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October 5, 2020

Ms. Jeanne Klinefelter Wilson
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U.S. Department of Labor
200 Constitution Avenue, NW
Washington, D.C. 20210

Submitted Electronically Through www.regulations.gov

**Re: Notice of Proposed Rulemaking: Fiduciary Duties Regarding Proxy Voting and Shareholder Rights
RIN 1210-AB91**

Dear Acting Assistant Secretary Wilson:

The National Coordinating Committee for Multiemployer Plans (“NCCMP”) appreciates this opportunity to comment on the Employee Benefits Security Administration (“EBSA”), U.S. Department of Labor’s (“the Department” or “DOL”) Notice of Proposed Rulemaking: Fiduciary Duties Regarding Proxy Voting and Shareholder Rights (“NPRM” or “proposal”), published at 85 Fed. Reg. 55219 (September 4, 2020). For the reasons outlined below, we encourage the Department to abandon this rulemaking in toto until such a time that the Department corrects the serious infirmities underpinning this proposal.

The NCCMP is the only national organization devoted exclusively to protecting the interests of the job-creating employers of America and the more than 20 million active and retired American workers and their families who rely on multiemployer retirement and welfare plans. The NCCMP’s purpose is to assure an environment in which multiemployer plans can continue their vital role in providing retirement, health, training, and other benefits to America’s working women and men.

The NCCMP is a non-partisan, nonprofit, tax-exempt social welfare organization established under Internal Revenue Code Section 501(c)(4), with members, plans and contributing employers in every major segment of the multiemployer universe. Those segments include the airline, agriculture, building and construction, bakery and confectionery, entertainment, health care, hospitality, longshore, manufacturing, mining, office employee, retail food, service, steel, and trucking industries. Multiemployer plans are jointly trusted by employer and employee trustees.

Ms. Jeanne Klinefelter Wilson
Acting Assistant Secretary
Employee Benefits Security Administration
RIN 1210-AB91
October 5, 2020
Page 2

Summary of Comments

As discussed below, the NCCMP disagrees with the Department's proposal as it is premised on a series of incomplete, inaccurate, erroneous, or unsupported assertions. We are disappointed that a rulemaking of such import would be pursued in such a haphazard manner. However, we appreciate the opportunity to provide the Department with real and verifiable data that supports the approach taken by the Department in its guidance from 1988 through 2018 and that requires reconsideration of the Department's views underlying this proposal.

Over the past 30 years, the Department has consistently promulgated its position that the voting of proxies appurtenant to a plan's investments is a fiduciary duty. While this does not necessarily require that a plan fiduciary vote every proxy, it does require that proxy votes be evaluated and documented in the same manner as any other fiduciary decision.¹ The current proposal abandons this position. In its place, the Department has adopted a presumption *against* voting by abruptly changing its 30 years of prior guidance and making the voting process so burdensome that it will be extremely difficult for plans to comply. DOL then presumes that because the cost and burden of voting is so great – a cost and burden DOL that exists solely in the NPRM and not in reality — plans will likely not vote proxies. Under the proposal, this presumption becomes a self-fulfilling prophecy.

Under the proposal, a plan's fiduciaries must now not only justify *how* shares are voted on a vote-by-vote basis, they must also justify any decision *to* vote shares on a vote-by-vote basis. Furthermore, the cost of *deciding* whether and how to vote shares must be weighed against the expected financial benefits of actually voting the shares, again on a vote-by-vote basis. Past DOL guidance specifically stated that a vote-by-vote analysis was not required and that proxies were generally to be voted absent special circumstance.² The statement was clear and specific. There was no misunderstanding of the intent of prior DOL guidance, contrary to the statement in the NPRM. In addition, prior DOL guidance included detailed discussions of the economic benefit of proxy voting even if that benefit was not quantifiable on a vote by vote basis.³ Thus, DOL misinterprets its own prior guidance and, like a dishonest butcher, puts its thumb on the scale against the voting of shares for reasons that make no sense in view of that prior guidance.

Premised as it is on faulty assumptions and flawed and misleading analysis, and contrary to prior DOL guidance, the proposal creates an inappropriate and unnecessary burden on plans and their fiduciaries. In addition to damaging the direct financial interests of the plans, the proposal would

¹ Although prior guidance required a cost benefit analysis, that analysis was not performed on a vote-by-vote basis. Rather fiduciaries were encouraged to adopt policies for voting and to evaluate the overall cost of voting, which DOL has acknowledged is negligible. The DOL also has previously acknowledged the economic benefit of proxy voting from its earliest guidance.

² 81 Fed. Reg. 95879, 95880-95881 (December 29, 2016); DOL Field Assistance Bulletin 2018-01.

³ 81 Fed. Reg. 95879, 95881 (December 29, 2016); DOL Field Assistance Bulletin 2018-01.

Ms. Jeanne Klinefelter Wilson
Acting Assistant Secretary
Employee Benefits Security Administration
RIN 1210-AB91
October 5, 2020
Page 3

stifle an important check on corporate mismanagement and risk long-term economic growth for short-term and short-sighted interests that will not only harm the plans themselves, but the entire U.S. economic system.

The Department fails to recognize the material nature of every matter that management brings to shareholders for a vote and the vital governance role of shareholder votes as recognized by, among others, Congress and the U.S. Securities and Exchange Commission (“SEC”). The Department overstates the current costs of proxy voting and understates the new costs that ERISA plans will incur as a result of this proposal. The Department seems to be unaware of the costs imposed on shareholders by corporate management and boards through their careless or reckless actions that have resulted in more than \$546 billion in civil and criminal penalties since 2000. Even the most routine proxy vote is the approval of the external auditor, yet the Department appears to be unaware that the annual inspections by Public Company Accounting Oversight Board (“PCAOB”) show that the top six U.S. auditors have an audit failure rate of almost 27%, which should be of significant concern to DOL in the context of this proposal. The Department seems equally unaware of the material and pecuniary nature of Environmental, Social and Governance matters addressed by public companies and their management, investors, governmental entities, business organizations, and non-profit standard setting organizations. The Department also appears to be unaware of extensive public comments from market participants that undermine the Department’s assertions on proxy voting firms as well as the academic research that contradicts major assumptions that the proposal is built on. All of these issues are addressed later in this comment letter.

Finally, the proposal infringes on the plan participants’ First Amendment rights by imposing a prohibited burden on protected expression based on the content of the speech and the identity of the speaker. Because a plan is itself an association of participants and beneficiaries, by abridging the plan’s ability to engage in free expression, it is abridging the rights of those participants and beneficiaries. Additionally, the proposal interferes with the participants’ and beneficiaries’ rights as shareholders, through their fiduciaries, to influence the protected speech of the corporations in which their plans invest. Since a corporation’s First Amendment rights are solely derivative of the rights of its individual shareholders, this type of suppression of speech violates that most basic right.

Ms. Jeanne Klinefelter Wilson
Acting Assistant Secretary
Employee Benefits Security Administration
RIN 1210-AB91
October 5, 2020
Page 4

The Proposed Rule and Its Effect

Although the proposed rule begins with a non-controversial premise – that the management of shareholder rights appurtenant to shares of stock held as plan assets, including the voting of proxies, is a fiduciary duty⁴ – it proceeds to distort that duty in ways that represent a radical departure from existing law, including the Department’s prior guidance.

First, it imposes a level of specificity on the application of that duty that is absent from other areas of fiduciary scrutiny. Thus, the level of recordkeeping required for the voting of proxies by fiduciaries, as well as the level of scrutiny required of plan fiduciaries who delegate the voting of shares to investment professionals, including proxy voting services, exceeds that required for any other investment decision.

Second, and more notably, it imposes a negative duty on plan fiduciaries to *not* vote shares unless the expected benefits of each vote *exceed* the costs associated with voting, *including the cost of deciding how to vote*. This is a unique and unprecedented requirement, not because it mandates that the expected benefits of a decision must be weighed against the costs, but because it tips the scales against voting by adding in costs that are irrelevant to the actual voting decision. Furthermore, it is internally inconsistent with other requirements of the same regulation. Thus, a fiduciary is required to “[i]nvestigate material facts that form the basis for any particular proxy vote or other exercise of shareholder rights.”⁵ At the same time, the *cost* of that required investigation must be weighed against the decision to actually vote those shares. What this means is that if, for example, upon reasonable and prudent investigation, a fiduciary concludes that an affirmative vote on a particular shareholder initiative will promote shareholder value, but it is unclear whether the marginal benefit of the plan’s individual vote will exceed the cost of performing the investigation in the first place, the fiduciary is violating its duties under the proposal by voting those shares at all, and potentially by even performing the legally-required investigation. This is nonsensical and harmful to plans and their participants and beneficiaries.

Under a traditional fiduciary analysis and the Department’s decades long guidance, of course, the fiduciary would have been required to vote those shares in the manner most beneficial to the plan, since the reasonable cost of the research in determining how to vote had already been expended, as required by law, that research had led the fiduciary to the decision on how to vote in the plan’s best interests, and the actual cost of voting is negligible. Thus, the proposed rule inflicts economic harm on plans in two ways. First, it requires the fiduciary to waste plan assets to obtain knowledge that it is prohibited from using. Second, the fiduciary is prohibited from voting in the manner that the fiduciary has determined would likely enhance the value of the plan’s investment, and the performance of the investigation itself may be a violation.

⁴ 29 C.F.R. § 2550.404a-1(e)(2)(i) (proposed).

⁵ 29 C.F.R. § 2550.404a-1(e)(2)(ii)(D).

Ms. Jeanne Klinefelter Wilson
Acting Assistant Secretary
Employee Benefits Security Administration
RIN 1210-AB91
October 5, 2020
Page 5

The scales are further tipped against voting by the Department's implicit assumption that a plan's vote or other form of shareholder engagement be considered in isolation. By contrast, prior guidance was explicit that fiduciaries were permitted to consider their votes in the context of the likely votes of other shareholders. In explaining why it may be appropriate to vote shares even where the voting involves "out of the ordinary costs" (such as in certain cases involving non-U.S. corporations), the Department stated in 2016 that:

"a fiduciary should consider whether the plan's vote, either by itself *or together with the votes of other shareholders*, is expected to have an effect on the value of the plan's investment that warrants the additional cost of voting."⁶

This acknowledgment of the cumulative effect of voting is entirely absent from the current proposal.

Third, and equally troubling, the proposal creates a series of "permitted practices" or safe harbors that purport to resolve the conflict inherent in the proposed regulation, as described above, by further tipping the scales against voting, or by, in essence, having the plan's fiduciaries delegate their fiduciary responsibilities to corporate management. One of these safe harbors permits fiduciaries to adopt a policy to *not* vote shares unless they fall into particular categories of issues.⁷ Another safe harbor permits a blanket policy of voting with the recommendations of management unless there is some particular reason to vote otherwise.⁸

In addition to justifying these two safe harbors with its erroneous and baseless assumption that the cost of voting typically outweighs the expected benefits, the Department adds an even more remarkable rationale, that plan fiduciaries should be permitted to rely upon the "fiduciary duties that officers and directors owe to a corporation based on state corporate laws."⁹ Curiously, this is far more deference and reliance than the Department seems willing to permit plan fiduciaries to afford to their own investment professionals who have a direct fiduciary obligation to the plan itself. This rationale is contrary to the prior Department guidance that discussed the economic risks to investors that resulted from shareholder inattention to corporate governance leading up to the 2008 financial crisis. As those events demonstrated in losses to shareholders, directors, several of whom were indicted, could not be relied upon to act in the interests of shareholders.¹⁰ In fact, a Senate investigation specifically found that Enron's Board of Directors failed to act in the interest

⁶ IB 2016-01.

⁷ 29 C.F.R. § 2550.404a-1(e)(3)(iii)(A) (proposed).

⁸ 29 C.F.R. § 2550.404a-1(e)(3)(iii)(B) (proposed).

⁹ 85 Fed. Reg. 55225. *See* additional discussion below.

¹⁰ 81 Fed. Reg. 95879, 95882 (December 29, 2016; *The Role of the Board of Director's In Enron's Collapse*, Report of the Permanent Subcommittee on Investigations of the Committee on Governmental Affairs, United States Senate (July 8, 2002) ("Senate Report on Enron Investigation"), Accessed at <https://www.govinfo.gov/content/pkg/CPRT-107SPRT80393/pdf/CPRT-107SPRT80393.pdf>.

Ms. Jeanne Klinefelter Wilson
Acting Assistant Secretary
Employee Benefits Security Administration
RIN 1210-AB91
October 5, 2020
Page 6

of shareholders and had conflicts of interest.¹¹ This resulted in a \$1.2 billion reduction in shareholder equity. Shareholder pressure also resulted in the resignation of nine Tyco Directors for failure to oversee irregularities that resulted in a 72 percent drop in shareholder value, according to an article in the Los Angeles Times.¹²

Both of these safe harbors have a partial exception. For example, a blanket policy to vote with management should not apply if the issues to be voted on involve:

“[a] matter that may present heightened management conflicts of interest or is likely to have a significant economic impact on the value of the plan’s investment . . . such as proposals relating to corporate events (mergers and acquisitions transactions, dissolutions, conversions, or consolidations), corporate repurchases of shares (buy-backs), issuances of additional securities with dilutive effects on shareholders, or contested/ elections for directors.”¹³

Nevertheless, under the proposed rule, even in a case where these special circumstances appear, plan fiduciaries are not required to vote their shares. They are instead required to perform “additional analysis”¹⁴ so that the decision *whether* to vote is still subject to the general, biased balancing test set forth in the proposal.

The final proposed safe harbor is the most troubling of all. It would allow a blanket policy against voting in cases where the value of the plan’s shares in the company fall below a fixed percentage of the plan’s total assets.¹⁵ A plan that adopts such a policy would not even be required to consider the potential benefits to the plan of its vote (or the possible harm to the plan of not casting a vote) for any security that falls below the arbitrary threshold selected by the plan. Most remarkably, the Department suggests that an appropriate threshold is 5 percent of plan assets.¹⁶ As the Department quickly acknowledges, however, a fiduciary that permits a plan to invest more than 5 percent of its assets in a single stock may well be in violation of its duty to diversify the plan’s assets.¹⁷ Indeed, in our experience, most plans have a policy of prohibiting the investment of more than 5 percent of their total assets in the stock of any single corporation and many plans adopt an even lower threshold. Although the proposed safe harbor suggests that such a policy should consider the plan’s percentage ownership of the issuer, even the very largest multiemployer plans would rarely hold one percent or more of the outstanding shares of publicly held companies. In fact, the largest passive investment managers are most often the investors with stakes of five percent and

¹¹ Ibid. Accessed at <https://www.govinfo.gov/content/pkg/CPRT-107SPRT80393/pdf/CPRT-107SPRT80393.pdf>.

