October 5, 2020

Office of Regulations and Interpretations
US Department of Labor
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 (RIN1210–AB91)

To whom it may concern:

This comment letter is submitted to point out damaging flaws in the above proposed rule (the "Proposal") that require its withdrawal. We believe the Proposal is unnecessary, would create (rather than reduce) confusion, add plan documentation expenses not recognized in the cost-benefit analysis, violate express fiduciary duty provisions of the ERISA statute, constitute viewpoint discrimination that infringes on constitutional free speech rights and suppress the ability of ERISA fiduciaries to engage in prudent risk management practices.

Preventable Surprises is think tank and network of investment industry insiders, as well as scientists, economists, sustainability and risk experts and civil society organization executives.[1] The goal of the network is to help market participants identify and avoid risks that are systemic in nature and are likely to trigger preventable and damaging market events.

We see the Proposal as an effort to "kill the canary in the coal mine" by impeding use of an investor corporate governance risk management communication channel that provides companies with independent, real-time market information from company shareowners.[2] The predictable result will be increasing company exposure to short-term pressures from investors that do not share the same inter-generation obligations as pension funds, due to a primary channel for communication from long-term shareholders being restricted. [3]

[1] https://preventablesurprises.com/about/

[2] Marty Lipton, founding partner at the premier corporate law firm, Wachtell Lipton, quotes Vanguard when discussing the role of shareholders in corporate risk oversight in a 2019 firm Memorandum. *("Investors benefit when the market has better visibility into significant risks to the long-term sustainability of a company's business. The evaluation and disclosure of significant risks to a business arising from various potential factors, including environmental and social concerns, result in a more accurate valuation of the company. Accurate valuation over time is critical to ensuring that our fund shareholders are appropriately compensated for the investment risks they assume.")*

[3] For an analysis of how unbalanced short-term focus can affect long-term company value, see Alex Edmans, Vivian Fang & Allen Huang, The Long-Term Consequences of Short-Term Incentives ("*The concern with short-term incentives is that they lead to the CEO taking myopic actions that boost the short-term stock price at the expense of long-run value.*"); Focusing Capital for the Long Term (An analysis of

The Proposal is based on Outdated and Incomplete Data

Lack of Empirical Support

The Proposal rightly references "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.'" However, it then proceeds to cherry pick data from a limited number of studies that reach the Department's conclusion that ERISA fiduciaries "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 investment." Those studies however largely focus on outdated practices, apply short-term time horizons, or fail to examine returns adjusted for long-term and systemic risk exposures. They are basically not applicable to long-term ERISA funds with broad market exposure.

We note that comment letters submitted in response to the Department's Proposed rule on Financial Factors in Selecting Plan Investments (RIN 1210-AB95) provided the Department with a large number of academic and investment industry studies that demonstrate the material long-term economic value (including risk management benefits) that ESG shareholder resolutions can have and how mainstream institutional investor peer practices have evolved.[4] We refer the Department to those comment letters, and incorporate them herein, for the additional data they contain. The submissions refute the Proposal's assumption that proxy votes on ESG matters have no connection to protecting plan assets from the financial effects of material long-term agency and systemic risks.

Management of Agency and Systemic Risks

Agency risk arises from conflicts of interest between management and shareholder interests and is inherent in corporate governance. The conflict arises from the dynamic that company management, as agents for the shareholders, are obligated to make decisions in the interest of shareholders even though that may not always serve the personal compensation and employment-related interests of management.

Corporate agency conflict risks permeate proxy voting issues. For example, say on pay votes or diversity initiatives which would result in board membership changes could threaten management compensation and job security interests. The Proposal completely ignores this dynamic and fails to

---

615 large and mid-cap U.S. publicly listed companies from 2001 to 2015 highlighted the benefits to long-termism, including: *"From 2001 to 2014, the revenue of long-term firms cumulatively grew on average 47 percent more than the revenue of other firms, and with less volatility. Cumulatively the earnings of long-term firms grew 36 percent more on average over this period than those of other firms, and their economic profit grew by 81 percent more on average."*)

[4] For example, Morningstar reported that ESG-related shareholder resolution support from the 50 largest mutual funds was 46% in 2019, up from 27% in 2015. Morgan Stanley found, after looking at performance of nearly 11,000 mutual funds between 2004 and 2018, that there was no financial trade-off in the returns of sustainable funds when compared to peers. They also concluded that sustainable funds had lower downside risk.

consider the benefit to shareholders that the aggregate impact of proxy votes provides in management of agency risk.

