Via email to rule-comments@sec.gov [or method you choose]

1/20/2019

Vanessa A. Countryman
Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

RE: Proposed Rule on Procedural Requirements and Resubmission Thresholds Under Exchange Act Rule 14a-8; File Number S7-23-19

Dear Ms. Countryman:

On behalf of Impax Asset Management LLC, I welcome the opportunity to provide this comment letter on the "Proposed Rule on Procedural Requirements and Resubmission Thresholds Under Exchange Act Rule 14a-8," File Number S7-23-19. We are the investment adviser to the Pax World Funds. We have advised the Pax World Funds since 1971.

Overall, the SEC's proposed changes to Rule 14a-8 are, in our view, not warranted by the purported costs to companies or investors, particularly in view of the fact that shareholder proposals have benefits that are not adequately acknowledged in the rulemaking proposal. Because of its superficial analysis of the benefits of the shareholder proposal system as it exists, and by using very dated and often anecdotal cost estimates based on a biased selection of shareholder proposals to portray the costs of all shareholder proposals, the SEC rule has failed to comply with its own guidance on economic analysis in economic rulemakings.[1]

The SEC characterizes the existing process as one that is both costly and burdensome, acknowledges only briefly that there may be benefits to company engagement with shareholders, and suggests that there are other channels by which companies can engage with or hear the concerns of shareholders that are less onerous. We believe that this proposed rulemaking likely significantly overstates the costs and burden and provides a significantly biased underestimation of the benefits of the process.

We urge the SEC not to adopt the changes in this proposed rule. We believe that adopting these changes, or any variant that would significantly curb investors' ability to communicate and engage with companies through shareholder proposals, could serve to isolate management and boards from emerging and existing societal concerns, and would impair the ability of directors to hear diverse perspectives that can and, in fact, have been helpful in building the long-term performance and resilience of companies.

A solution in search of a problem

More generally, this rule proposal is framed as though there were a significant and rising threat to corporate and shareholder well-being from shareholder proposals. The empirical evidence does not support this. Thus, the proposed rule has not established the existence of a market failure that justifies the rule change, as recommended by the SEC's guidance for rulemakings.[2] The big picture shows that the number of proposals filed is falling, shareholder support (in the form of votes) for shareholder resolutions is rising, and the

[1] "Current Guidance on Economic Analysis in SEC Rulemakings," Securities and Exchange Commission, March 16, 2012. https://www.sec.gov/divisions/riskfin/rsfi_guidance_econ_analy_secrulemaking.pdf.
[2] Ibid.

nonbinding nature of shareholder proposals means that most of what companies spend to deal with them is discretionary, not mandatory. This is not the portrait of a problem affecting business performance.

Overall, the number of shareholder proposals is falling, as the SEC's own data on pages 74-5 of the proposal shows, and the likelihood that any company will receive even one shareholder proposal in a given year is low and sinking. Even among the companies most likely to be the recipient of a proposal, e.g., S&P 500 companies, the average number of proposals a company received dropped from 1.85 in 2004 to 1.24 in 2018.[3] The fact that generally less than half of these proposals go to a shareholder vote makes the impacts on companies and other investors even smaller. In short, if this is considered the economic baseline for the action, as recommended in the guidelines for economic analysis in rulemakings, it does not establish the existence of a problem in need of a solution.

Furthermore, almost all shareholder proposals filed in the United States are nonbinding, meaning that even if they pass, companies are not obliged to implement them. That makes shareholder proposals a very good channel for companies to hear about investor interests and concerns without being straitjackets that significantly limit companies' options, something that goes almost unmentioned in the proposed rule. Typically, more than half of all shareholder proposals do not end up on the company's proxy to be voted at the annual shareholder meeting[4]; nearly 40% are withdrawn prior to the publication of the proxy, and the vast majority of withdrawals are the result of an agreement between the filer and the company that is mutually agreeable. In short, it is not necessary for companies to incur any significant expense in dealing with shareholder proposals, except for the expense of putting them in the proxy. One shareholder proposal adds at most 500 words to a proxy statement, or essentially one page per proposal in a ballot that averages 80 pages in length for Russell 3000 companies.[5] If companies do not wish to spend money on these proposals, all they have to do is put them on the proxy ballot. For the companies that choose to engage, there is no obligation to spend money on outside legal counsel. Finally, companies already must record and report on the votes on each issue in every proxy, so the incremental expense of tabulating and reporting votes on shareholder proposals is likely tiny.