¹² Los Angeles Times, *Tyco Board Considers Exit of 9 Directors*, August 22, 2002. Accessed at <https://www.latimes.com/archives/la-xpm-2002-aug-22-fi-rup22.6-story.html>.

¹³ 85 Fed. Reg. 55225 - 55226.

¹⁴ 85 Fed. Reg. 55225.

¹⁵ 29 C.F.R. § 2550.404a-1(e)(3)(iii)(C) (proposed).

¹⁶ 85 Fed. Reg. 55226.

¹⁷ *Ibid.*, fn. 62; *see* ERISA Section 404(a)(1)(C), 29 U.S.C. § 1104(a)(1)(C).

Ms. Jeanne Klinefelter Wilson
Acting Assistant Secretary
Employee Benefits Security Administration
RIN 1210-AB91
October 5, 2020
Page 7

above.¹⁸ Thus, for the vast majority of plans, the adoption of such a policy would *require it to never vote its proxies*.

Furthermore, these “permitted practices” place plan fiduciaries in a quandary. Because they so clearly run contrary to the fiduciary analysis consistently applied by the courts since ERISA’s passage in 1974, reliance on them is problematic. Thus, if the proposal is adopted in anything close to its current form, a fiduciary will need to decide whether to follow them, notwithstanding the fact that the conduct condoned by the regulations may nevertheless constitute a fiduciary violation, subjecting the fiduciary to personal liability.

Importance of Shareholder Voting in Governance of Public Companies

The Department’s clear and unambiguous intent in issuing the proposal is to suppress proxy voting by ERISA plan fiduciaries, particularly when those votes are not in accord with the recommendations of corporate management. In addition to being a sudden and unexplained break with the Department’s prior positions and guidance, DOL’s new-found view is at odds with that of Congress and the SEC on the important role that shareholders play in the governance of public companies and our capital markets through proxy voting.

Given the importance of shareholder voting, the SEC has a website, www.investor.gov, that provides information on this vital right. The SEC states:

“One of your key rights as a shareholder is the right to vote your shares in corporate elections. Shareholder voting rights give you the power to elect directors at annual or special meetings and make your views known to company management and directors on significant issues that may affect the value of your shares.”¹⁹

On September 3, 2020, SEC issued its Final Rule on Exemptions from the Proxy Rules for Proxy Voting Advice. The SEC noted:

“..the services provided by proxy voting advice businesses can be an *important component* of the larger proxy voting process and, as such, help *facilitate the participation of shareholders in corporate governance through the exercise of their voting rights*.”²⁰

“In calibrating the rules and exemptions, the Commission has generally sought to *avoid unnecessary burdens that may deter the expression of views* on matters presented for a vote

¹⁸ Walker, Owen, “Blackrock, Vanguard and SSGA tighten hold on US boards,” *Financial Times*, June 15, 2019, available at: <https://www.ft.com/content/046ec082-d713-3015-beaf-c7fa42f3484a>.

See also: McLaughlin, David and Massa, Annie, “The Hidden Dangers of the Great Index Fund Takeover,” *Bloomberg Businessweek*, January 9, 2020, available at: <https://www.bloomberg.com/news/features/2020-01-09/the-hidden-dangers-of-the-great-index-fund-takeover>.

¹⁹ U.S. Securities and Exchange Commission, Shareholder Voting. Accessed at <https://www.investor.gov/shareholder-voting>.

²⁰ 85 Fed. Reg. 55084.

while ensuring that shareholders have *transparent, accurate, and materially complete information* upon which to make their voting decisions. In this regard, the Commission has been guided by the “fundamental conclusion that the interests of shareholders are *best served by more, and not less, discussion of matters presented for a vote.*”²¹ (footnote omitted)

“As we noted in the Proposing Release, proxy voting advice businesses provide voting advice to clients that exercise voting authority over a sizable number of shares that are voted annually, and these businesses are uniquely situated in today's market to influence investors' voting decisions. This advice also implicates interests beyond those of the clients who utilize it when voting. Because these clients vote shares they hold on behalf of thousands of retail investors, this *advice affects the interests of these underlying investors.* Further, in light of proxy voting advice businesses' clients' ability to affect the outcome of the vote on a particular matter through their voting power, the proxy voting advice guiding the clients' votes potentially *affects the interests of all shareholders of the registrant, the registrant, and the proxy system in general.*”²² (footnotes omitted)

“This is the result of Congress establishing these two separate statutory provisions with different purposes, with Section 13(d) focused on providing notice about concentration of voting power and the use of that power, including to change or influence the control of the issuer, and Section 14(a) focused on providing information needed for informed shareholder voting, and the fact that a shareholder may engage in an activity that triggers obligations under both provisions.”²³

“In various circumstances where shareholders are voting by proxy, and solicitation activity is ongoing—for example, the election of directors or the approval of an extraordinary corporate transaction—the information required to be disclosed publicly by Section 13(d) may be material to a voting decision and, accordingly, important to the regulation of the proxy voting process. Similarly, the Commission—noting that Section 13(d) already sets forth the circumstances for when public disclosures of such plans, proposals, or agreements are needed—adopted the Rule 14a-2(b)(1) exemption despite concerns from some commenters that proxy filings are needed for disclosure of a shareholder's plans or proposals regarding the registrant or shareholders' voting agreements on a particular matter.”²⁴ (footnote omitted)

“Other statutes that often play an important and complementary role in furthering all aspects of the Commission's mission in the context of proxy voting and proxy solicitation

²¹ 85 Fed. Reg. 55085.

²² 85 Fed. Reg. 55086.

²³ 85 Fed. Reg. 55087.

²⁴ Ibid.

include Sections 5, 11, and 12 of the Securities Act of 1933 (the “Securities Act”), in particular in circumstances where the vote being solicited is in connection with a significant transaction, such as a merger, in which new securities may be issued to the shareholders who are voting on the transaction. In such a situation, both the registration and prospectus requirements of Securities Act Section 5 and the proxy solicitation requirements of Exchange Act Section 14(a) apply, with public companies often filing a joint proxy statement/prospectus to fulfill both statutory obligations.”²⁵

“Accordingly, *given the importance of a properly functioning proxy system to investors and the capital markets*, even if other provisions of the federal securities laws may apply to certain of their activities, it is appropriate for voting advice furnished by proxy voting advice businesses to be subject to the rules under Section 14(a), which are designed specifically to *enhance the transparency and integrity of the proxy voting process, with the ultimate aim of facilitating informed voting decisions.*”²⁶

This statement by the SEC stands in stark contrast to the Department’s repeated references to the “immateriality” of proxy votes to a plan’s financial interests.²⁷ It is simply inconceivable that Congress would establish the statutory framework that has existed for more than 85 years for an immaterial issue. It is equally inconceivable that the SEC would spend resources to regulate a function that was immaterial. Nor is it credible that the New York Stock Exchange would develop a rule (NYSE Rule 452) for an issue that was immaterial. Finally, public companies do not have proxy votes on issues that are immaterial to the value of their securities.

Furthermore, as the Department is aware, the active discouragement of voting by plans that pervades its proposal is likely to have a seriously deleterious effect on corporate governance in general. The Department specifically notes that a plan’s proxy voting policy “may” include an “advance” exception permitting votes in cases where voting is necessary for a corporation’s meeting of shareholders to meet its quorum requirement.²⁸ Indeed, the proposal specifically acknowledges that the failure to achieve a quorum “would be an economic detriment to the plan’s holding.” Notwithstanding the Department’s explicit acknowledgment of the importance of obtaining a quorum in corporate shareholder meetings, it entirely ignores the cumulative effect of the proposal’s suppression of the voting of shares on the ability of corporations to obtain a quorum. Indeed, by the Department’s own calculation, its regulation could effectively suppress the voting of a cumulative total of 5.5 percent of the nation’s shareholder equity.²⁹ It is inconceivable that the

²⁵ Ibid.

²⁶ Ibid.

²⁷ E.g., 85 Fed. Reg. 55229, 55233, 55239.

²⁸ 85 Fed. Reg. 55226.

²⁹ 85 Fed. Reg. 55228.

suppression of this many corporate share votes would not impede the ability of corporations to obtain the necessary quorum.

The effect of potentially suppressing such a large number of shareholder votes on the outcome of corporate elections also cannot be overstated. During the period from January 1, 2018 through September 30, 2020, among the universe of Russell 3000 companies, on just these specific categories of proposals, the level of shareholder support was between 45 – 55%:³⁰

| <i>Category of Proposal</i> | <i>Votes in 45%-55% Range</i> |
|----------------------------------|-------------------------------|
| Say-On-Pay Proposals | 103 |
| Elect Director Proposals | 162 |
| Omnibus Stock Plan Proposals | 14 |
| Special Meeting Proposals | 36 |
| Act by Written Consent Proposals | 36 |

In each of these votes, the margin was slim enough that the effect of the proposal could easily have changed the outcome. Indeed, in 2008, Professors Marcel Kahan and Edward Rock noted “[n]ever has voting been more important in corporate law. With greater activism among shareholders and the shift from plurality to majority voting for directors, the number of close votes is rising.”³¹ This level of interference in corporate governance by the Department is unnecessary, unwarranted, and counter-productive.

Furthermore, the deleterious effect of the suppression of votes by plans in corporate elections goes even further. Many corporations include in their bylaws super-majority requirements for certain important matters that are based upon the total number of shares, rather than the number of shares voting. Reducing the number of shares voted will necessarily impede the ability to obtain these supermajorities without any consideration of the merits of the proposals and the effect of these failures on shareholder value.

³⁰ ISS Voting Analytics, Russell 3000, January 1, 2018-September 30, 2020.

³¹ Kahan, Marcel and Rock, Edward B., "The Hanging Chads of Corporate Voting" (2008). Faculty Scholarship at Penn Law. 164. Accessed at https://scholarship.law.upenn.edu/faculty_scholarship/164.

Ms. Jeanne Klinefelter Wilson
Acting Assistant Secretary
Employee Benefits Security Administration
RIN 1210-AB91
October 5, 2020
Page 11

Importance of Voting Proxies as Part of Fiduciary Duty and Good Governance

As the Department notes in the proposal, its position emphasizing the importance of shareholder engagement, and proxy voting in particular, by plan fiduciaries was stated at least as long ago as 1988 in the so-called “Avon Letter.”³² While the Department seems intent on withdrawing the Avon Letter and the Department’s other sub-regulatory guidance by contradicting their basic premise, this is entirely inconsistent with the views of the other governmental regulatory agencies that consider the voting of proxies to be a fiduciary duty.

In 2002, SEC Chairman Harvey Pitt said “We believe, however, that an investment adviser *must exercise its responsibility to vote the shares* of its clients in a manner that is consistent with the general antifraud provisions of the Advisers Act, as well as *its fiduciary duties* under federal and state law to act in the best interests of its clients.”³³

We are unaware of any multiemployer pension plan that utilizes an investment advisor for the investment management of publicly traded equity or debt securities that is not a registered Investment Adviser with the SEC. These investment advisers have a fiduciary duty imposed by the Investment Advisers Act of 1940 (“Advisers Act”), which is not one that DOL can regulate away.

On March 3, 2003, the SEC issued Final Rule: Proxy Voting by Investment Advisers (17 CFR Part 275). The SEC actions over the past two years have not altered any aspect of the 2003 Final Rule. In 2003, the SEC summarized the Final Rule as:

“The new rule requires an investment adviser that exercises voting authority over client proxies to adopt policies and procedures reasonably designed to ensure that the adviser votes proxies in the best interests of clients, to disclose to clients information about those policies and procedures, and to disclose to clients how they may obtain information on how the adviser has voted their proxies. The rule amendments also require advisers to maintain certain records relating to proxy voting. The rule and rule amendments are designed to ensure that *advisers vote proxies in the best interest of their clients and provide clients with information about how their proxies are voted.*”³⁴

In the background section, the SEC noted:

“Investment advisers registered with us have discretionary authority to manage \$19 trillion of assets on behalf of their clients, including large holdings in equity securities. In most cases, clients give these advisers authority to vote proxies relating to equity securities. *This*

³² Letter to Helmuth Fandl, Chairman of the Retirement Board, Avon Products, Inc. 1988 WL897696, (Feb. 23, 1988).

³³ Letter from Harvey Pitt, SEC Chairman, to John M. Higgins, President, Ram Trust Services (February 12, 2002).

³⁴ U.S. Securities and Exchange Commission, Final Rule: Proxy Voting by Investment Advisers, Release No. IA-2106; File No. S7-38-02. Accessed at <https://www.sec.gov/rules/final/ia-2106.htm>.

Ms. Jeanne Klinefelter Wilson
Acting Assistant Secretary
Employee Benefits Security Administration
RIN 1210-AB91
October 5, 2020
Page 12

enormous voting power gives advisers significant ability collectively, and in many cases individually, to affect the outcome of shareholder votes and influence the governance of corporations. Advisers are thus in a position to significantly affect the future of corporations and, as a result, the future value of corporate securities held by their clients.”³⁵

The SEC explicitly recognizes that shareholder votes influence the governance of the issuers and that these votes “significantly affect the future of corporations, and, as a result, *the future value of corporate securities*”. The SEC’s longstanding regulation is directly at odds with the premise underlying one of DOL’s permitted practices, which states:

“the Department proposes 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*, subject to any conditions determined by the fiduciary as requiring additional analysis because the matter being voted upon concerns a matter that may present heightened management conflicts of interest or is likely to have a significant economic impact on the value of the plan’s investment. *Under this permitted practice, 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.*

The SEC clearly disagrees with DOL’s idea that the issues coming to shareholders through proxy votes “are unlikely to have a significant impact on the value of the plan’s investment”.

