



OFFICE OF THE ILLINOIS STATE TREASURER
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October 5, 2020

VIA ELECTRONIC FILING

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

Re: Fiduciary Duties Regarding Proxy Voting and Shareholder Rights (RIN 1210-AB91)

To Director Canary,

I am writing to voice my strong opposition to the proposed rulemaking titled "Fiduciary Duties Regarding Proxy Voting and Shareholder Rights" (RIN 1210-AB91) ("Proposed Rule").

The Employee Benefits Security Administration ("ESBA") under the Department of Labor ("DOL" or "Department") announced the proposed rule on September 4, 2020, to provide interpretive guidance to the U.S. Employee Retirement Income Security Act of 1974 ("ERISA"). I also request an extension of the comment period from 30 to 120 days for public comments on the notice of the Proposed Rule and schedule a public hearing to allow input from investors and other stakeholders affected by the proposed rule.

As the Treasurer of the State of Illinois, I am responsible for safeguarding and prudently investing \$35 billion on behalf of the people of the State of Illinois, taxpayers, retirement and college savers, and units of local government (collectively referred to as "Beneficiaries"). To effectively execute my fiduciary duties as State Treasurer, my office routinely votes on proxy ballot items and is an active proponent of shareholder resolutions designed to serve the mutual interests of shareowners and corporate managers. These activities are critical in our endeavor to provide the highest level of service, stewardship, and financial value to our beneficiaries and participants.

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It has been long-recognized that proxy voting and shareholder resolutions constitute critically important investor protections, providing a cost-effective, voluntary, market-based way to maintain a system of accountability among shareholders, corporate managers, and boards. Not only do these activities help protect investors, they help maintain fairness, order and efficiency in critically important corporate governance matters, and they facilitate capital formation by enhancing corporate managerial accountability and company performance.^{1,2}

In 2019 alone, my office voted on 25,580 individual ballot items at 2,815 shareholder meetings. In the interest of transparency, all our proxy voting decisions are posted online for our beneficiaries and portfolio companies to review.³

The proposed rule in question would radically impair ERISA funds from acting in the best interests of beneficiaries and plan participants. Restricting the ability of investors to cast informed proxy votes on crucial governance and business decisions will undoubtedly weaken investor protections that have proven indispensable in strengthening corporate governance, improving business performance, and protecting shareholder value. This adverse impact of this deficit will reverberate across the market, impacting both ERISA and non-ERISA funds. If passed, the new rule will weaken the processes that contribute to market efficiencies, effective risk management, and the creation of long-term shareholder value across industries and sectors. In doing so, it will undermine a well-established system of value creation for investors, companies, and the U.S. equity market.

Further, the proposed change represents an unnecessary and unprecedented intrusion on the ability of fiduciaries to act in the best interests of their plan participants and beneficiaries. For over three decades, ERISA plans have recognized that proxy votes constitute *plan assets*, and ERISA plans manage those assets according to their fiduciary responsibilities. Proxy voting helps fiduciaries manage, communicate, and establish accountability for the oversight material investment risks, including environmental, social and governance (ESG) risks that impact long-term value. The proposed rule would impose cost burdens and effectively dissuade ERISA fiduciaries from exercising proxy voting rights that assist in the management of material risk exposures.

DOL points to the SEC's recent rulemaking on shareholder proposals and proxy voting to mischaracterize voting as a time-consuming and costly activity. This is factually incorrect. Firstly, proxy advisor firms serve the market by keeping costs low while consolidating research on broad swaths of the market. Second, DOL has in Field Assistance Bulletin 2018-01 and Interpretive Bulletin 2016-01 acknowledged that the exercise of proxy voting rights and other shareholder rights *does not impose significant costs on plans*. It is noted in the proposed rule that "the Department's concern 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." Shareholder proposals represent a minority of items on a proxy ballot – in fact they make up less than two percent of all proxy votes.

¹ Tamas Barko, Martijn Cremers, Luc Renneboog, "Shareholder Engagement on Environmental, Social and Governance Performance," European Corporate Governance Institute, September 5, 2018.

https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2977219.

² Elroy Dimson, Oguzhan Karakas, Xi Li, "Active Ownership," June 4, 2013. http://www.hbs.edu/faculty/conferences/2013-sustainability-and-corporation/Documents/Active_Ownership_-_Dimson_Karakas_Li_v131_complete.pdf?pwd=6295.

³ Illinois State Treasurer's Office, Proxy Voting Dashboard, available at <https://vds.issgovernance.com/vds/#/NzkwOA==/>.