For those proposals that do make it to a vote, vote counts in favor of the proposals have been rising, indicating that increasing proportions of investors see these as worth companies' and directors' attention. Data from ISS Analytics show that the median support for shareholder proposals rose from 23.3% in 2003 to 33.4% in 2018.[6]

Taken together, again, this is not the picture of a problem in need of a solution. The SEC has failed to establish a need for change as required under its own guidance on economic analysis, and particularly has not justified a change as impactful as the SEC's proposed changes, which, according to analysis would block nearly a third of

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[3] That does not mean that every company in the S&P 500 gets a shareholder proposal each year. According to the ISS Voting Analytics Database, there were on average 836 proposals filed at 386 companies each year between 2004 and 2017, meaning that the average for companies that received proposals was 2.1. Most companies in the S&P 500 get none. Source: Council of Institutional Investors, "Frequently Asked Questions about Shareholder Proposals." https://www.cii.org/files/10_10_Shareholder_Proposal_FAQ(2).pdf

[4] Council of Institutional Investors, "Frequently Asked Questions about Shareholder Proposals," states, "Less than half of all submitted proposals actually go to a vote. Out of the 11,706 proposals that the ISS database tracked between 2004 and 2017, only 5,342 of these shareholder proposals (46%) went to a shareholder vote. The SEC permitted companies to omit 1,741 proposals (15%). The remaining proposals were withdrawn after mutually agreeable outcomes with companies or otherwise did not go to a vote." https://www.cii.org/files/10_10_Shareholder_Proposal__FAQ(2).pdf

[5] Stanford Graduate School of Business, RR Donnelley, Equilar and Rock Center for Corporate Governance, "2015 Investor Survey: Deconstructing Proxy Statements — What Matters to Investors," https://www.gsb.stanford.edu/sites/gsb/files/publication-pdf/cgri-survyey-2015-deconstructing-proxy-statements_0.pdf.

[6] Kosmas Papadopoulous, ISS Analytics, "The Long View: U.S. Proxy Voting Trends on E&S Issues from 2008 to 2018," Harvard Law School Forum on Corporate Governance, Jan. 31, 2019.

the environmental, social and governance (ESG) shareholder proposals voted at annual meetings in 2019.[7] The SEC's own calculations[8] of the rule's cost savings—which, as noted below, are based on very limited and likely misleading cost estimates—are $70.6 million for all Russell 3000 companies, or less than $24,000 per company. Even using poorly supported and overestimated costs, the SEC's estimate of $70.6 million in cost savings falls below the threshold established for an economically significant or "major" rule, defined as any regulation likely to result in economic savings of at least $100 million, which in today's dollars would be more than $292 million.[9] If the agency's own cost calculations do not reach the threshold of a "major" rule, it is difficult to see why a change is needed and casts doubt on the existence of a market failure.

The SEC's Economic Analysis Relies on Irrelevant, Short-term Market Reactions and Fails To Include Analysis of Relevant Long-Term Effects of Shareholder Engagement and Proposals

Short term or long term

The proposed rulemaking notes in footnote 214 that "We focus our discussion on short-term market reactions to shareholder proposals because findings on the long-term effects are less reliable than the findings on the short-term effects as it can be hard to attribute the long-term effects to the shareholder proposals." The rulemaking proposal then summarizes a few studies that examine short-term impacts of shareholder proposals (either votes or appeals for no-action relief) that largely depend on event studies, measuring the impact on stock prices over a window that typically lasts only a few days following a defined event, such as announcements of shareholder votes or publication of letters to the SEC requesting no-action relief.