Further, the SEC states:

“The federal securities laws do not specifically address how an adviser must exercise its proxy voting authority for its clients. Under the Advisers Act, however, *an adviser is a fiduciary that owes each of its clients’ duties of care and loyalty* with respect to all services undertaken on the client’s behalf, *including proxy voting*. The duty of care requires an adviser with proxy voting authority to monitor corporate events and to vote the proxies. To satisfy its duty of loyalty, the adviser must cast the proxy votes in a manner *consistent with the best interest of its client and must not subrogate client interests to its own.*” (footnotes omitted)

Under the “Voting Client Proxies” header, the SEC explains:

“The *duty of care* requires an adviser with voting authority to monitor corporate actions and vote client proxies. Therefore, the adviser should have procedures in place designed to ensure that it fulfills these duties. We do not suggest that an adviser that fails to vote every

³⁵ Ibid.

Ms. Jeanne Klinefelter Wilson
Acting Assistant Secretary
Employee Benefits Security Administration
RIN 1210-AB91
October 5, 2020
Page 13

proxy would necessarily violate its fiduciary obligations. There may even be times when refraining from voting a proxy is in the client's best interest, such as when the adviser determines that the cost of voting the proxy exceeds the expected benefit to the client.¹⁸ An adviser may not, however, ignore or be negligent in fulfilling the obligation it has assumed to vote client proxies.”³⁶ (footnotes 17 and 19 omitted)

In footnote 18, the SEC addressed the cost exception to a duty to vote, saying “[f]or example, *casting a vote on a foreign security may involve additional costs such as hiring a translator or traveling to the foreign country to vote the security in person.*” This is a sensible example, and one cited by the Department in its earlier guidance,³⁷ but not remotely the kind envisioned by DOL in its proposal where there seems to be a blanket assumption that voting proxies will rarely benefit the plan or participants.

This general view of the fiduciary nature of an advisor’s fiduciary obligation to its clients with regard to the voting of proxies has not changed. In the SEC’s “Guidance Regarding Proxy Voting Responsibilities of Investment Advisers” effective September 10, 2019, the SEC affirmed that “[i]nvestment advisers are fiduciaries that owe each of their clients duties of care and loyalty with respect to services undertaken on their client’s behalf, *including voting.*”³⁸

The CFA Institute is “a global, not-for-profit professional association of nearly 178,500 investment analysts, advisers, portfolio managers, and other investment professionals in 165 countries, of whom more than 171,000 hold the Chartered Financial Analyst® (CFA®) designation.”³⁹ The mission of the CFA Institute is to “lead the investment profession globally by promoting the highest standards of ethics, education, and professional excellence for the ultimate benefit of society.”⁴⁰ With regard to voting proxies, the CFA Institute includes the following in its Code of Ethics and Standards of Professional Conduct:

“Part of a member’s or candidate’s duty of loyalty includes voting proxies in an informed and responsible manner. *Proxies have economic value to a client*, and members and candidates must ensure that they properly safeguard and maximize this value. An investment manager who fails to vote, casts a vote without considering the impact of the question, or votes blindly with management on nonroutine governance issues (e.g., a

³⁶ Ibid.

³⁷ E.g. IB 2016-01.

³⁸ U.S. Securities and Exchange Commission, Commission Guidance Regarding Proxy Voting Responsibilities of Investment Advisers, page 3. Accessed at <https://www.sec.gov/rules/interp/2019/ia-5325.pdf>.

³⁹ CFA Institute, Letter to the U.S. Securities and Exchange Commission dated February 3, 2020, footnote 1. Accessed at <https://www.sec.gov/comments/s7-22-19/s72219-6738832-207643.pdf>.

⁴⁰ CFA Institute, Mission Statement. Accessed at <https://www.cfainstitute.org/en/about/vision>.

Ms. Jeanne Klinefelter Wilson
Acting Assistant Secretary
Employee Benefits Security Administration
RIN 1210-AB91
October 5, 2020
Page 14

change in company capitalization) may violate this standard. *Voting of proxies is an integral part of the management of investments.*⁴¹

The CFA Institute is the world gold standard in the investment management industry. The Department's views are inconsistent not only with its own longstanding positions, which have informed fiduciaries for more than 30 years, but also inconsistent with the SEC and the investment management industry.

DOL Erroneously Asserts that “Change in Proxy Voting Behavior” is a Problem that Must be Solved

The Department asserts that the “change in proxy voting behavior” is a problem that must be solved, particularly in view of its perception that these changes relate to environmental, social, and governance (“ESG”) issues. The Department notes that:

“According to ISS Analytics, ‘for the overwhelming majority of share capital represented in the U.S., voting is certainly no longer a compliance exercise.’ (36) Instead, *‘proxy voting policies are becoming more complex, as investors continue to add to the list of factors they consider in their review and analysis of governance practices, including board independence, board accountability, diversity, myriads of executive compensation factors, shareholder rights, and environmental and social factors.’*”⁴²

“The Department is now concerned that some fiduciaries and proxy advisory firms—in part relying on the Avon Letter—*may be acting in ways that unwittingly allow plan assets to be used to support or pursue proxy proposals for environmental, social, or public policy agendas that have no connection to increasing the value of investments used for the payment of benefits or plan administrative expenses, and in fact may have unnecessarily increased plan expenses.*”⁴³

While the Department did not specifically mention governance in the second quote, it was included in the language that the Department chose to quote from ISS Analytics. Contrary to the Department's unsubstantiated and erroneous assertion, however, there is simply too much evidence that ESG issues are in fact material “to increasing the value of investments used for the payment of benefits or plan administrative expenses”.⁴⁴ The evidence of materiality, discussed below in more detail under the “Environmental, Social, Governance” section and the “Auditors, Accounting Scandals, and Audit Failures after Sarbanes-Oxley” section, includes the following facts:

⁴¹ CFA Institute, Standards of Practice Handbook, 2014, Eleventh Edition, Standard III(C), page 85. Accessed at <https://www.cfainstitute.org/-/media/documents/code/code-ethics-standards/standards-practice-handbook-11th-ed-eff-July-2014-corr-sept-2014.ashx>.

⁴² 85 Fed. Reg. 55222.

⁴³ 85 Fed. Reg. 55222.

⁴⁴ 85 Fed. Reg. 55222.

Ms. Jeanne Klinefelter Wilson
Acting Assistant Secretary
Employee Benefits Security Administration
RIN 1210-AB91
October 5, 2020
Page 15

1. ESG issues have been proven by the management of SEC registrants to be material to their business and the securities they issue by virtue of including ESG components in the “Risk Factors” identified in the SEC filings as required by Item 503(c) of Regulation S-K. We also have evidence from the Business Roundtable, investors, academics, industry groups, consulting firms, and the U.S. Government that ESG issues have a material effect on shareholder value.
2. A review of all public companies in the Corporate Research Project of Good Jobs First Violation Tracker database reveals civil and criminal penalties of \$546 billion since 2000 for more than 70,800 acts.⁴⁵ The money used to pay these penalties represent shareholder assets that shareholders will never be able to get back. The corporations used these shareholder assets to pay for a litany of offenses related to, for example, the environment, labor, financial fraud, securities fraud, accounting fraud, anti-competitive behavior, price-fixing, healthcare fraud, False Claims Act, Foreign Corrupt Practices Act, consumer protection, government contracting fraud, economic sanctions, kickbacks and bribery, anti-money laundering, safety, and market manipulation. The civil and criminal misconduct that resulted in these penalties and the resulting diminution of shareholder assets was committed, overseen, sanctioned, or ignored by management and boards.
3. As discussed in more detail below, in April 2020, the PCAOB released reports of its inspections of the top 6 U.S. audit firms intended to identify errors in the audits conducted by these firms so severe that they could not support the firms’ audit opinions, sometimes referred to as audit failures. A review of these reports shows that these firms had average audit failure rates of 26.9% in 2018, 29.9% in 2017, and 30.9% in 2016.⁴⁶ The external auditor and the audit process is central to a company’s financial statements and internal controls, and these audit failure rates are astounding for a profession that should tolerate zero defects.
4. On September 20, 2020, the International Consortium of Investigative Journalists released its findings from its review of “records [that] include more than 2,100 suspicious activity reports filed by nearly 90 financial institutions to the United States’ Financial Crimes

⁴⁵ The Violation Tracker database, prepared by the Corporate Research Project of Good Jobs First, combines enforcement data obtained from over 40 federal regulatory agencies and the U.S. Department of Justice. Accessed at <https://www.goodjobsfirst.org/violation-tracker>.

⁴⁶ Public Company Accounting Oversight Board, 2018 Inspection Reports for BDO-USA LLP, Deloitte-Touche LLP, Grant Thornton LLP, Ernst & Young LLP, KPMG LLP, and PricewaterhouseCoopers LLP, April 28, 2020. Accessed at <https://pcaobus.org/Inspections/Reports/Documents/104-2020-007-BDO-USA-LLP.pdf>, <https://pcaobus.org/Inspections/Reports/Documents/104-2020-008-Deloitte-Touche-LLP.pdf>, <https://pcaobus.org/Inspections/Reports/Documents/104-2020-010-Grant-Thornton-LLP.pdf>, <https://pcaobus.org/Inspections/Reports/Documents/104-2020-009-Ernst-Young-LLP.pdf>, <https://pcaobus.org/Inspections/Reports/Documents/104-2020-011-KPMG-LLP.pdf>, and <https://pcaobus.org/Inspections/Reports/Documents/104-2020-012-PricewaterhouseCoopers-LLP.pdf>.

Ms. Jeanne Klinefelter Wilson
Acting Assistant Secretary
Employee Benefits Security Administration
RIN 1210-AB91
October 5, 2020
Page 16

Enforcement Network, known as FinCEN. The documents . . . include information on more than \$2 trillion in transactions dated from 1999-2017 that had been flagged by the banks as suspicious.”⁴⁷ Despite longstanding efforts of the U.S. Government to stop money laundering for criminal and terrorist organizations, it seems that the hard work of good governance is needed more than ever, especially because these activities can result in massive penalties and existential reputational damage that are ultimately borne by shareholders.

DOL’s Assertion on “Mixed Evidence on Effectiveness of Shareholder Voting” is Wrong and Unsupported

In an attempt to justify the Department’s proposal to suppress ERISA plan proxy voting, the Department asserts that “research regarding whether proxy voting has reliable positive effects on shareholder value and a plan’s investment in the corporation has yielded mixed results.”⁴⁸ DOL then cites academic research that is focused on shareholder *activism*, and not shareholder voting.

Interestingly, DOL’s citation includes one article⁴⁹ that is focused on activism by public pension funds, which are not ERISA plans. Another article that concludes that:

“First, activism that adopts some of the investment-intensive aspects of corporate takeover, such as hedge fund activism, *is associated with improvements in target firms’ values and operation.*”⁵⁰

“Second, studies of *shareholder activism that draw from recent samples reveal more evidence of improvements in target firms’ values and operations than earlier studies that are based on activism from the 1980’s and 1990’s.*”⁵¹

A third article⁵² is focused on passive funds and asserts that “they lack a financial incentive to ensure that each of the companies in their very large portfolios are well-run.” This statement is factually false. In fact, John Bogle, the founder of Vanguard and the father of passive index investing noted the importance of shareholder governance when asked by a conference attendee:

⁴⁷ International Consortium of Investigative Journalists, *Global Banks Defy U.S. Crackdowns by Serving Oligarchs, Criminals and Terrorists*, September 20, 2020. Accessed at <https://www.icij.org/investigations/fincen-files/global-banks-defy-u-s-crackdowns-by-serving-oligarchs-criminals-and-terrorists/>.

⁴⁸ 85 Fed. Reg. 55222.

⁴⁹ Tracie Woidtke, *Public Pension Fund Activism and Firm Value: An Empirical Analysis*, Manhattan Institute (2015), https://media4.manhattan-institute.org/pdf/lpr_20.pdf.

⁵⁰ Matthew R. Denes, Jonathan M. Karpoff & Victoria B. McWilliams, *Thirty Years of Shareholder Activism: A Survey of Empirical Research*, 44 J. Corp. Fin. 417, June 21, 2017. Accessed at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2608085.

⁵¹ *Ibid.*

⁵² Dorothy S. Lund, *The Case Against Passive Shareholder Voting*, 43 J. Corp. Law (2018) <https://corpgov.law.harvard.edu/wp-content/uploads/2019/11/Dorothy-Shapiro-Lund.pdf>.

Ms. Jeanne Klinefelter Wilson
Acting Assistant Secretary
Employee Benefits Security Administration
RIN 1210-AB91
October 5, 2020
Page 17

“You know Jack, I understand where you’re trying to go, but why don’t you just leave it to Adam Smith’s invisible hand?”

Mr. Bogle replied:

“Don’t you realize that we are Adam Smith’s invisible hand? And we are. We’re supposed to be operating in the interests of our shareholders, but when you stand back from your governance responsibilities, you’re simply not doing the job your shareholders have the right to expect you to do.”⁵³

The last two articles cited were not focused on shareholder voting, but instead on shareholder activism and on proxy voting firms. Neither has anything to do with the value of shareholder voting or fulfilling fiduciary duties. Furthermore, shareholder proposals, which constitute “activism” at least by the shareholders who present them, represented less than 2 percent of all proxy votes, and ERISA plan “activism” is but a *de minimis* subset of this already *de minimis* “problem”.

There is actually academic literature that supports the importance of shareholder voting and activism on governance and long-term returns. Among others, Cuñat, Gine and Guadalupe concluded that “the market reacts to the passage of a governance-related shareholder proposal with positive abnormal returns around 1.3% on the day of the vote”⁵⁴ and that “[t]his reflects an increase in market value of between 2.7% and 2.8% per implemented proposal.”⁵⁵ Further, the results “suggest that changing the internal corporate governance in targeted firms is rewarded by the market – with more pronounced effects for proposals to remove anti-takeover provisions –, and yields performance improvements in the long run.”⁵⁶ Dimson and Karakaş found “that ESG engagements generate a cumulative size-adjusted abnormal return of +2.3% over the year following the initial engagement” and that “[c]umulative abnormal returns are much higher for successful engagements (+7.1%) and generally flatten out after a year”.⁵⁷ Appel, Gormley and Keim found that “[p]assive investors appear to exert influence through their large voting blocs,

⁵³ Institute, Investments & Wealth, Putting the Shareholder First, A Lifetime Ideal: A Conversation with John Bogle (2006). Journal of Investment Consulting, Vol. 8, No. 1, pp. 8-22, Summer 2006, Available at SSRN: <https://ssrn.com/abstract=1690710>.