Systemic risks are also getting greater focus from investors, as they have a far greater impact on long-term returns than pursuit of alpha (seeking to beat the market).[5] For long-term investors like pension funds, systemic risks cut across companies and portfolios and often materialize over time. They can have significant material impact, because as much as 75-95% of variability in investment return is caused by exposure to non-diversifiable systematic factors.[6]

The systemic (or non-diversifiable) market risk and return exposure of a portfolio is often referred to as "beta." Systemic risks that are part of beta can be financial (e.g., global financial crisis), environmental (e.g., climate change, biodiversity loss), or social (e.g., income inequality or political instability, or global health crises). Because they have both societal and financial effects, systemic risks are often misperceived only as "one-off" political or social concerns. However, they are often also material financial factors that far outweigh the impact of alpha for long-term investors, like pension funds.

Proxy voting and other shareholder communications with companies can be an integral systemic risk management tool. Even systemic risk reduction actions at a few companies can have a huge long-term effect if it "moves the herd."[7] For example, the Boardroom Accountability Project undertaken by the New York City retirement systems, which started with an announcement in 2014 of a proxy access shareholder resolution involving 75 companies, caused a 53 basis point increase in return for the systems, generating $266 million. The resulting increase in total market value over time, as 600 companies have now adopted proxy access, may be as much as $132 billion.

The Proposal uses a short-term and company/issue specific framework to evaluate risk and return costs and benefits. That approach is inconsistent with ERISA, which requires portfolio-level attention to risk and return objectives over an appropriate time horizon (for pension funds that is usually long term). In addition, the Proposal reverts to an outdated pre-ERISA view that prudence is a fixed concept and impervious to advancement.

The Restatement of Trusts (Third) summarizes the trust law principle that resulted from pre-ERISA resistance to consideration of improved investment concepts in Modern Portfolio Theory. "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."[8]

---

[5] For an in-depth discussion of systemic risk management, see Jim Hawley and Jon Lukomnik, *The Long and Short of It: Are We Asking the Right Questions? Modern Portfolio Theory and Time Horizons*, 41 SEATTLE U. L. REV. 449 (2018).
[6] G. Ibbotson, "*The Importance of Asset Allocation*," Financial Analysts Journal, Vol 86, No 2, 2010, 18-20.
[7] This is a reference to the way you herd cattle by moving the outliers and thereby changing the herd's direction.
[8] RESTATEMENT (THIRD) OF TRUSTS ch. 17, intro. note (AM. LAW INST. 1992).

However, the Proposal seems to do just that – reject the notion that prudent risk management practices have evolved and now recognize the materiality of systemic risk.

The Proposal is Unnecessary

The Proposal cites no hard evidence that ERISA fiduciaries are unfamiliar with its current guidance regarding consideration of the costs and benefits of voting proxies. It references only anecdotal evidence to reach a conclusion that there "may" be a problem. Collective experience is completely at odds with the Department's conclusion. The Department's mere assertion that there "may" be a problem provides insufficient support for this wide-ranging regulatory action that seeks to impose new limits on risk management practices and impose untested limits on exercise of shareholder rights. Without greater empirical support, the Proposal would likely be subject to challenge under the Administrative Procedures Act.[9]

The Proposal then turns a blind eye toward the impact that recently enacted SEC regulations which impose stricter regulatory standards on proxy advisors and limit the ability of investors to put forth shareholder resolutions. We did not see those regulations as necessary or appropriate, but they are now in place and will have an impact. The regulations were described by the SEC as an effort to resolve some of the same alleged issues which are cited by the Department as creating a need for the Proposal.[10] They will undoubtedly change the landscape around volume, analysis and subject matter of future proxy issues upon which shareholders will have the right to vote.

It makes no practical sense for the Department to proceed with the proposal until effect of the new SEC regulations can be determined. The SEC's actions have put new dynamics in place and upended reliability of the Proposal's cost-benefit analysis. The Department should not proceed with the Proposal before effects of the new SEC regulations can be fully determined.

The Proposal Misapplies ERISA Fiduciary Duties

Duty of Loyalty Concerns

The Proposal encourages ERISA fiduciaries to defer on proxy voting decisions to the judgment of corporate management. However, those officers are likely to have conflicting personal, financial, job responsibility and reputational interests in proxy votes. For example, requests for additional reporting on company risk exposures could have implications for performance evaluations and personal credibility involving past decisions of company officers. Say on pay votes directly implicate personal compensation interests. Indeed, the risk of conflicts between company

---

[9] Unfortunately, the use of a short 30-day comment period during the COVID crisis has effectively precluded commenters from undertaking the comprehensive empirical reviews that the Proposal requires.
[10] The SEC described the proxy advisor rules as aimed "to facilitate the ability of those who use proxy voting advice—investors and others who vote on investors' behalf—to make informed voting decisions without imposing undue costs . . ." In its final adoption of the shareholder resolution rule amendments, the SEC said the order "takes into consideration the interests of not only the shareholder who submits a proposal, but also the other shareholders who bear the costs associated with reviewing, considering and voting on such proposals in the company's proxy statement."

management and shareholders is inherent on any matter where the company has made a voting recommendation.

