THE U.S. IMPACT INVESTING ALLIANCE
Private Capital for Public Good

October 5, 2020

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

Attention: Proxy Voting and Shareholder Rights NPRM

Re: Proposed Rule - RIN 1210-AB91

To Whom It May Concern:

Thank you for the opportunity to provide comment on the proposed rule. The U.S. Impact Investing Alliance ("the Alliance") and our members have significant concerns with the U.S. Department of Labor's ("the Department") changes to the proxy voting guidelines for plan fiduciaries under the Employee Retirement Income Security Act ("ERISA"). The Alliance is concerned that the proposed rule would have a chilling effect on shareholder engagement by ERISA-regulated investors, ultimately discouraging fiduciaries from voting proxies on issues related to material, long-term or systemic risks. We also fear that the administration of the rule will create significant compliance and administrative costs for ERISA-regulated fiduciaries and the investment managers they select – costs which will ultimately be borne by plan beneficiaries.

For context, the Alliance is an organization committed to catalyzing the growth of impact investing in the United States. Members of our boards and councils include individual and institutional investors collectively owning hundreds of billions of dollars of invested assets, in addition to asset and fund managers collectively managing trillions of dollars in assets. We define impact investing broadly to include those investments that create financial returns alongside measurable and positive social, economic or environmental impacts across asset classes.

The Alliance has already submitted a request to extend the comment deadline well beyond the resolution of the COVID-19 pandemic and crisis. Even without considering the pandemic and ongoing uncertainty, a 30-day time period is unusually short and insufficient for all stakeholders to weigh in on a proposed rule that has broad implications for critical shareholder engagement rights. Compounding this short time period for public review is the equally insufficient effective date of a final rule – again only 30 days from publication. The complex bureaucratic requirements of the proposal, coupled with the threat of costly regulatory investigations for noncompliance, cannot responsibly or realistically be implemented in such a short period of time.

The rushed and unwarranted rulemaking process is unfortunately a part of a broader trend by the Department. This proposed rule follows on the heels of another from the Department with a similarly inadequate 30-day comment period, that one regarding "financial factors in selecting plan investments" that will create arbitrary and undue burdens for fiduciaries considering financially material ESG factors. [1] The Department has yet to resolve significant issues related to that proposed rule, which was

[1] U.S. Department of Labor, RIN 1210-AB95, "Financial Factors in Selecting Plan Investments."

overwhelmingly opposed by the public. In fact, an analysis of the over 8,700 public comments in response to that proposed rule found that 95% were in opposition.[2] Given these considerations and our substantive concerns, which we outline below, we echo our earlier calls here and urge regulators to suspend this rulemaking.

Suppression of Shareholder Voting Rights and Undue Burdens for Fiduciaries

Of paramount concern for the Alliance is that the proposed rule will suppress the shareholder votes of retirement savers and other small investors, in particular on issues related to environmental, social and governance ("ESG") concerns. In crafting the proposed rule, the Department is ignoring the long-term, material importance of ESG factors that more and more investors, businesses and governments are coming to understand. ESG investing is no longer a niche concept and has indeed entered into the mainstream. Thanks to a mountain of academic and industry studies, we now know that ESG often drives financial performance,[3] mitigates long-term systemic risk,[4] and is considered valuable, material information to businesses and investors alike.[5]

Frequently cited meta-studies have demonstrated a strong case for the materiality of ESG factors, for example. A 2015 meta-analysis of over 200 academic studies and industry reports revealed that sustainability practices and profitability are "wholly complementary," given that 88% of the analyzed research found a positive correlation between ESG and improved operational performance, and 80% of the studies showed a similarly positive link between ESG and improved stock performance.[6] An even larger meta-analysis of around 2,200 individual studies, found that 90% of the studies revealed a non-