⁵⁴ Vicente Cuñat & Mireia Gine & Maria Guadalupe, 2012. “*The Vote Is Cast: The Effect of Corporate Governance on Shareholder Value*”, Journal of Finance, American Finance Association, vol. 67(5), pages 1943-1977, October. Accessed at <https://www.nber.org/papers/w16574.pdf>.

⁵⁵ Ibid.

⁵⁶ Ibid.

⁵⁷ Dimson, E., Karakaş, O., & Li, X. (2015). *Active ownership*. The Review of Financial Studies, 28 (12), 3225-3268. Accessed at <https://academic.oup.com/rfs/article/28/12/3225/1573572>.

Ms. Jeanne Klinefelter Wilson
Acting Assistant Secretary
Employee Benefits Security Administration
RIN 1210-AB91
October 5, 2020
Page 18

and consistent with the observed governance differences increasing firm value, passive ownership is associated with improvements in firms' longer-term performance.”⁵⁸

Finally, the Department itself in the Preamble to Interpretive Bulletin 2016-01 cites multiple examples of the growing trend in shareholder engagement, including shareholder resolutions, by large institutional investors and the benefits thereof.⁵⁹ Significantly, the Department did not cite its own prior resources in the NPRM likely because those resources did not support its revised narrative.

However, the real take away from all of this is that public companies do not conduct proxy votes on issues that are immaterial to the value of their securities. Under a traditional fiduciary analysis, simply not voting, or voting blindly with management, is more likely than not to be a breach of fiduciary duty and one which DOL should not be so cavalier about.

Cost of Voting Proxies and Potential to Avoid Those Costs

The Department, which has responsibility for the Form 5500 and its contents, conducted its own analysis by mining for data from a category that does not exist (Proxy Voting) and used the information gleaned from this search as the basis for its cost estimates and conclusions. Unfortunately, cost estimates inferred from responses to questions not designed to elicit that information are unreliable and unlikely to provide good data. That, however, is exactly what we see from DOL in support of the proposal.

DOL ignores statements in its own prior guidance that the cost of proxy voting is typically insignificant and cites 64 payments to service providers that provide proxy advice, concluding that it averages 0.2 basis points of total plan assets.⁶⁰ DOL cites 363 payments to one service provider that average 6.3 basis points. Unfortunately, if DOL had contacted that service provider (which principally provides investment management and investment consulting services), DOL would have discovered that the 6.3 basis points were predominately attributable to investment management consulting services, and a *de minimis* portion of the fee would be attributed to proxy voting. It is also relevant to point out that the 64 payments come from a universe of 709,527⁶¹ ERISA plans.

⁵⁸ Appel, Ian and Gormley, Todd A. and Keim, Donald B., *Passive Investors, Not Passive Owners* (February 6, 2016). Journal of Financial Economics (JFE), Forthcoming, Available at SSRN: <https://ssrn.com/abstract=2475150> or <http://dx.doi.org/10.2139/ssrn.2475150>.

⁵⁹ 81 Fed. Reg. 95879, 95881 (December 29, 2016).

⁶⁰ 85 Fed. Reg. 55229.

⁶¹ Employee Benefits Security Administration, U.S. Department of Labor, Private Pension Plan Bulletin, Abstract of 2018 Form 5500 Annual Reports, September 2019, Page 2, Table of Highlights for 2017 and 2016. Accessed at <https://www.dol.gov/sites/dolgov/files/EBSA/researchers/statistics/retirement-bulletins/private-pension-plan-bulletins-abstract-2017.pdf>.

Notwithstanding the abbreviated timeframe for comments, NCCMP has discussed the proposal with multiemployer pension plan fiduciaries and service providers. These discussions suggest that:

1. The fees paid for proxy voting are *de minimis*, and more likely around 0.1 basis points or less;
2. Proxy voting fees would not go away by adopting any of the Department's "permitted practices" as a plan fiduciary is encouraged to "focus its resources only on particular types of proposals that the fiduciary has prudently determined are likely to have a significant impact on the value of the plan's investment, such as proposals relating to corporate events (mergers and acquisitions transactions, dissolutions, conversions, or consolidations), corporate repurchases of shares (buy-backs), issuances of additional securities with dilutive effects on shareholders, or contested/elections for directors",⁶² and therefore there would not be any savings from adopting DOL's approach; and
3. Plan expenses would in fact rise from the new burden created by the NPRM in the form of the significant record keeping and economic justifications needed for every decision to vote shares.

While we find serious flaws in the Department's calculation of "net cost savings" of \$540.9 million, we note that even that inflated figure represents less than one tenth of one percent of the \$546 billion in civil and criminal case penalties that the management and boards of public companies have paid from shareholder assets since 2000 for more than 70,800 wrongful acts. Alternatively, this corporate waste of shareholder assets represents more than 1,000 years of DOL "savings".

Matters Subject to Proxy Votes are Material to an Issuers' Securities

Proxy votes are a means for shareholders to weigh in on material issues. For example, NYSE Rule 452.11 requires instructions from the beneficial owners before a NYSE member organization may act when the matter:

- "(1) is not submitted to stockholders by means of a proxy statement comparable to that specified in Schedule 14-A of the Securities and Exchange Commission;
- (2) is the subject of a counter-solicitation, or is part of a proposal made by a stockholder which is being opposed by management (i.e., a contest);
- (3) relates to a merger or consolidation (except when the company's proposal is to merge with its own wholly owned subsidiary, provided its shareholders dissenting thereto do not have rights of appraisal);

⁶² 85 Fed. Reg. 55225.

- (4) involves right of appraisal;
- (5) authorizes mortgaging of property;
- (6) authorizes or creates indebtedness or increases the authorized amount of indebtedness;
- (7) authorizes or creates a preferred stock or increases the authorized amount of an existing preferred stock;
- (8) alters the terms or conditions of existing stock or indebtedness;
- (9) involves waiver or modification of preemptive rights (except when the company's proposal is to waive such rights with respect to shares being offered pursuant to stock option or purchase plans involving the additional issuance of not more than 5% of the company's outstanding common shares (see Item 12));
- (10) changes existing quorum requirements with respect to stockholder meetings;
- (11) alters voting provisions or the proportionate voting power of a stock, or the number of its votes per share (except where cumulative voting provisions govern the number of votes per share for election of directors and the company's proposal involves a change in the number of its directors by not more than 10% or not more than one);
- (12) authorizes the implementation of any equity compensation plan, or any material revision to the terms of any existing equity compensation plan (whether or not stockholder approval of such plan is required by subsection 8 of Section 303A of the Exchange's Listed Company Manual);
- (13) authorizes a new profit-sharing or special remuneration plan, or a new retirement plan, the annual cost of which will amount to more than 10% of average annual income before taxes for the preceding five years, or the amendment of an existing plan which would bring its cost above 10% of such average annual income before taxes.
- (14) changes the purposes or powers of a company to an extent which would permit it to change to a materially different line of business and it is the company's stated intention to make such a change;
- (15) authorizes the acquisition of property, assets, or a company, where the consideration to be given has a fair value approximating 20% or more of the market value of the previously outstanding shares;
- (16) authorizes the sale or other disposition of assets or earning power approximating 20% or more of those existing prior to the transaction.

Ms. Jeanne Klinefelter Wilson
Acting Assistant Secretary
Employee Benefits Security Administration
RIN 1210-AB91
October 5, 2020
Page 21

- (17) authorizes a transaction not in the ordinary course of business in which an officer, director or substantial security holder has a direct or indirect interest;
- (18) reduces earned surplus by 51% or more, or reduces earned surplus to an amount less than the aggregate of three years' common stock dividends computed at the current dividend rate; or
- (19) is the election of directors, provided, however, that this prohibition shall not apply in the case of a company registered under the Investment Company Act of 1940;
- (20) materially amends an investment advisory contract with an investment company;
or
- (21) relates to executive compensation.

The scope of this list suggests that fiduciaries need to be prepared for a number of material “non-routine” issues, which further confirms that constant monitoring and due diligence is required of any portfolio, and therefore there are zero “savings” available to plan fiduciaries despite DOL’s assertion to the contrary.

Even one of the most routine votes, the selection of the auditor, is a material item. Every year, shareholders are asked to vote on approving the auditor of the SEC registrant. As we have repeatedly seen throughout history, this is a serious and material matter to the registrant and its shareholders. Indeed, as noted above and explained in more detail below, the frequency of what amounts to malpractice by even the largest auditing firms is shocking. Yet, DOL suggests that this annual vote is so inconsequential that ERISA fiduciaries should either abstain from voting or blindly follow management’s recommendation.

Auditors, Accounting Scandals, and Audit Failures after Sarbanes-Oxley

After a number of major corporate and accounting scandals, including Enron, Tyco, Adelphia Communications and WorldCom, the U.S. Government passed the Sarbanes-Oxley Act of 2002 (P.L. 107-204). Title I of Sarbanes-Oxley created the PCAOB to “oversee the audit of public companies that are subject to the securities laws, and related matters, in order to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports for companies the securities of which are sold to, and held by and for, public investors.”⁶³

The PCAOB annually inspects public accounting firms that audit more than 100 issuers and at least every three years for those that audit 100 or fewer issuers to “assess the firm’s compliance with Public Company Accounting Oversight Board (“PCAOB”) standards and rules and other

⁶³ Sarbanes-Oxley Act of 2002, P.L. 107-204, July 30, 2002, Title I, Section 101(a). Accessed at <https://www.govinfo.gov/content/pkg/PLAW-107publ204/pdf/PLAW-107publ204.pdf>.

applicable regulatory and professional requirements.” “Part I.A of [these] report[s] . . . discuss[] deficiencies (“Part I.A deficiencies”) in certain issuer audits that *were of such significance that we believe the firm, at the time it issued its audit report(s), had not obtained sufficient appropriate audit evidence to support its opinion on the issuer's financial statements and/or internal control over financial reporting* (“ICFR”), and (2) Part I.B of the[se] report[s] . . . discuss[] deficiencies that do not relate directly to the sufficiency or appropriateness of evidence the firm obtained to support its opinion(s) but nevertheless relate to instances of non-compliance with PCAOB standards or rules.”

The PCAOB has been conducting these inspections since 2004. The 2018 inspection reports were issued in April 2020 for the six largest public accounting firms. Tables 1-6 provides PCAOB data for 2018, 2017, and 2016 of the six largest U.S. audit firms. It shows the total audits reviewed, audits with Part I.A deficiencies (referred to herein as “audit failures”), and the audit failure rate. Table 7 summarizes this data for the six firms.

Table 1

| BDO USA, LLP⁶⁴ | 2018 | 2017 | 2016 |
|----------------------------------|-------------|-------------|-------------|
| Total Audits Reviewed | 23 | 23 | 24 |
| Part 1.A Deficiencies | 11 | 9 | 16 |
| Audit Failure Rate | 47.8% | 39.1% | 66.7% |

Table 2

| Deloitte & Touche LLP⁶⁵ | 2018 | 2017 | 2016 |
|---|-------------|-------------|-------------|
| Total Audits Reviewed | 52 | 55 | 55 |
| Part 1.A Deficiencies | 6 | 11 | 13 |
| Audit Failure Rate | 11.5% | 20% | 23.6% |

⁶⁴ Public Company Accounting Oversight Board, 2018 Inspection, BDO USA, LLP. Accessed at <https://pcaobus.org/Inspections/Reports/Documents/104-2020-007-BDO-USA-LLP.pdf>.

⁶⁵ Public Company Accounting Oversight Board, 2018 Inspection, Deloitte & Touche LLP. Accessed at <https://pcaobus.org/Inspections/Reports/Documents/104-2020-008-Deloitte-Touche-LLP.pdf>.

Table 3

| Ernst & Young LLP⁶⁶ | 2018 | 2017 | 2016 |
|---|-------------|-------------|-------------|
| Total Audits Reviewed | 54 | 55 | 55 |
| Part 1.A Deficiencies | 14 | 17 | 15 |
| Audit Failure Rate | 25.9% | 30.9% | 27.2% |

Table 4

| Grant Thornton LLP⁶⁷ | 2018 | 2017 | 2016 |
|--|-------------|-------------|-------------|
| Total Audits Reviewed | 32 | 34 | 34 |
| Part 1.A Deficiencies | 8 | 6 | 8 |
| Audit Failure Rate | 25% | 17.6% | 23.5% |

Table 5

| KPMG LLP⁶⁸ | 2018 | 2017 | 2016 |
|------------------------------|-------------|-------------|-------------|
| Total Audits Reviewed | 52 | 52 | 51 |
| Part 1.A Deficiencies | 19 | 26 | 22 |
| Audit Failure Rate | 36.5% | 50% | 43.1% |

⁶⁶ Public Company Accounting Oversight Board, 2018 Inspection, Ernst & Young LLP. Accessed at <https://pcaobus.org/Inspections/Reports/Documents/104-2020-009-Ernst-Young-LLP.pdf>.

⁶⁷ Public Company Accounting Oversight Board, 2018 Inspection, Grant Thornton LLP. Accessed at <https://pcaobus.org/Inspections/Reports/Documents/104-2020-010-Grant-Thornton-LLP.pdf>.

⁶⁸ Public Company Accounting Oversight Board, 2018 Inspection, KPMG LLP. Accessed at <https://pcaobus.org/Inspections/Reports/Documents/104-2020-011-KPMG-LLP.pdf>.