Such conflicts raise duty of loyalty concerns under ERISA.[11] Unlike proxy advisers, that have investor fiduciary duties,[12] there is no fiduciary duty equivalent to ERISA owed to pension fund participants by corporate managers. nor does the Proposal establish any corresponding fiduciary delegation process.[13] ERISA requires that fund trustees exercise reasonable care when selecting third parties to whom fiduciary responsibilities are delegated, that they set parameters in the delegation and monitor the delegate's performance, including compliance with the duty of loyalty.[14] None of these ERISA requirements are recognized by the Proposal, and compliance with them would be both burdensome and costly.

Duty of Impartiality Compliance Concerns

In addition, the Proposal reflects no consideration of the fiduciary duty of impartiality. 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)."

ERISA fiduciaries must undertake good faith efforts to identify and reasonably balance conflicts of interest between different plan participant groups. For example, younger and older participants are likely to have differing investment risk tolerances, income generation needs and long-term capital growth expectations.

The Proposal fails to consider the role that proxy voting by shareholders with inter-generational obligations plays in company risk management over the long term. This results in the Department completely overlooking the Proposal's effects on transfer of agency and systemic risks (e.g., long term economic effects of climate change and other environmental disruption, impact of growing income inequality on economic demand and global trade, product safety shortcuts that generate

---

[11] Aschermann v. Aetna Insurance Company 2012 WL 3090291 (7th Cir. July 31, 2012) ("*Delegation could cause a problem by creating or aggravating a conflict of interest. Decision by a conflicted delegate requires closer judicial review.")*

[12] Harvard Corporate Governance Blog *("As an investment adviser, the proxy advisor has fiduciary duties that it owes its clients.")*

[13] The Business Judgment Rule affords significantly greater discretion to corporate directors than allowed under ERISA. In addition, corporate conflicts of interest can be waived by disinterested directors. 8 Del. C § 144 (2109).

[14] RESTATEMENT (THIRD) OF TRUSTS § 171 cmt. a, at 141 (1992). *("Abuse of discretion may also be found in failure to exercise prudence in the degree or manner of delegation. Prudence thus requires the exercise of care, skill, and caution in the selection of agents and in negotiating and establishing the terms of delegation. Significant terms of a delegation include those involving the compensation of the agent, the duration and conditions of the delegation, and arrangements for monitoring or supervising the activities of agents.")*

future liabilities, inadequate investment in research and development, group think errors from lack of board diversity) from older to younger plan participants.

This myopic approach to risk management aspects of proxy votes (many of which involve intangible assets and have growing financial consequences over time) is likely to unreasonably disfavor the financial interest of younger plan participants in the sustainability of pension benefits comparable to current levels. Corresponding implications for compliance with the duty of impartiality are completely unaddressed.

Inconsistencies in the Proposal will Increase Confusion and Cost

The Proposal recognizes that "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." It also requires maintenance of extensive documentation that supports each proxy voting decision and demonstrates diligence in oversight of proxy advisors.[15] It then warns that "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."

Under the Proposal, unless an ERISA fiduciary defers to company management or does not vote, they face a high risk of being second guessed by the Department in trying to thread the needle between these seemingly inconsistent requirements. However, as noted above, deferring to company management on discretionary investment-related decisions is also risky because it involves conflicts of interest and prudent delegation obligations when it is not clear the Department has ability to waive through this accelerated rulemaking process.

We expect that the result will be that fiduciaries will be forced to decide on engaging new independent service providers to provide additional analysis and documentation for decisions on whether to expend funds on voting proxies. They may also face increased risk of participant litigation for violating fiduciary duties in making wrong decisions.[16]

---

[15] The Proposal cautions that, "when making their voting decisions, fiduciaries must perform reasonable investigations, understanding that certain proposals may require a more detailed or particularized voting analysis. Information that will better enable fiduciaries to determine whether or how to vote proxies on particular matters includes the cost of voting, including opportunity costs; the type of proposal (*e.g.,* those relating to social or public policy agendas versus those dealing with issues that have a direct economic impact on the investment); voting recommendations of management and an analysis of the particular shareholder proponents. In the Department's view, fiduciaries must be prepared to articulate the anticipated economic benefit of proxy-vote decisions in the event they decide to vote."