[2] US SIF, Investor Organizations And Financial Industry Firms' Analysis Of Public Comments On Department Of Labor ESG Proposal Shows Landslide Of Opposition, (August 2020). Available at: https://www.ussif.org/blog_home.asp?Display=148

[3] See for example: Henisz, Witold and Koller, Tim and Nuttall, Robin, Five Ways that ESG Creates Value, McKinsey Quarterly, (Nov 2019.) Available at: https://www.mckinsey.com/business-functions/strategy-and-corporate-finance/our-insights/five-ways-that-esg-creates-value?cid=soc-web&fbclid=IwAR3onKpp8NgbyctliHjvZHNs7HcqFUhaKamqMamTYZYE8eE4aC10BbRgm_U; and Nagy, Zoltán and Kassam, Altaf and Lee, Linda-Eling, Can ESG Add Alpha? (June 2015). Available at MSCI: https://www.msci.com/www/research-paper/research-insight-can-esg-add/0182813629.

[4] See for example: Giese, Guido and Lee, Linda-Eling and Melas, Dimitris and Nagy, Zoltán and Nishikawa, Laura, Foundations of ESG Investing: How ESG Affects Equity Valuation, Risk, and Performance, (July 2019). Available at the Journal of Portfolio Management: https://jpm.pm-research.com/content/45/5/69.abstract and Henisz, Witold and McGlinch, James, ESG, Material Credit Events, and Credit Risk, Journal of Applied Corporate Finance, Volume 31, Number 2, Spring 2019. Available at Truevalue Labs: https://www.truvaluelabs.com/blog/in-brief-esg-material-credit-events-and-credit-risk-2?hsCtaTracking=aef42691-25a3-42a7-b948-a57f22bdbb95%7Cc14ac8d9-63b0-4df9-8404-b7ebee63cd6f

[5] See for example: Berg, Achim and Schlag, Nils and Stuchtey, Martin, Getting the most out of your sustainability program," (August 1, 2015). Available at McKinsey: https://www.mckinsey.com/industries/retail/our-insights/getting-the-most-out-of-your-sustainability-program and Delevingne, Lindsay and Gründler, Anna and Kane, Sean and Koller, Tim, The ESG premium: New perspectives on value and performance (February 12, 2020). Available at McKinsey: https://www.mckinsey.com/business-functions/sustainability/our-insights/the-esg-premium-new-perspectives-on-value-and-performance

[6] Clark, Gordon L. and Feiner, Andreas and Viehs, Michael, From the Stockholder to the Stakeholder: How Sustainability Can Drive Financial Outperformance (March 5, 2015). Available at SSRN: https://ssrn.com/abstract=2508281

negative correlation between ESG factors and financial performance, with the majority of studies in fact indicating a positive correlation.[7]

The Department overlooks this evidence when stating that many environmental and social proposals "have little bearing on share value or other relation to plan interests." In a recent comment letter[8] to the Department on a separate rulemaking,[9] the Alliance encouraged the Department to review the abundance of academic and industry research that suggests that ESG factors are financially material, help mitigate uncertainty and risk, and often lead to financial outperformance. We restate that request here and urge the Department to read and assess the literature in the context of this proposed rule.

Given that ESG factors are often material, it then follows that shareholder engagement on such issues is also economically relevant for investors. In the preamble to the proposed rule, the Department cites the growing popularity of ESG proposals as a potential cost driver. But the Department ignores that the rising investor demand for corporate accountability is driven by an increasingly robust understanding of the material benefits of shareholder engagement. The Department cites no research that demonstrates that the proxy voting practices of ERISA-regulated funds are not beneficial, nor does the proposal provide any indication that retirement plan resources are being excessively burdened by the need to engage in the proxy process. In fact, the research presented to substantiate the need for this proposal does not actually address ERISA-regulated investors or the practices they are commonly using.