Table 6

| PricewaterhouseCoopers LLP⁶⁹ | 2018 | 2017 | 2016 |
|--|-------------|-------------|-------------|
| Total Audits Reviewed | 55 | 55 | 56 |
| Part 1.A Deficiencies | 14 | 13 | 11 |
| Audit Failure Rate | 25.4% | 23.6% | 19.6% |

Table 7

| Six Largest U.S. Audit Firms Summary | 2018 | 2017 | 2016 |
|---|-------------|-------------|-------------|
| Total Audits Reviewed | 268 | 274 | 275 |
| Part 1.A Deficiencies | 72 | 82 | 85 |
| Audit Failure Rate | 26.9% | 29.9% | 30.9% |

Given the material importance of financial statements and internal controls to the business operations, finances, and the value of the securities of public companies, one would expect to see zero defects from the auditors. Yet, as the 2018 PCAOB inspections demonstrate, this is not the case. In fact, the audit failure rate for each firm ranges from a low of 11.5% to high of 47.8%, and averages 26.9% for all six firms combined. These data are even more problematic since these six firms perform well over half of all of the audits of publicly traded U.S. corporations.⁷⁰

This is clear evidence that shareholders should be extremely concerned about auditor selection and of the registrant’s management team and board. It should also trigger alarms at DOL (given this NPRM), the SEC, and the PCAOB. Referring to the PCAOB, John Coffee, the director of the Center on Corporate Governance at Columbia Law School, said “we have a watchdog who is not watching” and “we have a watchdog who looks increasingly like a lapdog.”⁷¹

⁶⁹ Public Company Accounting Oversight Board, 2018 Inspection, PricewaterhouseCoopers LLP. Accessed at <https://pcaobus.org/Inspections/Reports/Documents/104-2020-012-PricewaterhouseCoopers-LLP.pdf>.

⁷⁰ Audit Analytics, *Who Audits Public Companies- 2020 Edition*, <https://blog.auditanalytics.com/who-audits-public-companies-2020-edition/>.

⁷¹ Max de Haldevang, Quartz, *Big Four accounting firms bungle a third of US audits but are rarely fined*, September 19, 2020. Accessed at <https://qz.com/1705744/big-four-accounting-firms-are-bunbling-a-third-of-us-audits/>.

Ms. Jeanne Klinefelter Wilson
Acting Assistant Secretary
Employee Benefits Security Administration
RIN 1210-AB91
October 5, 2020
Page 25

Imagine airlines having 27% of their flights crash annually, or 27% of the nation's bridges collapsing annually, or and other critically important service or product having a 27% failure rate. Yet DOL suggests that shareholders should either not vote at all or blindly vote with management in approving these auditors. The audit failure rate also reflects poorly on management and boards, but more importantly, represents a clear danger to shareholders and the underlying value of the securities that they hold.

Even 17 years after the creation of the PCAOB, we see accounting scandals throughout the world. In 2019, the Federal Deposit Insurance Corporation settled with PricewaterhouseCoopers ("PwC") for \$335 million for professional negligence claims brought by the FDIC over PwC's audit of the failed Colonial Bank.⁷² Other accounting and auditing failures include Bernard Madoff, MF Global, Hertz, Valeant, Wells Fargo, Carillion (U.K.), Tesco (U.K.), Autonomy (U.K.), Toshiba (Japan), Olympus (Japan), Petrobras (Brazil), FIFA (Switzerland), Volkswagen (Germany), Steinhoff International (South Africa), Danske Bank (Estonia branch), Parmalat (Italy), 1Malaysia Development Berhad (Malaysia), Wirecard (Germany), Nortel (Canada), and the Noble Group (Hong Kong).

Decades after Enron, we see variants of the same issues time after time, courtesy of corrupt or incompetent management and boards, as well as negligent or complicit auditors. The auditor problems are exacerbated by a permissive regulator, the PCAOB. In a September 2019 report, the Project on Government Oversight ("POGO") noted that since 2003, "the PCAOB has found 808 instances in which the four largest auditing firms in the U.S. performed defective audits of major public companies."⁷³ POGO observed that the PCAOB could have fined the big four \$1.6 billion, but instead opted for \$6.5 million.⁷⁴ This compares to SEC registrants paying the big four \$13.6 billion in audit fees and other fees in 2018.⁷⁵

DOL cites concern about conflicts of interest within proxy advisory firms, which the SEC has recently addressed in its rulemaking, and asserts that the independence of public accounting firms is mandated under the Sarbanes-Oxley Act of 2002 by prohibiting the auditors from providing non-audit services to the issuer.⁷⁶ Contrary to DOL's assertion, however, there are a number of exceptions that apply. In fact, revenues for non-audit services performed by the largest public

⁷² Federal Deposit Insurance Corporation, FDIC Settles with PricewaterhouseCoopers LLP on Audits of a Failed Bank, March 15, 2019. Accessed at <https://www.fdic.gov/news/press-releases/2019/pr19019.html>.

⁷³ David S. Hilzenrath and Nichols Trevino, Project on Government Oversight, *How an Agency You've Never Heard of Is Leaving the Economy at Risk*, September 5, 2019. Accessed at <https://www.pogo.org/investigation/2019/09/how-an-agency-youve-never-heard-of-is-leaving-the-economy-at-risk/>.

⁷⁴ Ibid.

⁷⁵ Ibid.

⁷⁶ 85 Fed. Reg. 55224 and footnote 55.

Ms. Jeanne Klinefelter Wilson
Acting Assistant Secretary
Employee Benefits Security Administration
RIN 1210-AB91
October 5, 2020
Page 26

accounting firms have grown faster than for their audit services, which has concerned at least one PCAOB board member.⁷⁷

A presentation by the PCAOB Investor Advisory Group found that within the S&P 500, 230 auditors performed non-audit services in 2010, an increase from 186 in 2007.⁷⁸ While certainly not the only enforcement case of this type, on September 23, 2019, the SEC charged PricewaterhouseCoopers and one of its audit partners with improper professional conduct and violating auditor independence rules pertaining to nineteen engagements with fifteen SEC-registrant issuers for prohibited non-audit services.⁷⁹ Both respondents agreed to settle the charges.

Simply put, for shareholders, matters of accounting and auditing are critical. Abandoning a plan's shareholder duty to vote proxies or following a DOL "permitted practice" of voting for management recommendations is hazardous to the finances of the plan and its participants.

DOL Permitted Practice of Relying on Corporate Management as Fiduciaries

The Department proposes 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” and that it may “maintain a proxy voting policy that relies on the fiduciary duties that officers and directors owe to a corporation based on state corporate laws.”⁸⁰

Unfortunately, the data on corporate officers and directors fulfilling their fiduciary duties is underwhelming. Not only are corporate scandals involving decisions by officers and directors widespread, even when they are not criminally charged, there is substantial pecuniary evidence that should serve as caution to ERISA fiduciaries relying solely on the good intentions, fiduciary duty, or business judgment of corporate officers and directors.

A number of comment letters provided to the SEC during its proposed rulemaking on Proxy Voting came from organizations representing corporations. The generalized comments suggested that

⁷⁷ Public Company Accounting Oversight Board, *The Rise of Advisory Service in Audit Firms*, November 24, 2014, Steven B. Harris, Board Member, Speech to the Practising Law Institute 12th Annual Directors' Institute on Corporate Governance. Accessed at https://pcaobus.org/News/Speech/Pages/11242014_Harris.aspx.

⁷⁸ Public Company Accounting Oversight Board, Audit Firm Practice and Transparency, What Area of Audit Firm Practice and Transparency would Improve Auditor Professional Skepticism and, More Broadly, Audit Quality. Accessed at https://pcaobus.org/News/Events/Documents/03282012_IAGMeeting/Audit_Firm_Practice_Working_Group_Report.pdf.

⁷⁹ U.S. Securities and Exchange Commission, September 23, 2019, In the Matter of PricewaterhouseCoopers LLP, Respondent. Accessed on at <https://www.sec.gov/litigation/admin/2019/34-87052.pdf>.

⁸⁰ 85 Fed. Reg. 55225.

Ms. Jeanne Klinefelter Wilson
Acting Assistant Secretary
Employee Benefits Security Administration
RIN 1210-AB91
October 5, 2020
Page 27

Proxy Voting Advisors were a significant problem, and that management would provide shareholders with the most accurate, complete and competent advice on voting and the topics of importance.

As previously mentioned, public companies have paid civil and criminal penalties of \$546 billion since 2000 for more than 70,800 acts.⁸¹ The money used to pay these penalties represent shareholder assets that shareholders will never be able to get back. The civil and criminal misconduct that resulted in these penalties came about directly from the decisions of corporate management and their boards. This is the very same management that DOL wants ERISA fiduciaries to defer to. Given the size and breadth of violations, many of which are directly linked to environmental, social or governance issues, it should be clear to DOL that these issues are in fact material to the investment, and pecuniary in nature. It also demonstrates the vital importance of strong governance at public companies, which includes strong shareholder oversight. All shareholders (including ERISA plans) have a material interest and responsibility to exercise the full set of rights attached to the shares they own.

Another indicator of the need for proactive shareholder governance comes from the large number of public companies that file for bankruptcy. The SEC published a list of 246 public companies that filed for bankruptcy protection under Chapter 11 in 2009, 2010, and 2011.⁸² Bankruptcy is the ultimate recognition that management failed. Furthermore, in nearly every case in which a bankrupt company cannot pay its debts, its shareholders are wiped out, leaving them with nothing to show for their investments.⁸³ Clearly management in corporate America is fallible, and to blindly follow management because DOL authorizes it, or because an ERISA plan does not have 5 percent of its assets in the company or own a sufficient, undefined share of the company, is a fiduciary that is violating its duty under any rational fiduciary analysis.

DOL thus proposes permitted practices to suppress proxy voting from ERISA plans that is demonstrably unwarranted, unwise, and would itself be a violation of the duty that fiduciaries owe to plan participants under traditional fiduciary analysis.

Management's Thumb on the Scale of Governance

There is academic evidence of management being able to exert significant influence over proxy votes to advance their own interest and that close votes are disproportionately more likely to be won by management than by shareholder activists. Good governance is hard enough without the additional manipulation that would result from the Department's proposal. Bach and Metzger

⁸¹ The Violation Tracker database, prepared by the Corporate Research Project of Good Jobs First, combines enforcement data obtained from over 40 federal regulatory agencies and the U.S. Department of Justice. Accessed at <https://www.goodjobsfirst.org/violation-tracker>.

⁸² U.S. Securities and Exchange Commission, Public Company Bankruptcy Cases Opened and Monitored. Accessed at <https://www.sec.gov/open/datasets-bankruptcy.html>.

⁸³ See 11 U.S.C. § 507(a).

Ms. Jeanne Klinefelter Wilson
Acting Assistant Secretary
Employee Benefits Security Administration
RIN 1210-AB91
October 5, 2020
Page 28

noted that between 2003 and 2016, “an abnormal share of shareholder proposals [are] won by a small margin by management” and that since 2003, “approximately 75% more shareholder proposals [are] rejected by a margin of one percent of shares outstanding than proposals that were approved by a similarly narrow margin.”⁸⁴ Further, they estimated “that approximately 11% of the proposals were rejected by a margin of less than 10% of the votes because management and their allies could alter the voting results.”⁸⁵

Bach and Metzger also showed that “managers are also more likely to exercise their option packages to obtain additional votes when they expect to face contested shareholder proposals” and that “[m]anagers may have a greater ability than activists to shift votes in their preferred direction.”⁸⁶ Fos and Jiang noted that CEO’s exercise options “to maintain or strengthen voting rights when facing challenges.”⁸⁷

Unlike U.S. political election voting, corporate proxy votes are already tilted against shareholders without DOL’s help through a regulation that suppresses shareholder voting to the detriment of pension plans and participants.

Environment, Social, and Governance (“ESG”) Observations and Comments

The Department stated that:

“[it] is now concerned that some fiduciaries and proxy advisory firms—in part relying on the Avon Letter—*may be acting in ways that unwittingly allow plan assets to be used to support or pursue proxy proposals for environmental, social, or public policy agendas that have no connection to increasing the value of investments used for the payment of benefits or plan administrative expenses, and in fact may have unnecessarily increased plan expenses.*”⁸⁸

“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.*”⁸⁹ (footnote 81 omitted)

This fails to acknowledge the mountain of evidence to the contrary. The evidence includes significant changes and advancements over the years in (1) U.S. and global financial markets, (2)

⁸⁴ Laurent Bach, Daniel Metzger, *How Close Are Close Shareholder Votes?*, The Review of Financial Studies, Volume 32, Issue 8, August 2019, Pages 3183–3214, <https://doi.org/10.1093/rfs/hhy126>.

⁸⁵ Ibid.

⁸⁶ Ibid.

⁸⁷ Fos, Vyacheslav and Jiang, Wei, *Out-of-the-Money CEOs: Private Control Premium and Option Exercises* (September 8, 2015). Review of Financial Studies, Forthcoming, Available at SSRN: <https://ssrn.com/abstract=2355084> or <http://dx.doi.org/10.2139/ssrn.2355084>.

⁸⁸ 85 Fed. Reg. 55222.

⁸⁹ 85 Fed. Reg. 55229.

Ms. Jeanne Klinefelter Wilson
Acting Assistant Secretary
Employee Benefits Security Administration
RIN 1210-AB91
October 5, 2020
Page 29

generally accepted investment and portfolio theory, (3) the development of ESG, and its potential contributions to a well-diversified portfolio (4) the actions and views of investors, other market participants, and corporate managements for what constitutes investment risks and opportunities, (5) the views of plan fiduciaries as to risk tolerance and capacity, (6) the actions of governmental bodies and non-profit standard setting organizations related to ESG, and (7) federal regulatory requirements.

The Department made similar claims in the June 30, 2020 Notice of Proposed Rulemaking: Financial Factors in Selecting Plan Investments Proposed Regulation, RIN 1210-AB95, which seems to have relied on the writings⁹⁰ of individuals that similarly seem to be unaware of these changes and for whom investment management is not their primary professional occupation.

Contrary to the Department's apparent presumption that ESG factors are non-pecuniary in nature, the management of public companies in the United States have clearly and unambiguously articulated a very different view. Since 2005, registrants of the SEC have been required to include "Risk Factors" in 10-K and 10-Q filings through Item 503(c) of Regulation S-K. The SEC notes that these "Risk Factors" are a "discussion of the most significant factors that make the offering speculative or risky⁹¹" and are "intended to provide investors with a clear and concise summary of the material risk to an investment in the issuer's securities."⁹² The material risks described by the SEC are in fact financial, or pecuniary, in nature. Today, it would be grossly inaccurate to consider the "Risk Factors" identified by registrants and required by the SEC, whether related to ESG or not, as non-pecuniary, "a scarlet letter phenomenon⁹³", or "trendy"⁹⁴.