Perhaps most importantly, the empirical research on ESG factors shows that these matters are material to investors, and companies that manage these factors well have higher long-term returns than their peers.⁴ As such, studies demonstrate that 73 percent of global investors take ESG issues into account in their investment analysis and decision-making^{5, 6} A July 2020 Government Accountability Office (“GAO”) report notes that the majority of institutional investors agreed that ESG issues have a large impact on long-term performance and they actively sought this information to better understand risks to their investments.⁷

It is not merely a few investors taking note of ESG risks. There is widespread recognition of the materiality of ESG factors on company performance. Accordingly, proxy voting represents a critically important mechanism for management of these risk exposures. DOL notes that “[shareholder] proposals increasingly call for disclosure, risk assessment and oversight.” As a fiduciary, it is vital to have access to the total mix of information in order to be educated on evolving factors that drive performance. Shareholder proposals often serve the purpose of alerting investors to shortfalls in disclosure and risk management and are thus vitally important.

Given the market benefits, operability, and cost-effectiveness of the current system for voting on corporate and shareholder items, it is extremely important that any new regulation that will hamper this system be rigorously scrutinized. The proposed rule institutes a new economic analysis requirement to permit proxy voting by ERISA funds. Recognizing that this is a costly and burdensome requirement, DOL allows ERISA plans to utilize one of the three “permitted practices,” described below, none of which are acceptable in the fulfillment of fiduciary responsibilities:

1. A policy of generally voting all proxies in accordance with the voting recommendations of corporate management

This is not in the fiduciary interest of plan participants. When making recommendations, corporate directors and companies are not acting as ERISA fiduciaries. ERISA plans are subject to the duty of loyalty to plan participants and voting in accordance with management might violate that duty. Voting all proxies alongside management could force them to forsake their fiduciary responsibility, and effectively prohibit them from voting.

2. A policy to vote only on particular types of proposals (corporate mergers and acquisitions, share buybacks, stock issuances, and proxy contests)

As noted above, there are numerous items that appear on a proxy ballot. Those related to governance issues, such as director elections and executive compensation, make up the majority and are an important method by which investors can voice their displeasure or support of company policies, practices, and risk management practices. This also applies to shareholder proposals. As such, this restriction will effectively prohibit funds from voting on a wide array of proxy items that are material and relevant to fiduciaries.

⁴ Council of Institutional Investors, “Empirical Research on ESG Factors and Engaged Ownership,” August 2020. <https://www.cii.org/files/publications/misc/09-24-20-Final-Bibliography.pdf>.

⁵ CFA Institute, “CFA Institute Survey: How Do ESG Issues Factor into Investment Decisions?” August 2015. <https://blogs.cfainstitute.org/marketintegrity/2015/08/17/cfa-institute-survey-how-do-esg-issues-factor-into-investment-decisions/>.

⁶ CalPERS, Sustainable Investment Research Initiative Library. <https://www.calpers.ca.gov/page/investments/sustainable-investments-program/esg-integration/siri-library>.

⁷ GAO, “Public Companies: Disclosure of Environmental, Social, and Governance Factors and Options to Enhance Them,” July 2020. <https://www.gao.gov/products/gao-20-530>.

- 3. A policy of refraining from voting unless the plan holds a concentrated position in a company relative to the size of the plan's overall portfolio or relative to the plan's percentage of ownership in the company. The suggested cap on both measures is five percent.**

In order to fulfill their fiduciary duty, ERISA plans are diversified and may not meet the ownership threshold proposed in the third permitted practice. The proposed rule silences and disenfranchises the voices of diversified investors to communicate their concerns and effectively execute their fiduciary duty. Through ownership comes the right to a vote on company matters, and the right to have a voice on corporate decisions. This ability should not be limited to only those with exceedingly large holdings. Relatively smaller investors have a right to a voice that should not be rescinded. It will not only be investors who suffer as a result, but companies will also have reduced access to shareholder input under this provision. This will further limit their ability to respond to owners with information about their strategy, governance, and risk management approaches.

Proper procedure is vital to ensuring regulatory quality prior to and following the comment period. Prior to proposing a new rule, it is important that an agency ensure that the rule will not promulgate substantial and burdensome administrative and enforcement costs on plan participants. The added requirement of conducting an economic analysis will impose a burdensome cost on ERISA funds. It will effectively prevent them from voting and acting in the best interests of their plan participants.

Furthermore, DOL has failed to quantify the costs to plan participants accurately. While DOL is concerned that plan fiduciaries may "impose costs on plans that exceed the consequent economic benefits," there is a paucity of quantitative estimates given to support this assertion. Furthermore, DOL states that it lacks complete data on attendant costs and benefits of plan proxy voting activities. It is extremely alarming that this proposal is moving forward without full data and consideration of the direct and indirect consequences.

To reiterate, I respectfully request that DOL not move forward with the proposed rule on proxy voting. I also request that DOL extend the comment period from 30 to 120 days to provide my office and other stakeholders with the time necessary to fully analyze and provide additional comments and schedule a public hearing to allow input from investors affected by the proposed rule. A 30-day comment period is not sufficient, especially given these sweeping concerns.

Thank you for your time and attention, and please do not hesitate to contact me with any questions.

Sincerely,



Michael W. Frerichs
Illinois State Treasurer