It is indeed difficult to attribute financial performance to *any* single factor over the long term, as time spans involving months or years always involve multiple moving parts affecting company performance. Nevertheless, investors are always looking for ways to add value over months to years in their portfolios, and much of portfolio construction focuses on what adds value (or doesn't) over longer time spans. That is why statistical techniques such as multiple regression and difference-in-difference studies are done — to isolate the impact of certain factors. More to the point, however, time spans of a few days are rarely all that relevant for investors, especially in today's markets, where so much investing is passive and involves long-term holding periods. What happens to a stock price over an event window of three or seven days is far less important to investors than long-term performance. In addition, short-term stock price movements are really measures of immediate investor sentiment and are not necessarily good indicators of the long-term performance of companies, which are better measured by indicators that are about what the company is doing, such as return on equity or assets, Tobin's Q and measures of volatility and risk. Using longer-term measures gives a better picture of the true economic impacts of shareholder proposals and the engagements they enable.

Looking at longer term performance, there is abundant evidence that the topics that form the major focus of many shareholder proposals correlate with superior financial performance in portfolios. The SEC's proposed rule notes in passing that there is some evidence of longer-term positive impacts, but consideration of those long-term impacts is far more important to most investors—particularly as more and more investors rely on

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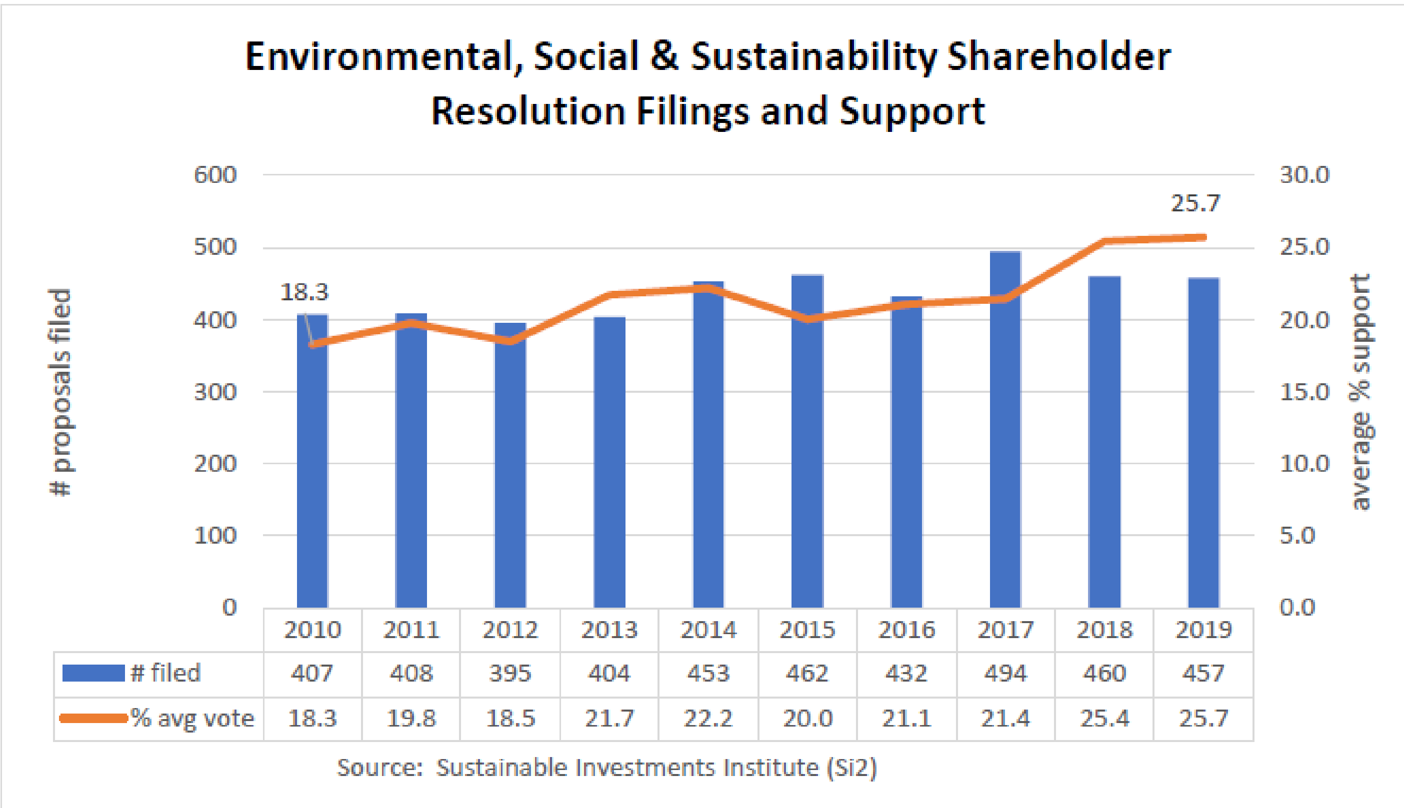
[7] Esther Whieldon, "SEC Proposed Rule Would Have Blocked 614 ESG Resolutions Since 2010, Data Shows," S&P Global Market Intelligence, Jan. 6, 2020.