A review of the 2019 10-K's of more than one hundred⁹⁵ of the largest SEC registrants by market capitalization show that ESG related factors were identified as "Risk Factors" by every single one

⁹⁰ Max Schanzenbach & Robert Sitkoff, Reconciling Fiduciary Duty and Social Conscience: The Law and Economics of ESG Investing by a Trustee, 72. *Stanford Law Review*, February 2020. We disagree with their view that ties are "unicorns" (page 410) as well as their belief that if a tie did exist that a fiduciary would need to equally split the investment (page 409) because "textbook financial economics teaches that."

⁹¹ U.S. Securities and Exchange Commission, *Securities Offering Reform*, See page 257, <https://www.sec.gov/rules/final/33-8591.pdf>.

⁹² *Ibid*.

⁹³ *Scarlet Letters: Remarks of SEC Commissioner Hester M. Peirce before the American Enterprise Institute (June 18, 2019)*, www.sec.gov/news/speech/speech-peirce-061819.

⁹⁴ *Ibid*.

⁹⁵ See 10-K's at <https://www.sec.gov/edgar/searchedgar/companysearch.html> of Apple, Microsoft, Amazon, Alphabet, Facebook, Berkshire Hathaway, Visa, Johnson & Johnson, Walmart, Mastercard, Procter & Gamble, UnitedHealth Group, JPMorgan Chase, Home Depot, Intel, NVIDIA, Verizon, Tesla, AT&T, Adobe, Netflix, PayPal, Bank of America, Merck, Walt Disney, Coca-Cola, Cisco, Pfizer, ExxonMobil, PepsiCo, Comcast, Salesforce.com, Oracle, Chevron, Abbott Laboratories, Eli Lilly, Nike, Amgen, AbbVie, Thermo Fisher Scientific, McDonald's, Costco, Bristol-Myers Squibb, Broadcom, Danaher, NextEra Energy, American Tower, Texas Instruments, Union Pacific, Philip Morris, Charter Communications, International Business Machines (IBM), Citigroup, Wells Fargo, Qualcomm, Lowe's, Boeing, Honeywell, Lockheed Martin, Gilead Sciences, Raytheon, United Parcel Service (UPS), 3M, CVS Health, Starbucks, Fidelity National, Altria, Mondelez, General Electric,

Ms. Jeanne Klinefelter Wilson
Acting Assistant Secretary
Employee Benefits Security Administration
RIN 1210-AB91
October 5, 2020
Page 30

of the registrants reviewed. The simple fact is that these companies have routinely identified a number of ESG related topics such as climate change, sustainability, labor, diversity, compensation, internal controls, bribery, and corruption, as “Risk Factors.” Interestingly, ESG related “Risk Factors” are identified by firms representing every segment of the economy.

Given that the management of any SEC registrant is highly unlikely to willfully misrepresent their filings (and expose themselves to civil or criminal litigation), it is prudent and reasonable for investors to consider all of the “Risk Factors” identified in an SEC filing in their analysis of a potential or continuing investment in the company’s securities.

On September 16, 2020, the “Business Roundtable released new principles and policies to address climate change, including the use of a market-based strategy that includes a price on carbon where feasible and effective.”⁹⁶ As stated, “Business Roundtable CEO members lead companies with more than 15 million employees and \$7.5 trillion in revenues. The combined market capitalization of Business Roundtable member companies is the equivalent of over 27 percent of total U.S. stock market capitalization.”⁹⁷ The Business Roundtable report is further recognition that climate change is material to the securities of public companies, which has consistently been identified under “Risk Factors” in their SEC filings. Many of the CEO’s of these public companies are members of the Business Roundtable and signatories to this report.

On September 9, 2020, the Commodity Futures Trading Commission’s (“CFTC”) Climate-Related Market Risk Subcommittee of the Market Risk Advisory Committee (MRAC) released a report entitled *Managing Climate Risk in the U.S. Financial System*.⁹⁸ The reports presents 53 recommendations to mitigate the risks to the financial markets posed by climate change and concludes that:

“Climate change poses a major risk to the stability of the U.S. financial system and to its ability to sustain the American economy;

American Express, BlackRock, CIGNA, Fiserv, Caterpillar, Stryker, Becton Dickinson, CME Group, Vertex Pharmaceuticals, Dominion Energy, Crown Castle, Intuit, Prologis, Duke Energy, S&P Global, Automatic Data Processing, Intuitive Surgical, Estee Lauder, TJX, Anthem, Southern Company, Colgate-Palmolive, Zoetis, Goldman Sachs, Booking Holdings, Biogen, ServiceNow, Regeneron Pharmaceuticals, Equinix, Advanced Micro Devices, U.S. Bancorp, Cummings, Samson Resources, Excel Energy, and the 20-F of ArcelorMittal. Accessed between July 8, 2020 and July 17, 2020.

⁹⁶ Business Roundtable Press Release, Business Roundtable: Market-Based Solutions Best Approach to Combat Climate Change, September 16, 2020. Accessed at <https://www.businessroundtable.org/business-roundtable-market-based-solutions-best-approach-to-combat-climate-change>.

⁹⁷ Business Roundtable, Addressing Climate Change, Principles and Policies, September 2020, second page. Accessed at <https://s3.amazonaws.com/brt.org/Business-RoundtableAddressingClimateChangeReport.September2020.pdf>.

⁹⁸ Commodity Futures Trading Commission, Release 8234-20, September 9, 2020. Accessed at <https://www.cftc.gov/PressRoom/PressReleases/8234-20>.

Ms. Jeanne Klinefelter Wilson
Acting Assistant Secretary
Employee Benefits Security Administration
RIN 1210-AB91
October 5, 2020
Page 31

Climate risks may also exacerbate financial system vulnerability that have little to do with climate change; including vulnerabilities caused by a pandemic that has stressed balance sheets, strained government budgets, and depleted household wealth;

U.S. financial regulators must recognize that climate change poses serious emerging risks to the U.S. financial system, and they should move urgently and decisively to measure, understand, and address these risks;

Existing statutes already provide U.S. financial regulators with wide-ranging and flexible authorities that could be used to start addressing financial climate-related risk now;

Regulators can help promote the role of financial markets as providers of solutions to climate-related risks; and

Financial innovation is required not only to efficiently manage climate risk but also to facilitate the flow of capital to help accelerate the net-zero transition and increase economic opportunity.”⁹⁹

While climate change is but one aspect of the “E” in ESG, the report identifies categories of assets exposed to climate change impacts including the debt and equity securities of (1) power and water utilities, (2) communications companies, (3) public and private transportation infrastructure entities, (4) firms in the sectors of agriculture, airlines, automobiles, cement, steel, chemicals, plastics, energy. Hospitality, metals and mining, power generation, service and infrastructure providers to oil and gas, tourism, insurance, commercial and residential real estate.¹⁰⁰

The CFTC is not alone in its concerns about the financially material impact of climate change and other components of ESG. Among the concerned organizations are the International Organization of Securities Commissioners (“IOSCO”)¹⁰¹, the European Union, the United Kingdom, the Financial Stability Board’s Task Force on Climate Related Financial Disclosures, the Climate Disclosures Standards Board, the Global Reporting Initiative, the International Integrated Reporting Council, and the Sustainability Accounting Standards Board (“SASB”). SASB is an independent, non-profit standard-setting organization. SASB’s Investor Advisory Group includes

⁹⁹ Ibid.

¹⁰⁰ Report of the Climate-Related Market Risk Subcommittee, Market Risk Advisory Committee of the U.S. Commodity Futures Trading Commission, Managing Climate Risk in the U.S. Financial System, September 9, 2020, Table 3.1, page 31. Accessed at <https://www.cftc.gov/sites/default/files/2020-09/9-9-20%20Report%20of%20the%20Subcommittee%20on%20Climate-Related%20Market%20Risk%20-%20Managing%20Climate%20Risk%20in%20the%20U.S.%20Financial%20System%20for%20posting.pdf>.

¹⁰¹ International Organization of Securities Commissioners, January 18, 2019, Statement on Disclosure of ESG matters by Issuers. Accessed at <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD619.pdf>.

Ms. Jeanne Klinefelter Wilson
Acting Assistant Secretary
Employee Benefits Security Administration
RIN 1210-AB91
October 5, 2020
Page 32

51 asset owners and asset managers with \$40 trillion in assets.¹⁰² More than 380 companies use SASB standards to “communicate financially material sustainability information to investors.”¹⁰³

According to the Forum for Sustainable and Responsible Investment (“US SIF”), the U.S. assets in “Sustainable Investing” (which is principally ESG) has grown from \$570 billion (\$170 billion in ESG) in 1995 to \$11.7 trillion (\$10.0 trillion in ESG) in 2018.¹⁰⁴ According to PRI (Principles for Responsible Investment) the assets under management that were “responsibly invested” exceed \$65 trillion globally. This level of market depth shows that ESG has become an important market sector in its own right.

From a U.S. investor’s perspective, it is simply not credible that a particular sector obtains \$12 trillion in investments without any expectation of enhancing economic value and advancing the financial interests of the investor (also participants and beneficiaries), whether an ERISA plan or not.

In 2018, Harvard Business School professors conducted a survey of asset managers that showed that “more than 80% now consider ESG criteria when making investment decisions and do so not only because of growing client demand but also because they believe ESG information is material to investment performance.”¹⁰⁵ A 2018 global survey concluded “the vast majority of surveyed investors are motivated by financial reasons rather than ethical reasons in using ESG data, which is not surprising given that our respondents consist mainly mainstream institutional investors”¹⁰⁶ and that the “majority of respondents suggested that ESG information is material to investment performance.”¹⁰⁷

¹⁰² Sustainability Accounting Standards Board, SASB Announces New Chair and Vice Chair to Its Investor Advisory Group; Membership Now Exceeds 50 Organizations, April 14, 2020. Accessed at <https://www.sasb.org/wp-content/uploads/2020/04/IAG-ChairAdditionsPressReleaseFINAL041420.pdf>.

¹⁰³ Sustainability Accounting Standards Board, Companies Reporting with SASB Standards. Accessed at <https://www.sasb.org/company-use/sasb-reporters/>.

¹⁰⁴ US|SIF, The Forum for Sustainable and Responsible Investment, Fast Facts, *Overview, Size of Sustainable, Responsible and Impact (SRI) Investing 2018*, See [https://www.ussif.org/files/2018%20Infographic%20overview%20\(1\).pdf](https://www.ussif.org/files/2018%20Infographic%20overview%20(1).pdf).

¹⁰⁵ Jon Hale, *Sustainable Funds U.S. Landscape Report: Record Flows and Strong Performance in 2019*, February 14, 2020. See https://www.morningstar.com/content/dam/marketing/shared/pdfs/Research/Sustainable_Funds_US_Landscape_021920.pdf?utm_source=eloqua&utm_medium=email&utm_campaign=&utm_content=20871.

¹⁰⁶ Amir Amel-Zadeh & George Serafeim (2018) *Why and How Investors Use ESG Information: Evidence from a Global Survey*, *Financial Analysts Journal*, 74:3, 87-103, 101. See <https://www.tandfonline.com/doi/full/10.2469/faj.v74.n3.2>.

¹⁰⁷ *Ibid.*

Ms. Jeanne Klinefelter Wilson
Acting Assistant Secretary
Employee Benefits Security Administration
RIN 1210-AB91
October 5, 2020
Page 33

The U.S. Government Accountability Office issued a report in May 2018¹⁰⁸ that, among other things, reviewed the academic research into the relationship between ESG factors and financial performance. GAO concluded that 1). “[a]cademic research on the performance of investments incorporating ESG factors suggests such factors can be a valid financial consideration, both in the aggregate and as individual factors”, 2). “[t]he vast majority (88 percent) of the scenarios in studies we reviewed that were published in peer reviewed academic journals between 2012 to 2017 reported finding a neutral or positive relationship between the use of ESG information in investment management and financial returns in comparison to otherwise similar investments”, 3). “[w]hen considered independently, environmental, social, and governance factors were each found to have either a neutral or positive relationship with financial performance in over 90 percent of the scenarios”, 4). “a 2015 meta-analysis, which reported aggregate evidence from more than 2,000 empirical studies, similarly found that 90 percent of the studies reported finding a neutral, positive or mixed (i.e., non-negative) relationship between incorporating ESG factors and financial performance”, and 5). “a 2017 study commissioned by DOL also reported that while some investors may continue to perceive that incorporating ESG factors entails accepting lower investment performance, its review of academic literature suggests that incorporating ESG factors generally produced investment performances comparable to or better than non-ESG investments.”¹⁰⁹

In a study by the McKinsey & Company examining one particular ESG factor – diversity – the results were striking:

“We first established a positive, statistically significant correlation between executive team diversity and financial performance in our 2015 Why Diversity Matters report (using 2014 diversity data). We find this relationship persists in our expanded, updated, and global 2017 data set. In Why Diversity Matters we found that companies in the top quartile for gender diversity on their executive teams were 15% more likely to experience above-average profitability than companies in the fourth quartile. Almost exactly three years later, this number rose to 21% and continued to be statistically significant. For ethnic/cultural diversity, the 2014 finding was a 35% likelihood of outperformance, comparable to the 2017 finding of a 33% likelihood of outperformance on EBIT margin, both statistically significant.”¹¹⁰

¹⁰⁸ U.S. Government Accountability Office, *Retirement Plan Investing: Clearer Information on Consideration of Environmental, Social, and Governance Factors Would Be Helpful*, May 2018. See <https://www.gao.gov/assets/700/691930.pdf>.

¹⁰⁹ *Ibid*, 7-8.

¹¹⁰ *Delivering through Diversity*, Vivian Hunt, Sara Prince, Sundiatu Dixon-Fyle, Lareina Yee, McKinsey & Company, January 2018, page 8. Accessed July 28, 2020 at <https://www.mckinsey.com/business-functions/organization/our-insights/delivering-through-diversity#>.

