173 F. 3d 313 par. 9 (1999)

The Proposal would add confusion and increase net costs

We see no problem with the proposal's stated intent. It starts with a simple goal. "The Department wishes to be clear: there is no fiduciary mandate under ERISA always to vote proxies appurtenant to shares of stock. The Department's longstanding position—that 'the decision as to how proxies should be voted with regard to the issues that might affect the economic value of the underlying securities is a fiduciary act of plan asset management'—does not mean that ERISA requires fiduciaries to always vote such proxies."

Were the proposal to stop there, it could provide clear and helpful guidance to ERISA fiduciaries. Unfortunately, it proceeds to mix unsupported assumptions, outdated data and misinterpretation of ERISA fiduciary standards with tautological and conflicting directives to create a confusing (and costly) policy mashup.

For example, the proposal says that many shareholder resolutions which implicate environmental or social issues "have little bearing on share value or other relation to plan interests," and directs that "fiduciaries must not vote in circumstances where plan assets would be expended on shareholder engagement activities that do not have an economic impact on the plan," while warning that "fiduciaries must be prepared to articulate the anticipated economic benefit of proxy-vote decisions in the event they decide to vote," [Emphasis added]

Despite the assumption that most ESG resolutions have no value, research cited by Bank of America advises that companies with better ESG performance have lower costs of capital and are less likely to file bankruptcy. Similarly, BlackRock has concluded that "ESG data is most often categorized as 'non-accounting' information because it captures components important for valuations that are not traditionally reported. The valuation of companies has become more complex, with a growing portion tied up in intangible assets. ESG metrics provide insights into these intangibles, such as brand value and reputation, by measuring decisions taken by company management that affect operational efficiency and future strategic directions."

Similarly, the proposal says, "because the decision regarding whether a proxy vote will or will not affect the economic value of a plan's investments is critical in triggering a fiduciary's obligations under ERISA to vote or abstain from voting, fiduciaries may need to conduct an analytical process which could in some cases be resource-intensive." The proposal also says that "fiduciaries should require documentation of the rationale for proxy-voting decisions so that fiduciaries can periodically monitor proxy-voting decisions made by third parties. A plan fiduciary must also assess and monitor an investment manager's use of any proxy advisory firm, including any review by the manager of the advisory firm's policies and procedures for identifying and addressing conflicts of interest." Both delegation of proxy analyses and expenditure of plan funds on proxy voting are discouraged.

The proposal also contains two contrasting mandates, "a plan fiduciary must not vote any proxy unless the fiduciary prudently determines that the matter being voted upon would have an economic impact on the plan" and "a plan fiduciary must vote any proxy where the fiduciary prudently determines that the matter being voted upon would have an economic impact on the plan." The juxtaposition of these opposing duties in a rule-based directives creates a high risk

compliance dilemma that cannot be resolved without expenditure of funds on analysis and documentation, without knowing in advance whether the expenditure is allowable.

Furthermore, the proposal fails to take into consideration how proxy advisor and shareholder resolution regulatory changes that were recently put in place by the SEC might alter the assumptions upon which the proposal is based, rendering it no longer necessary but still costly. The SEC regulations could turn the cost-benefit analysis upside down.

The proposal acknowledges that the "SEC stated that proxy advisory firms can capture economies of scale for several of the services they provide, including voting advice" but cautions ERISA fiduciaries about using these economies of scale. Fiduciaries are warned, "When using a proxy advisory firm, ERISA fiduciaries must exercise prudence and diligence in selecting and monitoring the firm . . . Particular attention must be given to proxy advisory firms that provide both proxy advisory services to investors and consulting services to issuers on matters subject to proxy resolutions." This provision makes it appear that ERISA fiduciaries can only continue to use proxy advisors if they place no reliance on the work done by those advisors – regardless of whether the new SEC regulations resolve DoL's concerns. Fiduciaries would be expected to ensure they have determined that each vote at every company has been independently evaluated and found to have been considered appropriately, then maintain documentation to demonstrate that this both was accomplished (even if the new SEC regulations have addressed past concerns). And how many levels of monitoring are required to backstop the SEC reforms? We count at least three!