[8] Securities and Exchange Commission, 17 CRF Part 240, "Procedural Requirements and Resubmission Thresholder Under Exchange Act Rule 14a-8," pp. 137-138.

[9] Maeve P. Carey, "Cost-Benefit and Other Analysis Requirements in the Rulemaking Process," Dec. 9, 2014. https://fas.org/sgp/crs/misc/R41974.pdf. As the SEC applied an inflation factor to other monetary figures in the proposed rule, we do so here as well, using the CPI Inflation Calculator from BLS as the SEC does in its proposed rule.

passive funds with longer holding periods—than the short-term results studies noted in the proposal. Inattention to these more relevant figures is another indication that the rulemaking proposal has not adequately assessed the existing baseline, as required in its guidance for economic analysis in rulemaking.

We will focus here mainly on the environmental and social shareholder proposals, which account for about half of shareholder proposals filed. The number of these sustainability-related proposals filed at U.S. companies since 2010 has risen modestly, from 407 in 2010 to 454 in 2019, according to the Sustainable Investments Institute.[10] So, too, has investor interest in them: Average votes in favor of these proposals has risen from 18.3% of all sustainability proposals that went to vote in 2010 to 25.6% in favor in 2019.



Source: Sustainable Investments Institute, "Social & Environmental Shareholder Proposals at U.S. Companies," October 2019.

The benefits of sustainability

Shareholder interest in sustainability has been rising as the business and financial case for sustainability has improved, a factor that likely underlies the rising vote counts, and the basis of around half of all shareholder proposals filed over the past few years. We have for many years collected academic and financial studies that link various aspects of sustainability to financial performance, and we now have nearly 700 such studies, the majority of which find that incorporating sustainability into portfolios or company operations is almost always correlated with comparable or superior financial performance, both for companies and for portfolios.

Examples of recent, relevant studies are below, with relevant excerpts or abstracts. Links to each study are footnoted. A longer list of such studies is appended to this letter.

[10] Sustainable Investments Institute, "Social & Environmental Shareholder Proposals at U.S. Companies," October 2019.