Indeed, despite the purported interest of reducing the cost of administering ERISA-regulated funds, the rule actually imposes massive new regulatory burdens that will ultimately harm retirement savers in the form of plan expenses and reduced returns. The proposed rule would require plans to document extensive calculations to justify votes or abstentions on every proxy ballot, including nominations of directors and independent auditors, "say on pay" proposals, and other routine governance matters.

In contrast to these unfounded assertions, we argue that proxy voting is an efficient, low-cost system in which investors can responsibly engage corporate management, especially related to issues that could present long-term risks for shareholder value. Further, it appears that the cost created for issuers due to the increased number of ESG shareholder proposals has been overstated by the Department. According to the Council of Institutional Investors, on average, only 13% of Russell 3000 companies received a shareholder proposal from 2004-2017, meaning that the average Russell 3000 company is likely to receive a proposal once every 7.7 years.[10] By extension, the concern that plan fiduciaries might be overwhelmed by needing to contend with a significant number of proxy votes on what the Department might consider more complicated proposals, is also unfounded.

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[7] Friede, Gunnar and Busch, Timo and Bassen, Alexander, ESG and Financial Performance: Aggregated Evidence from More than 2000 Empirical Studies (October 22, 2015). Journal of Sustainable Finance & Investment, Volume 5, Issue 4, p. 210-233, 2015, DOI: 10.1080/20430795.2015.1118917, Available at SSRN: https://ssrn.com/abstract=2699610

[8] U.S. Impact Investing Alliance, Comment Letter to U.S. Department of Labor on Proposed Rule - RIN 1210-AB95, (July 2020).

[9] U.S. Department of Labor, RIN 1210-AB95, "Financial Factors in Selecting Plan Investments."

[10] Council of Institutional Investors, Comment Letter to U.S. Securities and Exchange Commission on proposed amendments to Rule 14a-8 in Release No. 34–87458, (May 2020). Available at: https://www.sec.gov/comments/s7-23-19/s72319-7214366-216887.pdf

The Department writes that the evidence surrounding the effectiveness of shareholder engagement is "mixed," which the Alliance contests given that there is a great deal of evidence that shareholder engagement drives value and is used to mitigate risk.[11] For example, a 2013 paper found that social and environmental shareholder proposals that passed by a small margin led to increased shareholder returns and improved operating performance for the business.[12] The author argues that the "close call" nature of the successful proposals reveals a causal link between the socially or environmentally responsible resolutions and financial performance, given that the boost in the latter would be unlikely to be explained away by factors endogenous to the business.[13] Additionally, a recent *Harvard Business Law Review* article illustrates that beyond serving as an "important vehicle for shareholders to communicate their preferences to the board," shareholder engagement also leads to positive "spill-over" effects by incentivizing corporate management to be more responsive to shareholder concerns and ultimately take actions that benefit shareholder interests.[14]

Additionally, a working paper from April 2020 analyzed over 1,700 shareholder engagements of a large institutional investor across 573 firms globally over a 13-year period and found that successful ESG shareholder engagements resulted in risk reduction in a way that was "economically meaningful."[15] These results mirror a prior analysis that found that successful engagements by an institutional investor on ESG issues led to an "increase in firm performance, investor base, and governance, and a decrease in stock return volatility."[16] The research cited here focuses on mainly private, intensive engagements that would not be feasible for ERISA-regulated funds, but it nonetheless suggests that shareholder engagement on ESG issues is a powerful tool for driving shareholder value and mitigating risk. Proxy voting is an efficient and low-cost form of shareholder engagement and an appropriate middle ground for ERISA-regulated funds to reap the potential benefits illustrated in the cited studies. It is therefore troubling that that the Department would seek to stifle participation in a fundamental shareholder right.

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[11] See for example BlackRock's 2020 Report on Investment Stewardship, which lists proxy voting and engagement with corporate management as a risk management tool. Available at: https://www.blackrock.com/corporate/literature/publication/our-commitment-to-sustainability-full-report.pdf

[12] Flammer, Caroline, Does Corporate Social Responsibility Lead to Superior Financial Performance? A Regression Discontinuity Approach (October 2013). Available at SSRN: https://ssrn.com/abstract=2146282 or http://dx.doi.org/10.2139/ssrn.2146282

[13] Ibid.