Ms. Jeanne Klinefelter Wilson
Acting Assistant Secretary
Employee Benefits Security Administration
RIN 1210-AB91
October 5, 2020
Page 34

“The penalty for not being diverse on both measures persists. Now, as previously, companies in the fourth quartile on both gender and ethnic diversity are more likely to underperform their industry peers financially. Specifically, they are 29% more likely than the other three quartiles to underperform on profitability.”¹¹¹

More generally, a February 2020 report from McKinsey & Company noted that in their July 2019 Global Survey 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” and 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.”¹¹²

In NCCMP’s work with asset managers and market participants, we simply see no credible information that suggests that the market in ESG investments is focused on anything other than the pecuniary aspects of the investment.

The fact that there are numerous mainstream strategy funds that incorporate ESG factor analysis into their investment decisions suggests that ESG issues are material. In fact, Morningstar noted that “564 ESG Consideration funds ha[ve] \$933 billion in assets under management at the end of 2019”¹¹³.

The Department’s position is also at odds with the July 2020 report by the U.S. Government Accountability Office that indicated “[i]nstitutional investors with who we spoke generally agreed that ESG issues can have a substantial effect on a company’s long-term financial performance.”¹¹⁴

The Department’s complete disregard to the material nature of ESG issues is ironic in view of the Administration’s outspoken statements in support of ESG investing, albeit in limited contexts. For example, in his speech to the National Governors’ Association, Secretary of State Mike Pompeo spoke in favor of disinvestment from China¹¹⁵:

¹¹¹ Ibid, 14.

¹¹² McKinsey & Company, *The ESG premium: New perspectives on value and performance*, February 2020, page 2. Accessed on July 21, 2020 at <https://www.mckinsey.com/~/media/McKinsey/Business%20Functions/Sustainability/Our%20Insights/The%20ESG%20premium%20New%20perspectives%20on%20value%20and%20performance/The-ESG-premium-New-perspectives-on-value-and-performance.pdf>.

¹¹³ Jon Hale, *Sustainable Funds U.S. Landscape Report: Record Flows and Strong Performance in 2019*, February 14, 2020. See page 6 at https://www.morningstar.com/content/dam/marketing/shared/pdfs/Research/Sustainable_Funds_US_Landscape_021920.pdf?utm_source=eloqua&utm_medium=email&utm_campaign=&utm_content=20871.

¹¹⁴ U.S. General Accountability Office, *Public Companies, Disclosure of Environmental, Social, and Governance Factors and Options to Enhance Them*, GAO-20-530, July 2020. Accessed at <https://www.gao.gov/assets/710/707949.pdf>.

¹¹⁵ Speech, [Michael R. Pompeo, Secretary of State](#), Walter E. Washington Convention Center, Washington, DC, National Governors Association Winter Meeting, February 8, 2020, <https://www.state.gov/u-s-states-and-the-china-competition/>.

Ms. Jeanne Klinefelter Wilson
Acting Assistant Secretary
Employee Benefits Security Administration
RIN 1210-AB91
October 5, 2020
Page 35

“I know you all have power over pension funds or the people that run them. As of its latest public filing, the Florida Retirement System is invested in a company that in turn is invested in surveillance gear that the Chinese Communist Party uses to track more than 1 million Muslim minorities. California’s pension fund, the largest public pension fund in the country, is invested in companies that supply the People’s Liberation Army that puts our soldiers, sailors, airmen, and Marines at risk.”

Similarly:¹¹⁶

“Why are we sending American capital to a country and supporting a defense industry that's popping out a couple destroyers and frigates a month and threatening to have total overmatch against us in the Pacific?” White House national security adviser Robert O’Brien said Wednesday at an event in Washington. “I don't see why we should be underwriting the Chinese defense industry.”

O’Brien singled out the California Public Employees' Retirement System, the largest retirement fund in the country, for a special warning that its investment decisions could harm both retirees in particular and U.S. national security in general.

Most striking, in May, Secretary Scalia raised the same concerns when he highlighted certain types of subjective factors that he wanted the fiduciaries of the Federal Retirement Thrift Investment Board to consider in their analysis of the appropriate index to use as a benchmark for the “I Fund”, an international stock index fund.¹¹⁷ Specifically, the Secretary endorsed the subjective ESG factors of national security and humanitarian concerns¹¹⁸ as reasons to exclude an international stock index that include investments in Chinese companies. The Secretary noted that these companies “could be subject to sanctions, public protests, trade restrictions, boycotts and other punitive measures that jeopardize their business and profitability.”¹¹⁹ What makes this most noteworthy and pertinent is that both the Members of the Board and the plan’s other fiduciaries are subject to the same, indistinguishable, standards of loyalty and prudence as those established under ERISA, including being subject to personal liability for violating those standards.¹²⁰

While no action has been taken at this point, it is interesting to note the October 2019 “I Fund Benchmark Study” for the Federal Retirement Thrift Investment Board (“Board”) which evaluated

¹¹⁶ *White House: California pension fund subsidizing Chinese plans to 'overmatch' US military*, Joel Gehrke, Foreign Affairs Reporter, Washington Examiner, March 11, 2020, <https://www.washingtonexaminer.com/policy/defense-national-security/white-house-california-pension-fund-subsidizing-chinese-plans-to-overmatch-us-military>.

¹¹⁷ Letter from Secretary Eugene Scalia to Michael D. Kennedy, Chairman, Federal Retirement Thrift Investment Board, May 11, 2020. Accessed July 21, 2020 at https://federalnewsnetwork.com/wp-content/uploads/2020/05/051220_scalia_frtib_letter_FNN.pdf.

¹¹⁸ *Ibid*, 2.

¹¹⁹ *Ibid*.

¹²⁰ 5 U.S.C. § 8477.

Ms. Jeanne Klinefelter Wilson
Acting Assistant Secretary
Employee Benefits Security Administration
RIN 1210-AB91
October 5, 2020
Page 36

the benchmark alternatives available. Aon included two indices without exposure to Emerging Markets (and China) that represented 58% and 65% of non-U.S. equity markets¹²¹, and two indices with Emerging Market exposure (China being 7.5% of one fund and 8.3% of the second¹²²) that represented 85% and 99% of non-U.S. equity markets.¹²³ Aon's recommendation was for the Board to select the index with the maximum exposure to non-U.S. equities, including Chinese equities. Aon based this recommendation on the legislative requirements of the Board, as well as the return, liquidity and diversification provided by the index.

Impact of Voting on Corporate Decisions

The Department asserts that research on “whether proxy voting has reliable positive effects on shareholder value and a plan’s investment in the corporation has yielded mixed results”. Yet, one Manhattan Institute source cited by DOL supports the impact of voting on corporate decisions.

“Proxy voting serves an important vehicle for shareholders to communicate their preferences to the board. While companies do not always take action in response to a shareholder vote – particularly when the vote is *advisory* rather than binding – research suggests that corporate directors pay attention to voting outcomes and in many cases, incorporate the results of the vote in future decisions. This is particularly the case when shareholders register a strong “protest vote” – a material vote in opposition to a proposed action.

Fischer, Gramlich, Miller, and White (2009) find that protest votes in uncontested director elections are associated with higher board turnover, higher management turnover, and increased corporate activity (such as major asset sale or acquisition) in the year following the vote. Martin and Thomas (2005) find that when shareholders protest against executive-only stock option plans directors respond by reducing executive salaries. Ferri and Marber (2013) study the impact of say-on-pay voting and find that companies that receive low levels of shareholder support are more likely to amend their executive compensation plans to make them more shareholder friendly.

Research also shows that activist investors use the shareholder voting process to influence corporate policies. Klein and Zur (2009) find that activist hedge funds have a 60 percent success rate in using their ownership position (including the threat of proxy contests) to meet their stated objectives, including board representation, replacing the CEO, increasing cash distributions to owners, altering strategy, terminating pending acquisitions, or

¹²¹ Aon, I Fund Benchmark Study, Federal Retirement Thrift Investment Board, Thrift Savings Plan, October 2019. Page 9. Accessed on July 21, 2020 at https://www.frtib.gov/ReadingRoom/InvBMarks/2019_Oct_Benchmark_Evaluation_Report.pdf.

¹²² *Ibid*, 11.

¹²³ *Ibid*, 9.

Ms. Jeanne Klinefelter Wilson
Acting Assistant Secretary
Employee Benefits Security Administration
RIN 1210-AB91
October 5, 2020
Page 37

agreeing to a proposed merger. Together, these findings indicate that shareholder voting is an effective means of shaping corporate policy.”¹²⁴

As previously mentioned, the SEC also disagrees with DOL’s new position. Regardless of whether the current DOL likes the outcome of particular proxy votes, the fact that management has engaged in illegal activities that have resulted in \$546 billion of shareholder assets being spent on civil and criminal activities over the past 20 years, suggests that the need for shareholder engagement on corporate governance is at an all-time high.

DOL Recitation of Debunked Assertions Does Not Make Them True

The DOL proposal states:

“In proposing its amendments, the SEC described concerns regarding proxy advisory firms, including the adequacy of disclosure of any actual or potential conflicts of interest, the accuracy and material completeness of the information underlying proxy advice, and the inability of proxy advice clients to receive information and views from the registrant, potentially contrary to that presented in the advice, in a manner that is consistently timely and efficient. Moreover, with respect to a small fraction of proposals, some commenters have asserted that proxy advisory firms have made factual and/or analytic errors in additional definitive proxy materials.”¹²⁵

“Such shortcomings make it more difficult for a responsible ERISA fiduciary to rely on a proxy advisory firm's recommendations. A fiduciary who does so rely could risk violating ERISA's fiduciary requirements.”¹²⁶

The DOL’s line of attack on proxy advisory firms has been completely debunked during the SEC comment process by numerous market participants,¹²⁷ including the SEC’s own Investment

¹²⁴ James R. Copeland, David F. Larcker and Brian Tayan, *The Big Thumb on the Scale: An Overview of the Proxy Advisory Industry*, May 30, 2018. Accessed at <https://www.gsb.stanford.edu/sites/gsb/files/publication-pdf/cgri-closer-look-72-big-thumb-proxy-advisory.pdf>.

¹²⁵ 85 Fed. Reg. 55230.

¹²⁶ 85 Fed. Reg. 55230.

¹²⁷ Council of Institutional Investors, Letter to the U.S. Securities and Exchange Commission dated February 4, 2020. Accessed at <https://www.sec.gov/comments/s7-22-19/s72219-6764339-208028.pdf>.

Elliott Management Corporation, Letter to the U.S. Securities and Exchange Commission dated January 31, 2020. Accessed at <https://www.sec.gov/comments/s7-22-19/s72219-6730874-207436.pdf>.

BMO Global Asset Management, Letter to the U.S. Securities and Exchange Commission dated January 31, 2020. Accessed at <https://www.sec.gov/comments/s7-22-19/s72219-6730761-207428.pdf>.

The City of New York, Office of the Comptroller, Scott M. Stringer, Letter to the U.S. Securities and Exchange Commission dated November 19, 2020. Accessed at <https://www.sec.gov/comments/s7-22-19/s72219-6451863-198927.pdf>.

Council of Institutional Investors, Letter to the U.S. Securities and Exchange Commission dated February 20, 2020. Accessed at <https://www.sec.gov/comments/s7-22-19/s72219-6847485-209707.pdf>.

Ms. Jeanne Klinefelter Wilson
Acting Assistant Secretary
Employee Benefits Security Administration
RIN 1210-AB91
October 5, 2020
Page 38

Advisory Committee, the U.S. Government Accountability Office¹²⁸ and multiple foreign regulators¹²⁹. In a free market economy, it defies logic that proxy advisory firms would

Pension Investment Association of Canada, Letter to the U.S. Securities and Exchange Commission dated January 23, 2020. Accessed at <https://www.sec.gov/comments/s7-22-19/s72219-6687749-205913.pdf>.

U.S. Securities and Exchange Commission (SEC) Investment Advisory Committee, Letter to the U.S. Securities and Exchange Commission dated January 24, 2020. Accessed at <https://www.sec.gov/comments/s7-22-19/s72219-6698769-206000.pdf>.

Neuberger Berman, Letter to the U.S. Securities and Exchange Commission dated January 27, 2020. Accessed at <https://www.sec.gov/comments/s7-22-19/s72219-6718144-206171.pdf>.

Legal & General Investment Management America, Letter to the U.S. Securities and Exchange Commission dated February 3, 2020. Accessed at <https://www.sec.gov/comments/s7-23-19/s72319-6744056-207893.pdf>.

Dimensional Fund Advisors, LP, Letter to the U.S. Securities and Exchange Commission dated February 3, 2020. Accessed at <https://www.sec.gov/comments/s7-22-19/s72219-6744334-207885.pdf>.

Teachers Insurance and Annuity Association, Letter to the U.S. Securities and Exchange Commission dated February 3, 2020. Accessed at <https://www.sec.gov/comments/s7-22-19/s72219-6742759-207808.pdf>.

MFS Investment Management, Letter to the U.S. Securities and Exchange Commission dated February 3, 2020. Accessed at <https://www.sec.gov/comments/s7-22-19/s72219-6743763-207863.pdf>.

Investment Company Institute, Letter to the U.S. Securities and Exchange Commission dated February 3, 2020. Accessed at <https://www.sec.gov/comments/s7-22-19/s72219-6743669-207831.pdf>.

California Public Employees' Retirement System, Letter to the U.S. Securities and Exchange Commission dated February 3, 2020. Accessed at <https://www.sec.gov/comments/s7-22-19/s72219-6744092-207880.pdf>.

California State Teachers' Retirement System, Letter to the U.S. Securities and Exchange Commission dated February 3, 2020. Accessed at <https://www.sec.gov/comments/s7-22-19/s72219-6744089-207898.pdf>.

Colorado Public Employees' Retirement Association, Letter to the U.S. Securities and Exchange Commission dated February 3, 2020. Accessed at <https://www.sec.gov/comments/s7-22-19/s72219-6743701-207841.pdf>.

