Manulife Investment Management

Filed Electronically

October 5, 2020

Acting Assistant Secretary Jeanne Wilson
Office of Regulations and Interpretations
Employee Benefits Security Administration
Room N–5655
Attention: Proxy Voting and Shareholder Rights NPRM
U.S. Department of Labor
200 Constitution Avenue N.W.
Washington, DC 20210

RE: RIN 1210–AB91—Fiduciary Duties Regarding Proxy Voting and Shareholder Rights Proposed Regulation

Dear Secretary Jeanne Wilson:

Manulife Investment Management (US) LLC ("MIM"), a federally-registered investment adviser with over $203 Billion in institutional assets under management, appreciates the opportunity to comment on the Department of Labor's (the "Department") proposed rule regarding the exercise of shareholder rights including the right to vote proxies ("proposed rule"). In taking up the matter, the Department emphasizes the importance of proxy voting as a significant duty of plan fiduciaries. MIM takes seriously our role as fiduciary and we believe that proxy voting is a key tool that we can use to preserve and protect investment value over the long-term for the benefit of our clients. As outlined below, however, MIM believes that the proposed rule has the potential to erode value and introduce volatility to plan assets over the long-term to the economic detriment of plan participants. Accordingly, we urge the Department to withdraw the proposed rule.

The Proposed Rule Does Not Properly Consider a Fiduciary's Duty to Mitigate Risk

MIM manages plan assets with an eye towards value creation and preservation over a term of *decades rather than years* so those assets grow during the career over which an ERISA beneficiary contributes to that plan. We are managing portfolios not only with an eye on the strength of the financials of issuers we hold, but also with a focus on the ability of an issuer and its management to mitigate risks that we see over that longer term. We are managing portfolios to build value *and* to remain resilient in the face of volatility and risk so that our client plans gain the benefit of outperformance, but also are protected through a market downturn.[1] We guard against these risks through proxy voting for the exclusive purpose of providing benefits to participants and beneficiaries.

[1] As MIM notes in its recent piece, *ESG Portfolio Resilience to Social Dislocations*, regarding the recent market downturn due to the COVID-19 pandemic, "it appears that companies with a stronger ESG proposition seemed better prepared to weather the economic storm that no one projected would happen." https://www.manulifeim.com/institutional/ca/en/viewpoints/sustainability/esg-portfolio-resilience-to-social-dislocations.

MIM mitigates risk, in large part, by executing proxy voting decisions to encourage firms to adopt best practices and to act prudently in managing what we have identified as material risks. Our focus in proxy voting is on those risk factors that have the potential to drive down issuer, or portfolio, value in the event those risks materialize. By the very nature of risk, however, we may not know the 'economic' value of that risk unless it actually manifests. In other words, it is difficult to perform an 'economic' analysis on the value of risk mitigation prospectively because the very information that would aid such an analysis is only generated after shareholder value is destroyed. Indeed, If MIM and shareholder peers wield influence effectively, in part through proxy voting, then risks will not materialize.

The risks MIM tries to address through proxy voting are material though difficult to quantify. Climate change is the prime example as a report from the U.S. Commodity Futures Trading Commission recently demonstrated. The report makes clear that climate change is a major risk to the U.S. financial system, with known risks such as disorderly price adjustments and unknown risks due to the rapidly advancing nature of climate change.[2]

As the U.S. Commodity Futures Trading Commission acknowledges in its comprehensive report – climate change is both a material risk and there is a significant gap in information available about the issue that makes 'economic' analysis difficult. Proxy voting decisions encouraging firms to disclose management of climate risks and related data will help provide the market with the information needed to address the significant risk which the U.S. Futures and Trading Commission recognizes in its report. As such, the Department should recognize that a prudent fiduciary should consider the risks acknowledged by the U.S. Commodity Futures Trading Commission.

Without the flexibility to mitigate risk through proxy voting at issuers and, more broadly, across portfolios, the proposed rule may also have the unintended consequence of introducing risk and volatility to ERISA plans over the long-term. As stated above, the proposed rule discourages voting purely to mitigate risk. As ERISA fiduciaries and their delegates step back from proxy voting to comply with requirements of the proposed rule many corporations will lose the valuable feedback to, and oversight of, firm management that proxy voting provides. Issuers will no longer benefit from the benefit of a check on risk management provided by the significant group of shareholders represented through ERISA plan ownership. As scrutiny of boards and management teams through proxy voting dwindles then issuers may become less risk averse or ignore certain risks altogether. Ultimately, this will lead to increased risk and volatility in ERISA plans to the detriment of plan beneficiaries.

The proposed rule, however, limits proxy voting by fiduciaries only to those situations that fiduciaries 'prudently determine *will* affect the economic value of the plan's investment…'. This language and requirement hamstrings fiduciaries from voting to mitigate risks that may, or may not, come to fruition. Indeed, the Department encourages fiduciaries to mitigate risk in other areas.[3] The Department should encourage fiduciaries of ERISA plans to mitigate risk in proxy voting as well.