[14] 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

[15] Hoepner, Andreas G. F. and Oikonomou, Ioannis and Sautner, Zacharias and Starks, Laura T. and Zhou, Xiaoyan, ESG Shareholder Engagement and Downside Risk (September 19, 2019). AFA 2018 paper, European Corporate Governance Institute – Finance Working Paper No. 671/2020, Available at SSRN: https://ssrn.com/abstract=2874252 or http://dx.doi.org/10.2139/ssrn.2874252

[16] Dimson, Elroy and Karakaş, Oğuzhan and Li, Xi, Active Ownership (August 7, 2015). Review of Financial Studies (RFS), Volume 28, Issue 12, pp. 3225-3268, 2015., Fox School of Business Research Paper No. 16-009, Available at SSRN: https://ssrn.com/abstract=2154724

Adverse Consequences of the Proposed "Permitted Practices"

The Department offers several options for plans to proactively implement blanket proxy voting policies. The Alliance is concerned that these would fundamentally subvert the shareholder engagement process and ultimately harm plan beneficiaries.

For instance, the Department writes that plans may institute a "policy of voting proxies in accordance with the voting recommendations of management of the issuer." The proposed rule's allowance of plans to defer to corporate management recommendations in a de facto manner falsely presumes that they are always correct or that they will always have interests aligned with those of a long-term owner such as an ERISA-regulated fiduciary. In fact, this proposed practice would seem to substitute the fiduciary standard for ERISA-regulated fiduciaries with that of corporate managers, diluting the fiduciary standard that the Department itself cites as "the highest known to the law."[17] Adoption of this practice would undermine the need for investor voices in holding corporations accountable. In particular, if plans opt into this voting policy, corporate managers and insider special interests would be able to avoid accountability for decisions that harm retirement savers.

Next, the proposed rule states that plans can create an affirmative list of economically relevant issues on which the fiduciary will respond to proxies. Effectively implementing such a plan will require plan fiduciaries to perfectly predict the future in understanding what novel, material issues may arise through the shareholder engagement and proxy process. This is especially problematic when one considers the concept of "dynamic materiality," or that issues material to businesses are fluid and cannot alone be defined by corporate management, instead needing the full stakeholder perspective.[18] The COVID-19 pandemic and the unique challenges thrust upon businesses related to employee health insurance and workforce safety, for example, serve as a particularly poignant illustration of dynamic materiality. Finally, as was explored in the previous section, we know that shareholder engagement on ESG issues can be critically important for investors and businesses alike, and this portion of the proposed rule could cause fiduciaries to arbitrarily exclude material considerations from their proxy voting policy.

Finally, the proposed rule allows plans to abstain from votes altogether unless a plan sponsor can somehow demonstrate that its voting will influence a proposal one way or the other. Once more, the Department places an unrealistic burden of prognostication on fiduciaries, instead of allowing them to rely on sound judgement and widely accepted investment principles. Widespread adoption of this particular practice could translate to significantly less accountability on the part of the largest corporations, where any individual plan is very unlikely to meet the quantitative threshold determined as part of the plan's proxy voting policy.