Studies linking sustainability to investment outcomes

1. Bank of America Merrill Lynch, "ESG from A to Z: A Global Primer," Nov. 25, 2019.[11] "Environmental, Social and Governance considerations are not optional for investors. Our primer provides quantitative evidence that incorporating ESG into one's investment approach can enhance returns and reduce risk…Our research suggests that corporate responsibility drives operating results. ESG metrics are the strongest predictors of earnings risk we have found, and they have systematically signaled stronger ROE…"
2. Cornerstone Capital Group, "Sacrifice Nothing: A Fresh Look at Investment Performance of Sustainable and Impact Strategies by Asset Class," 2019.[12] "Despite decades of competitive returns, a "myth" persists that sustainable and impact investment strategies financially underperform conventional strategies. We recently conducted a fresh review of the academic and practitioner literature on this topic. Sampling from 2,200 reports published over the past few decades, our review provides assurance that applying an ESG lens is consistent with fiduciary duty."
3. Gautam Dhingra, PhD, CFA, and Christopher J. Olson, CFA, "ESG Investing: Can You Have Your Cake and Eat It Too?", Sept. 3, 2019.[13] "So do companies with high ESG ratings outperform their lower-ranked counterparts? For insight on this, we created a High ESG Portfolio composed of S&P 500 companies that score above the median and a Low ESG Portfolio made up of firms that rate below it... We found that the High ESG Portfolio outperformed the Low ESG Portfolio by 16 basis points (bps) per year…Additional testing of the Quality factor suggests an association of high ESG scores with higher quality. Anecdotally, the High ESG Portfolio adds value more often during stock market declines. The correlation between stock market returns and the value added by the High ESG Portfolio over the Low ESG Portfolio is –0.27. This is statistically significant, with a t-statistic of 3.16. The phenomenon was most pronounced during the global financial crisis (GFC) in 2008 and the sharp recovery of 2009."
4. Christopher Geczy, John Guerard and Mikhail Samonov, "Efficient SRI/ESG Portfolios," July 30, 2019.[14] "We find that incorporation of ESG criteria can enhance stockholder returns holding risk constant under reasonable assumptions. The novel approach here uses a normalization of ESG strengths and weaknesses ratings, applied in both robust simply-weighted and realistic optimized portfolio settings… SRI/ESG investors may not have to expect lower portfolio returns and Sharpe Ratios."
5. Morgan Stanley Institute for Sustainable Investing, "Sustainable Reality: Analyzing Risk and Returns of Sustainable Funds," 2019.[15] "Can you invest sustainably without sacrificing financial returns? Research conducted on the performance of nearly 11,000 mutual funds from 2004 to 2019 shows that there is no financial trade-off in the returns of sustainable funds compared to traditional funds, and they demonstrate lower downside risk."

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[11] https://www.bofaml.com/content/dam/boamlimages/documents/articles/ID19_12722/ESG_from_A_to_Z.pdf and https://about.bankofamerica.com/en-us/what-guides-us/esg-a-z-report.html#fbid=8f8eV6yEmJA.

[12] https://cornerstonecapinc.com/wp-content/uploads/Sacrifice-Nothing_A-Fresh-Look-at-Performance.pdf

[13] https://blogs.cfainstitute.org/investor/2019/09/03/esg-investing-can-you-have-your-cake-and-eat-it-too/?s_cid=eml_Enterprising&mkt_tok=eyJpIjoiWkRVNVpqY3daVFl3TmpReiIsInQiOiI0elE5czlGTVliU3BIY0RESEVKV0NuNG5wRW4rM0g1d2ZxNW1CNG40ZGpUcm53YWRPTVdGXC9KRXFRXC8xSXBXMzVPbEY5ZXRLQnhxTytmdit2OG53d2gxeXV4akdhZmJIdVVmWkhnWDNlUmZnemRSRXZuU2VKK08wdDNtR0R2dWVHIn0%3D

[14] https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3011644&dgcid=ejournal_htmlemail_wharton:research:data:services:(wrds):research:paper:series_abstractlink

[15] https://www.morganstanley.com/content/dam/msdotcom/ideas/sustainable-investing-offers-financial-performance-lowered-risk/Sustainable_Reality_Analyzing_Risk_and_Returns_of_Sustainable_Funds.pdf