State Board of Administration of Florida, Letter to the U.S. Securities and Exchange Commission dated February 3, 2020. Accessed at <https://www.sec.gov/comments/s7-22-19/s72219-6743692-207840.pdf>.

Ohio Public Employees Retirement System, Letter to the U.S. Securities and Exchange Commission dated February 3, 2020. Accessed at <https://www.sec.gov/comments/s7-22-19/s72219-6744087-207879.pdf>.

National Conference on Public Employee Retirement Systems, Letter to the U.S. Securities and Exchange Commission dated February 3, 2020. Accessed at <https://www.sec.gov/comments/s7-22-19/s72219-6695058-205997.pdf>.

Australian Council of Superannuation Investors, Letter to the U.S. Securities and Exchange Commission dated January 31, 2020. Accessed at <https://www.sec.gov/comments/s7-22-19/s72219-6729689-207383.pdf>.

CFA Institute, Letter to the U.S. Securities and Exchange Commission dated February 3, 2020. Accessed at <https://www.sec.gov/comments/s7-22-19/s72219-6738832-207643.pdf>.

Segal Marco Advisors, Letter to the U.S. Securities and Exchange Commission dated February 3, 2020. Accessed at <https://www.sec.gov/comments/s7-22-19/s72219-6741197-207700.pdf>.

Glass, Lewis & Co., LLC, Letter to the U.S. Securities and Exchange Commission dated February 3, 2020. Accessed at <https://www.sec.gov/comments/s7-22-19/s72219-6745349-207938.pdf>.

Institutional Shareholder Services, Inc., Letter to the U.S. Securities and Exchange Commission dated January 31, 2020. Accessed at <https://www.sec.gov/comments/s7-22-19/s72219-6732023-207470.pdf>.

¹²⁸ United States Government Accountability Office, *Corporate Shareholder Meetings: Proxy Advisory Firms' Role in Voting and Corporate Governance Practices*, November 2016. Accessed at <https://www.gao.gov/assets/690/681050.pdf>.

¹²⁹ Securities and Exchange Board of India, *Working Group's Report on Issues Concerning Proxy Advisors*, May 2019. Accessed at https://www.sebi.gov.in/reports/reports/jul-2019/report-of-working-group-on-issues-concerning-proxy-advisors-seeking-public-comments_43710.html.

Ms. Jeanne Klinefelter Wilson
Acting Assistant Secretary
Employee Benefits Security Administration
RIN 1210-AB91
October 5, 2020
Page 39

consistently provide inaccurate research, data and analyses, whether based on their own criteria or their clients, and survive in the market. Clearly, institutional investors and asset managers (most of whom are fiduciaries) have a vastly different opinion of the value and work product of these proxy advisory firms than those recently expressed by the SEC or DOL. What companies and their cheerleaders call “errors” are largely disagreements between a company and a researcher over opinions, methodologies, the import of data and its analyses, and not actual errors. The market place of ideas, whether in research by buy-side or sell-side analysts, research by long or short fund managers, company management on products or markets, or proxy advisory firms, is actually alive and well.

Individuals in a free market are allowed to arrive at their own judgments and live with the consequences of those judgments. It is regrettable that DOL has not performed even the most basic of due diligence on this issue as DOL seems to have imputed significant weight to this inaccurate and thoroughly uninformed opinion to justify its proposal.

Additional Comments on Shareholder Activism

For the same reasons that proxy voting is a necessary tool for enhancing shareholder value, so too is shareholder activism. Interestingly, while DOL seems to harbor animosity toward shareholder proposals, shareholders seem to take a different view. Of the 177 proposals voted on as of August 26, 2020, the average support was 26.8 percent¹³⁰, however, 43 proposals received between 40.6 percent and 79.1 percent¹³¹. These are not inconsequential levels of support, and highlight the fact that all votes matter. Proxy access is an issue which the SEC has the statutory responsibility to address, and has recently through rulemaking made it more difficult for shareholders to get their proposals on a proxy ballot, which addresses DOL’s concerns.

Furthermore, DOL’s aversion to shareholder activism seems to be premised on two flawed assumptions. First, that shareholder activism is necessarily expensive, and second, that it is necessarily ineffective. Shareholder activism, however, may be nothing more than adding a name to letter, engaging in a telephone conversation, or sending an email.

Even in cases where shareholder engagement may go farther, such as by proposing a shareholder initiative, the Department unfairly minimizes the impact of such efforts. As the studies cited above show, the mere fact of bringing an issue to management’s attention – and forcing management to

European Securities and Market Authority, *Final Report: Feedback Statement on the Consultation Regarding the Role of the Proxy Advisory Industry*, February 19, 2013. Accessed at <https://www.esma.europa.eu/sites/default/files/library/2015/11/2013-84.pdf>. Canadian Securities Administrators, Canadian Securities Regulators Publish Guidance for Proxy Advisory Firms, April 30, 2015. Accessed at <https://www.securities-administrators.ca/aboutcsa.aspx?id=1348> and https://www.osc.gov.on.ca/documents/en/Securities-Category2/csa_20150430_25-201-proxy-advisory.pdf.

¹³⁰ Sustainable Investments Institute, *Proxy Season Mid-Year Review: Social, Environment & Sustainable Governance Shareholder Proposals in 2020*, Heidi Walsh, August 26, 2020. Page 3.

¹³¹ *Ibid*, 7.

Ms. Jeanne Klinefelter Wilson
Acting Assistant Secretary
Employee Benefits Security Administration
RIN 1210-AB91
October 5, 2020
Page 40

respond, as it does with shareholder initiatives – may be enough to effectuate change on issues that investors believe are material to their economic interests.

Past guidance had merely cautioned fiduciaries to balance the cost of the activism against the potential benefits, alone or in combination with other shareholders. As with the rules on proxy voting, however, the Department seeks to tip the scales by 1) apparently requiring any balancing of costs versus potential benefits to be performed in isolation, without taking into account the effect of the activities of other shareholders; and 2) requiring that the costs of deciding whether it is prudent to act be included in assessing the costs of any action.

DOL’s Proposal Violates First Amendment Protections on Free Speech

In *Citizens United v. Federal Election Commission*, the Supreme Court held that the U.S. Constitutional right to free speech was not limited to natural persons, but extends to associations of people, including corporations.¹³² As stated by Justice Scalia in his concurring opinion:

The dissent says that when the Framers "constitutionalized the right to free speech in the First Amendment, it was the free speech of individual Americans that they had in mind." That is no doubt true. All the provisions of the Bill of Rights set forth the rights of individual men and women — not, for example, of trees or polar bears. But the individual person's right to speak includes the right to speak *in association with other individual persons*. Surely the dissent does not believe that speech by the Republican Party or the Democratic Party can be censored because it is not the speech of "an individual American." It is the speech of many individual Americans, who have associated in a common cause, giving the leadership of the party the right to speak on their behalf. The association of individuals in a business corporation is no different — or at least it cannot be denied the right to speak on the simplistic ground that it is not "an individual American."¹³³

Thus, a corporation’s, or any other association’s, right of free expression is derived from the rights of its individual shareholders.

A plan is no less an association than a corporation or, as in the example cited by Justice Scalia, a political party.¹³⁴ Indeed, its assets are held in trust for the exclusive benefit of the trust’s beneficial owners: the participants and beneficiaries.¹³⁵ As the Court concluded in *Citizens United*, the abridgment of the speech rights of an association is the abridgment of the individual speech rights of each of its stakeholders, whether they are shareholders of a corporation or participants and beneficiaries of an employee benefit plan.

¹³² *Citizens United v. Federal Election Commission*, 558 U.S. 310, 343 (2010).

¹³³ *Citizens United*, 558 U.S. 392-93 (citations omitted, emphasis in original).

¹³⁴ *Ibid.*

¹³⁵ *See e.g.* ERISA Sections 403, 404(a), 29 U.S.C. §§ 1103, 1104(a).

Ms. Jeanne Klinefelter Wilson
Acting Assistant Secretary
Employee Benefits Security Administration
RIN 1210-AB91
October 5, 2020
Page 41

In its proposal, however, the Department seeks to restrict those rights by suppressing the ability of plan fiduciaries to vote their shares in the best interests of their participants and beneficiaries, unless they can document, on a vote-by-vote basis, that the financial benefit of the vote exceeds not only the cost of the vote itself, but also of the research required to determine how to vote. Even if the test were not biased, it is the type of test that was specifically rejected in *Citizens United*. As stated by the Court:

"We thus find no support in the First. . . Amendment, or in the decisions of this Court, for the proposition that speech that otherwise would be within the protection of the First Amendment loses that protection simply because its source is a corporation that cannot prove, to the satisfaction of a court, *a material effect on its business or property*. . . . [That proposition] amounts to an impermissible legislative prohibition of speech based on the identity of the interests that spokesmen may represent in public debate over controversial issues and a requirement that the speaker have a sufficiently great interest in the subject to justify communication."¹³⁶

Imposing the restrictions contained in the proposal, particularly where there is little or no cost or other harm to the participants and beneficiaries, is clearly an unwarranted abridgment of one of our most basic rights.

Furthermore, any decision to vote proxies or to engage in shareholder activism is a form of speech, even where that speech is not part of a broader public debate. As the Supreme Court stated in *Sorrell v. IMS Health Inc.*, in which it overturned a state ban on the sale of “prescriber-identifying information” to pharmaceutical manufactures for the purpose of direct marketing to physicians, even purely commercial speech is entitled to protection.¹³⁷ As stated by the Court:

But § 4631(d) imposes more than an incidental burden on protected expression. Both on its face and in its practical operation, Vermont's law imposes a burden based on the content of speech and the identity of the speaker. While the burdened speech results from an economic motive, so too does a great deal of vital expression. Vermont's law does not simply have an effect on speech, but is directed at certain content and is aimed at particular speakers.¹³⁸

Here the Department is attempting to do exactly what the Supreme Court struck down in *Sorrell*, imposing artificial and unnecessary burdens on proxy voting and other forms of shareholder activism based on both the content of the speech and the identity of the speaker.

¹³⁶ *Citizens United*, 558 U.S. 346-47, quoting from, *First National Bank of Boston v. Bellotti*, 435 U.S. 765, 784-85 (1978) (emphasis added).

¹³⁷ [Sorrell v. IMS Health Inc.](#), [564 U.S. 552, 557-58](#) (2011).

¹³⁸ [Sorrell](#), [564 U.S. at 567](#).

Ms. Jeanne Klinefelter Wilson
Acting Assistant Secretary
Employee Benefits Security Administration
RIN 1210-AB91
October 5, 2020
Page 42

Although regulation of commercial speech is not automatically prohibited by the First Amendment, it is subject to a heightened level of scrutiny. In the words of the Court:

Under a commercial speech inquiry, it is the State's burden to justify its content-based law as consistent with the First Amendment. To sustain the targeted, content-based burden § 4631(d) imposes on protected expression, the State must show at least that the statute directly advances a substantial governmental interest and that the measure is drawn to achieve that interest. As in other contexts, these standards ensure not only that the State's interests are proportional to the resulting burdens placed on speech but also that the law does not seek to suppress a disfavored message.¹³⁹

Under its proposed regulation, plans would be prohibited from voting in many instances. The only circumstance where voting is not either prohibited outright or at least discouraged is where the vote is part of a policy that favors management. As noted by the Supreme Court in *Citizens United*,

[the] First Amendment stands against attempts to disfavor certain subjects or viewpoints or to distinguish among different speakers, which may be a means to control content. . . . [T]he Government may also commit a constitutional wrong when by law it identifies certain preferred speakers.¹⁴⁰

Particularly because the Department has failed to justify the need for this regulation, the proposal cannot withstand the required scrutiny under the First Amendment.

Finally, as the Court in *Citizens United* noted in upholding the disclosure requirements of the challenged statute, protecting the interests of shareholders by ensuring shareholder democracy is part of the underpinning of the corporation's role as the aggregate voice of its shareholders:

Shareholder objections raised through the procedures of corporate democracy, can be more effective today because modern technology makes disclosures rapid and informative. A campaign finance system that pairs corporate independent expenditures with effective disclosure has not existed before today. It must be noted, furthermore, that many of Congress' findings in passing BCRA were premised on a system without adequate disclosure. With the advent of the Internet, prompt disclosure of expenditures can provide shareholders and citizens with the information needed to hold corporations and elected officials accountable for their positions and supporters. *Shareholders can determine whether their corporation's political speech advances the corporation's interest in making profits*, and citizens can see whether elected officials are "'in the pocket' of so-called moneyed interests." [*McConnell v. Federal Election Commission*, 540 U.S. 93, 259 (2003)] (opinion of SCALIA, J.), The First Amendment protects political speech; and disclosure *permits citizens and shareholders to react to the speech of corporate entities in a proper*

¹³⁹ [Sorrell](#), 564 U.S. at 571-72 (citations omitted).

¹⁴⁰ *Citizens United*, 558 U.S. at 340.

Ms. Jeanne Klinefelter Wilson
Acting Assistant Secretary
Employee Benefits Security Administration
RIN 1210-AB91
October 5, 2020
Page 43

*way. This transparency enables the electorate to make informed decisions and give proper weight to different speakers and messages.*¹⁴¹

Thus, the Department's proposal intrudes on the rights of plans' participants and beneficiaries in a second way. By seeking to suppress the ability of plan fiduciaries from voting shares and otherwise engaging in prudent and reasonable forms of shareholder activism, the Department is not only preventing plan participants and beneficiaries from having those fiduciaries protect their financial interests, but also depriving them of their opportunity to influence the protected speech of the corporations in which their plan assets are invested. As the Supreme Court made clear, the rights of a corporation under the First Amendment do not exist in isolation, but are derivative of the rights of the individual shareholders. By interfering with the rights of shareholders to participate in corporate speech, the Department is abridging both their rights and, because they are entirely derivative, the rights of the corporation as well.

Conclusion

In light of the information presented, we would encourage the Department to either withdraw the proposal or start this process over again. A subsequent rulemaking process should commence with stakeholder meetings, roundtables, and requests for information to respond to many of the foundational questions needed before this radical departure from the Department's long-term guidance is considered.

Regards,



Michael D. Scott
Executive Director

¹⁴¹ *Citizens United*, 558 U.S. 370-71 (Some citations omitted, emphasis added).