[16] The Proposal seems to invite litigation by creating a provision which states that it does not create or preclude liability for decisions about, "submitting a proxy vote when the fiduciary prudently determines that the matter being voted upon would have an economic impact on the plan after taking into account the costs involved, or for refraining from voting when the fiduciary prudently determines that the matter being voted upon would not have an economic impact on the plan after taking into account the costs involved."

The cost-benefit analysis of the Proposal neglects the impact of the costs that imposition of these confusing new mandates would generate. We believe they would be substantial.

The Proposal imposes Unconstitutional First Amendment Viewpoint Discrimination

The Department seems oblivious that the primary function of proxy voting is to serve as a form of unfiltered communication between a company and its shareholders. While some proxy votes have binding effect, most are merely advisory expressions of shareholder views on an issue that the SEC has found to be an appropriate topic for shareholder input. At most companies, even votes on election of directors (outside of a contest between opposing slates) only provide an expression of shareholder opinion which can be accepted or rejected by the board.[17] Similarly, say on pay votes are not binding, nor are votes on precatory shareholder resolutions seeking improved reporting or company policy changes.

Proxy voting, unlike most other forms of voting, is simply part of ongoing communications between companies and their shareholders – and is probably the most important channel of communications because it is not filtered through management or company consultants.[18]

The First Amendment precludes governments from restricting speech on a given subject when it singles out a particular opinion or perspective for treatment that is disparate from other views. Given that the Proposal is likely to discourage the expression of ERISA fiduciary views through proxy voting if those views are adverse to company management, it appears to fall within the First Amendment's prohibition on regulation of speech based on the speaker's opinion or perspective.[19]

The Proposal imposes obligations upon ERISA fiduciaries which will cause them to incur extra costs for additional analyses and creation of additional documentation, unless they opt to either say nothing or agree with company management when communicating the conclusions of their fiduciary analyses to company management and directors through advisory proxy votes. That appears to be viewpoint discrimination. In addition, the amount of discretion held by the Department to determine when a fiduciary's analysis of a proxy issue satisfies the confusing standards contained in the Proposal seems to constitute an impermissible prior restraint on speech.[20]

---

[17] Even directors at companies with a majority vote standard requiring candidates who fail to get a majority shareholder vote to submit a resignation, the board at most companies retains the discretion to reject it. In fact, the Council of Institutional Investors reports that in 2019 only 8% of candidates who failed to get a majority vote had left the board were no longer on the board three years later.

[18] While proxy advisors might be engaged to assist in developing a shareholder's communication, that advisor has been selected and contracted by the shareholder, owes a fiduciary duty directly to it and is monitored for compliance with applicable performance standards.

[19] *Simon* & *Schuster, Inc.* v. *Members of* N. *Y. State Crime Victims Bd., 502 U.S. 105,* 115 (1991). (The government offends the First Amendment when it imposes financial burdens on certain speakers based on the content of their expression.)

[20] *City of Lakewood v. Plain Dealer Pub. Co.,* 486 U.S. 750, 758 (1988).

The Proposal should be Withdrawn

As broadly diversified owners of corporate America, ERISA plan participants (and other pension savers) are exposed to financial and economic damage caused by systemic and other long-term economic risks. They have a unique role to play in improving corporate risk management oversight because of the long-term liability obligations they face.[21] The Dot Com Crash, Great Recession and ongoing Coronavirus Crisis demonstrate the damage that systemic risks can wreak on retirement security. We think the Proposal would magnify the likelihood of systemic preventable surprises with catastrophic economic and retirement plan sustainability consequences. American workers would bear the resulting costs as ultimate holders of added risks generated under the Proposal. Unfortunately, the Proposal goes beyond the Department's authority under ERISA and completely fails to consider most of the information that is currently available on industry risk management practices and impact of the Proposal.

In *Little Sisters of the Poor and Paul Home v. Pennsylvania 2020 WL 3808424, the* U.S. Supreme Court 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]." We believe the Proposal would likely be struck down under Federal Administrative Procedure Act legal review standards.

We respectfully request that the Proposal be withdrawn and that the Department defer consideration of related rulemaking until definitive experience demonstrating effect of recently enacted SEC regulations can be determined.

Thank you for your consideration of these comments.

Respectfully submitted,

Jerome Tagger
CEO, Preventable Surprises

---

[21] The US Government Accountability Office (GAO) issued a report earlier this year after conducting a study of investor use of ESG factors. The GAO reported that, "investors told us they sought additional ESG disclosures to better understand and compare companies' risks."