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[2] *Managing Climate Risk in the U.S. Financial System – Report of the Climate-Related Market Risk Subcommittee, Market Risk Advisory Committee of the U.S. Commodity Futures Trading Commission.* September 2020. 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.

[3] *See ERISA Fiduciary Advisor: What Are Fiduciary Responsibilities.* "Plan assets should be diversified to minimize the risk of large investment losses." https://webapps.dol.gov/elaws/ebsa/fiduciary/q4b.htm.

Determining the Economic Impact of Voting May be Impossible in Some Instances

There are decision points regarding the exercise of shareholder rights where fiduciaries and their delegates simply do not have enough information to perform a cost/benefit analysis as to whether they should vote. The most pertinent example is when shares are on loan. Fees from share lending are a means of improving the performance of ERISA plans. When shares are lent, however, the lender can lose voting rights if those shares are on loan on, or around, the record date for an upcoming shareholder meeting. On the record date, however, when a fiduciary must decide whether to recall shares, or restrict them from being lent, issuers have not yet released their shareholder meeting agenda. On, or around, the record date shareholders must decide whether to preserve voting rights and forgo lending revenue without the benefit of knowing what matters are to be voted upon. An 'economic' or cost/benefit analysis regarding voting versus lending is impossible to perform in this situation.

The proposal's criteria for determining the economic impact of a proxy vote is too narrow. The Department should expand the criteria for voting to include issuer risk-based factors that "promote long-term growth and maximize return on ERISA plan assets." Absent such an expansion, the Department should characterize the rule as a safe harbor. The rule should also be characterized such that liability relief is provided for voting on patently economic issues. And where issues are not patently economic, the Department should make clear that fiduciaries shall not be prohibited from voting on such issues when, after prudent consideration, they believe voting will benefit plan investors.

The Proposed Rule Does Not Consider How Voting on 'Non-Economic' Proposals Benefits Plan Performance

Proxy voting decisions can be non-economic on their face, but lead to results that are economic in nature. Technically a request for a report or information on diversity data or management practices is not necessarily an 'economic' decision. Indeed, in many instances shareholders may suspect that requested information could have a material impact on performance, but without information they cannot determine one way or the other whether a certain factor has a material impact on firm performance.

Proposals requesting data on gender, ethnic and racial diversity are one such example. Issuers have been faced with shareholder proposals requesting information on gender, racial and ethnic diversity for at least the past decade. Issuer responses to these requests have, over time, created the very data set that investors needed to make economic assessments where there was no information before. The resulting data not only helped demonstrate that firm diversity is correlated with firm outperformance, but also provided information that managers can use to compare performance of investment options.[4]

The proposed rule discourages voting on proposals that, at least traditionally, appear non-financial on

[4] *Diversity Wins: How Inclusion Matters,* McKinsey & Company, May 2020, "we found that the higher the representation, the higher the likelihood of outperformance. Companies with more than 30 percent women on their executive teams are significantly more likely to outperform those with between 10 and 30 percent women, and these companies in turn are more likely to outperform those with fewer or no women executives… In the case of ethnic and cultural diversity, the findings are equally compelling. We found that companies in the top quartile outperformed those in the fourth by 36 percent in terms of profitability in 2019, slightly up from 33 percent in 2017 and 35 percent in 2014. https://www.mckinsey.com/featured-insights/diversity-and-inclusion/diversity-wins-how-inclusion-matters.

their face, but may lead to material and relevant information about firm performance. The proposed rule decreases the likelihood that such information will be public and deprives fiduciaries and their delegates of significant price signals and data that can help ERISA managers find shareholder value and outperformance.

The Proposed Rule Will Amplify the Voice of Activist Holders

The increased burden of reviewing proxy votes will likely cause many plan asset managers to more frequently abstain in proxy voting. Activist investors, who do not manage plan assets and whose motivations are often purely non-economic, will continue to vote. The influence of activist shareholders on issuers will, therefore, be amplified.

This will be especially true for proxy proposals that are tallied based on a shares cast, rather than a shares outstanding, voting standard. The 'shares cast' standard only tallies those votes actually submitted for a given proposal and passage usually occurs if a majority of those votes cast approve a proposal. If fewer votes are cast, then those who do vote have a greater influence on the outcome. Moreover, this voting standard is often applied to some of the more contentious proxy voting proposals including advisory votes on compensation, shareholder proposals and director elections.[5] Ultimately, ERISA beneficiaries will suffer as corporations are influenced by activists who focus on short-term returns.

We urge the Department to withdraw the Proposed rule.

MIM appreciates the opportunity to comment on the Proposed rule and hopes that the Department finds these comments helpful and constructive. Please contact us if you wish to discuss these comments further or if we can provide any additional assistance.

Sincerely,

/S/ Peter Mennie

Peter Mennie
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[5] *An Overview of Vote Requirements at U.S. Meetings*, Kosmas Papadopoulos, ISS Analytics, 2019, "Advisory votes on compensation, shareholder proposals (which are also precatory in nature), equity compensation plan approvals, and auditor appointments are generally based on votes cast…" https://corpgov.law.harvard.edu/2019/07/06/an-overview-of-vote-requirements-at-u-s-meetings/.