The Alliance also challenges the premise of this permitted practice, as it seems to presume that proxy voting is inconsequential. In the previous section, we cited research that indicates that ESG proposals that pass by a narrow margin can lead to improved shareholder returns and overall business

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[17] U.S. Department of Labor, RIN 1210-AB91, "Fiduciary Duties Regarding Proxy Voting and Shareholder Rights."
[18] Kuh, Thomas and Shepley, Andre and Bala, Greg and Flowers, Michael, Dynamic Materiality: Measuring What Matters (January 17, 2020). Available at SSRN: https://ssrn.com/abstract=3521035 or http://dx.doi.org/10.2139/ssrn.3521035

performance.[19] It follows then that every vote matters and fiduciaries should not arbitrarily abstain from voting certain proxies based on ownership size. In fact, proposals on critical governance concerns frequently pass or fail by a narrow margin, such as the proposal put forth by shareholders of News Corp to eliminate the dual-class share structure in favor of a "one vote per share" voting structure that failed to pass by just 0.5% in 2015.[20] On such issues, the Department should consider that ERISA-regulated investors as a class are likely to have aligned, material interests that would go unrepresented if, as a class, they were effectively discouraged from voting.

Taken together, the widespread adoption of these permitted practices would lead to a concentration of voting power among a small number of very large firms to the disadvantage of smaller groups of investors and ERISA-regulated investors as a class. In contrast to the Department's purported concern with the role of proxy advisory services, ERISA-regulated fiduciaries would in fact be even more dependent on specialist consultants to design proxy policies or else forced to accept the blanket policies of large fund managers. In either instance, the fiduciary will lose the ability to represent beneficiary interests adequately. Finally, a goal of the proposed rule appears to be to discourage blanket voting policies that the Department identifies as too costly for plans, yet the inclusion of the permitted practices essentially encourages the adoption of such policies, meaning the rule is internally consistent and thus arbitrary.

Insufficient Cost-Benefit Analysis

Finally, the proposed rule lacks any meaningful analysis of the costs that will be imposed on retirement plans – costs that will ultimately be borne by retirees and other small investors. The lack of a meaningful cost-benefit analysis should by itself halt any further consideration of this proposal, especially given the other compounding issues laid out in the previous sections.

For instance, the proposed rule provides no data or analysis to defend statements like the following:

> "The societal resources freed for other uses due to voting fewer proxies (minus potential upfront transition costs) would represent benefits of the rule."

Once again, the Department is falsely presuming that shareholder engagement is too costly or ineffective for investors, when in fact, voting proxies is a cost-effective mechanism for shareholders to protect their interests. The proposed rule also suggests that the proposed permitted practices will allow fiduciaries to better preserve plan resources, yet this assumption ignores, for example, the opportunity costs plans will incur as fiduciaries arbitrarily abstain from voting materially relevant proxies. Additionally, the Department presumes that the proposed rule will allow plans to retain proxy advisory services at lower costs, a presumption that is in fact false given that plan fiduciaries could actually become more dependent on these firms to oversee complex proxy policies.

The application of this proposed rule to fund managers selected by ERISA-regulated fiduciaries will also likely lead to some fund managers choosing to stop accepting ERISA-regulated assets. Because the rule

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[19] Flammer, Caroline, Does Corporate Social Responsibility Lead to Superior Financial Performance? A Regression Discontinuity Approach (October 2013). Available at SSRN: https://ssrn.com/abstract=2146282 or http://dx.doi.org/10.2139/ssrn.2146282

[20] Australian Financial Review, "News Corp faces another shareholder revolt after 2015 close call," (October 2016). Available at: https://www.afr.com/companies/media-and-marketing/news-corp-faces-another-shareholder-revolt-after-2015-close-call-20161014-gs231a

runs counter to widely accepted investment practices, fund managers who continue to accept ERISA-regulated assets will be forced to choose between restricting the voting policies of all fund investors or establishing costly, niche products that apply the proposed rule for purposes of managing ERISA-regulated assets. As a direct result of this proposed rule, ERISA-regulated fiduciaries will face higher fees and fewer investment options, ultimately resulting in worse financial performance for plan beneficiaries. Likewise, the proposed rule would put ERISA-regulated plan beneficiaries at a disadvantage, given how out-of-step the proposal is with international trends and the growing consensus around the materiality of ESG considerations.[21] In other words, the proposed rule could limit U.S. retirement savers compared to global counterparts in markets where shareholder engagement is not stifled and the materiality of ESG is not denied.