Looking at how the proxy voting practices of large mutual funds diverge on some of the issues which the proposal treats as suspect, illustrates how difficult this new process could become. For instance, Majority Action reports that during the 2020 proxy season PIMCO and Legal & General supported all 36 of the S&P 500 company shareholder proposals it evaluated in the energy, utility, industrials and automotive sectors, with both funds voting in favor of improved emissions disclosures and reduction plans, transparency regarding corporate political influence activity, and governance reforms to improve accountability to long-term shareholders. On the other hand, BlackRock supported just three of the same resolutions and Vanguard only four. Management recommended voting for none of them. The mutual funds also diverged significantly in votes on election of director candidates (with no proxy contests involved) and say-on-pay votes.

What does this say about whether votes on these matters would be financially material[17] to shareholders under the strict rules-based approach for expenditure of funds on evaluation, monitoring and documentation of proxy voting decisions? We think it may encourage greater expenditure of plan funds on compliance than estimated by the proposal, especially since both delegation and collaboration through shared outsourcing of analytical and voting functions is also being discouraged.

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[17] As defined by the Supreme Court in *TSC Industries v. Northway, Inc.*, 426 U.S. 438, 449 (1976), and by the SEC in Regulation S-K, "materiality" relates to facts which a reasonable investor would consider non-disclosure of as having significantly altered the total mix of information on a company. It specifically includes known trends, events, and uncertainties that are reasonably likely to have material impacts on a company's financial condition or operating performance. Of particular note is that materiality should be evaluated from the investors' perspective.

Determining how to comply with the opposing rule-based directives contained in the proposal seems to raise more questions than the existing regulatory guidance. Unless a ERISA fiduciary decides to use one of the "safe harbors" and delegate voting decisions to corporate management (a potential violation of the statutory fiduciary duty of loyalty) or simply not vote anything that might be seen has having ESG implications (a practice that is inconsistent with industry peer risk management practices and might be imprudent at some level), the expenses of compliance with these conflicting directives could be astronomical – although perhaps no longer necessary given the SEC's recent regulatory changes. We are confused and believe that this confusion will be shared by many ERISA fiduciaries.

The cost-benefit analysis is deficient

Finally, the proposal's cost-benefit analysis is woefully inadequate and inaccurate. It is based on a series of unsupported conjectures. For instance, the DoL ambivalently states its asserted basis for the proposal as being the conjecture that some funds "may have unnecessarily increased plan expenses." The DoL admits that current "information sheds little light on the costs attendant to voting proxies or exercising other shareholder rights" and confesses "we do not know with any level of precision the percent of plans that are not currently meeting such standards." From this base, it creates an analysis littered with the words "we assume." Most importantly, the benefits that accrue over time from the role that proxy voting plays in mitigating investor exposure to long-term intangible, systemic and agency financial risks has simply not been considered.

We submit that an unbiased cost-benefit analysis would find the costs of this proposal would greatly exceed any alleged benefits. We also caution that an informed cost-benefit analysis that is forward looking cannot be realistically undertaken until impact of the recent SEC changes in proxy advisor and shareholder resolution regulations have been in place for several years.

Conflicts with other federal agencies

While the proposal indicates there are no inconsistencies with other Federal regulatory initiatives, there are several where direct conflicts are evident. The most obvious include:

- Recently enacted SEC rules governing proxy advisors and SEC rules restricting the ability of shareholders to offer shareholder resolutions address most of the concerns cited by the DoL. While we did not see a need for the regulations, because these major changes are now in place, the proposal should be deferred until there is a track record that shows how the SEC regulations will impact the issuer, advisor and investor practices. By acting too soon, the proposal could end up unnecessarily imposing costs on ERISA plans and their participants. We believe it would be speculative to finalize a cost-benefit analysis for the proposal prior to gaining the benefit of experience under the new SEC rules.

- The Commodities Futures Exchange Commission ("CFTC") issued a report from its Market Risk Advisory Committee on September 9 calling for enhanced disclosure by

public companies of climate-related financial risks to help prevent climate change from disrupting the U.S. financial system. By identifying climate change as a material financial system risk requiring enhanced company reporting, the CFTC appears to be pursuing a regulatory agenda that conflicts with the proposal's treatment of climate change risk reporting as having little bearing on share value. The DoL should consider the report findings and address them in any final proposal

We strongly urge the Department to withdraw the proposed rule and wait to proceed until there is a several year track record of experience under the new SEC proxy advisor and shareholder resolution rules before considering next steps.

We would be glad to discuss this further should the Department wish.

Respectfully submitted,

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