Lastly, the Department fails to meaningfully address the costs caused by the significant and burdensome documentation requirements placed on plan fiduciaries, rationalizing that "most, if not all plans, will adopt policies that utilize the permitted practices," ignoring the significant flaws and detriments those would cause for plan beneficiaries. These costs are all compounded by the excessively short comment period of 30 days and the rushed timeline for an effective date of just 30 days after finalization.

Expecting fiduciaries to properly analyze the rule and apply appropriate policies in such a short period of time amid ongoing health and economic crises is simply unreasonable. This short window to implement the proposed rule will be particularly disruptive considering the high proportion of ERISA-regulated assets that are invested through fund managers who do not exclusively service the ERISA-regulated market. Forcing ERISA-regulated fiduciaries to reallocate assets currently invested through outside managers during a time of historic market volatility exposes plans to intense trading risk and transaction costs.

Conclusion

In closing, the Alliance urges the Department to suspend this rulemaking until the significant issues presented in this comment letter have been thoroughly addressed. Upon analyzing the proposed rule in the extremely short window of time allotted in the 30-day comment period, we believe that if finalized, this proposal will suppress participation in an important practice that helps ensure corporate management remains accountable to shareholders. Discouraging ERISA-regulated plans from participating in the proxy process is unnecessary, if not outright harmful to the market as a whole. ERISA-regulated plans will be encouraged to abstain on the majority of shareholder proposals – and will be threatened with costly bureaucratic investigations if they do not – meaning the interests of retirement savers will be ignored in key corporate governance decisions.

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[21] For instance, consider the new UK Stewardship Code 2020 introduced by regulators, which requires a statement from asset managers on how they are addressing systemic risks like climate change, stating: "Environmental, particularly climate change, and social factors, in addition to governance, have become material issues for investors to consider when making investment decisions and undertaking stewardship." Available at the Financial Reporting Council: https://www.frc.org.uk/getattachment/5aae591d-d9d3-4cf4-814a-d14e156a1d87/Stewardship-Code_Final2.pdf

Taken alongside recent actions by the U.S. Securities and Exchange Commission ("SEC") on the proxy voting process,[22] which the Department cited as part of its rationale for introducing the proposed rule,[23] this move threatens to further consolidate voting power at U.S. companies in the hands of a few large institutions. In her dissent of the recently finalized SEC rules, Commissioner Allison Herren Lee raised the concern that the rule will "harm the governance process and suppress the free and full exercise of shareholder voting rights."[24] Commissioner Lee also warned that the rule will unnecessarily inject corporate management involvement into what is intended to be an independent process, a concern shared by the Alliance and many of the public commenters who responded to that rulemaking.[25] We agree with Commissioner Lee's assessment of the SEC's recent rulemaking as being "unwarranted, unwanted and unworkable,"[26] and we implore the Department to avoid the same pitfalls with this proposed rule.

In the midst of a public health and economic crisis, now is not the time to diminish the fundamental rights of an important class of investors in holding corporations accountable. Thank you for the opportunity to provide comment.

Sincerely,

Fran Seegull
Executive Director, U.S. Impact Investing Alliance

[22] U.S., Securities and Exchange Commission, RIN 3235-AM50, "Exemptions from the Proxy Rules for Proxy Voting Advice."
[23] Office of Information and Regulatory Affairs, Office of Management and Budget, DOL/EBSA, RIN: 1210-AB91, "Proxy Voting Update," (Spring 2020). https://www.reginfo.gov/public/do/eAgendaViewRule?pubId=202004&RIN=1210-AB91
[24] SEC Commissioner Allison Herren Lee Public Statement, "Paying More For Less: Higher Costs for Shareholders, Less Accountability for Management," (July 2020). https://www.sec.gov/news/public-statement/lee-open-meeting-2020-07-22
[25] Ibid.
[26] Ibid.