6. Gunnar Friede, Timo Busch and Alexander Bassen, "ESG and Financial Performance: Aggregated Evidence from More Than 2,000 Empirical Studies," Journal of Sustainable Finance & Investment, 5:4, 2015.[16] "The search for a relation between environmental, social, and governance (ESG) criteria and corporate financial performance (CFP) can be traced back to the beginning of the 1970s. Scholars and investors have published more than 2,000 empirical studies and several review studies on this relation since then…the study combines the findings of about 2,200 individual studies. Hence, this study is by far the most exhaustive overview of academic research on this topic and allows for generalizable statements. The results show that the business case for ESG investing is empirically very well founded. Roughly 90% of studies find a non-negative ESG–CFP relation. More importantly, the large majority of studies reports positive findings. We highlight that the positive ESG impact on CFP appears stable over time. Promising results are obtained when differentiating for portfolio and non-portfolio studies, regions and young asset classes for ESG investing such as emerging markets, corporate bonds and green real estate."

Studies linking sustainability to company financial performance

1. Hans Bonde Christensen, Luzi Hail and Christian Leuz, "Adoption of CSR and Sustainability Reporting Standards: Economic Analysis and Review," European Corporate Governance Institute – Finance Working Paper No. 623/2019, July 31, 2019.[17] "…We derive and evaluate possible economic consequences, including capital-market effects for select stakeholders as well as potential firm responses and real effects in firm behavior…This literature suggests that more and better (CSR) information can benefit capital markets through greater liquidity, lower cost of capital and better capital allocation. In addition, corporate disclosures can have real effects on firms' own operations and activities. Such real effects seem particularly relevant in a CSR context as one of the goals of CSR reporting could be exactly to influence firms' CSR activities and policies in a certain way."
2. Aneta Pintekova and Jiri Kukacka, "Corporate Social Responsibility and Stock Prices After the Financial Crisis: The Role of Primary Strategic CSR Activities," 2019.[18] "We analyze the relationship between corporate social responsibility and the stock market performance of U.S. companies in the post-global financial crisis period. A new measure of social responsibility, called the Thomson Reuters Environmental, Social, Governance, and Controversies Score (TRESGC Score), is used. The results of the fixed effects regression show a positive and statistically, as well as economically, significant impact of the TRESGC Score on the financial results of companies."
3. Societe Generale, "ESG rating and Momentum," March 5, 2019.[19] "Traditionally, asset managers have used environmental, social and governance ratings in a defensive way to mitigate portfolio risk, but the model ESG portfolio we have run over the past five years has consistently outperformed the index (and by 27.7% over the full period). Also note that the top-rated 10% of our ESG stocks outperformed in all 11 of the 11 semiannual periods since it was launched."
4. Barclays, "The Case for Sustainable Bond Investing Strengthens," Oct. 22, 2018.[20] "We confirm our 2016 findings that tilting a credit portfolio in favor of high-ESG bonds, while keeping all other risk characteristics unchanged, tends to lead to higher performance in all three markets considered."

[16] https://www.tandfonline.com/doi/pdf/10.1080/20430795.2015.1118917
[17] https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3427748
[18] https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3380881
[19] https://corpgov.law.harvard.edu/wp-content/uploads/2019/03/esg-momentum_SGCIB.pdf
[20] https://www.investmentbank.barclays.com/content/dam/barclaysmicrosites/ibpublic/documents/our-insights/ESG2/BarclaysIB-ImpactSeries4-ESG-in-credit-5MB.pdf

5. George Serafeim, “Public Sentiment and the Price of Corporate Sustainability,” Harvard Business School Accounting & Management Unit Working Paper No. 19-044, October 19, 2018.[21] “Combining corporate sustainability performance scores based on environmental, social and governance (ESG) data with big data measuring public sentiment about a company’s sustainability performance, I find that the valuation premium paid for companies with strong sustainability performance has increased over time and that the premium is increasing as a function of positive public sentiment momentum. An ESG factor going long on firms with superior or increasing sustainability performance and negative sentiment momentum and short on firms with inferior or decreasing sustainability performance and positive sentiment momentum delivers significant positive alpha.”
6. Muhammad Suhail Rizwan, Asfia Obaid and Sawood Ashraf, “The Impact of Corporate Social Responsibility on Default Risk: Empirical evidence from U.S. firms,” Business & Economic Review 9(3), January 2018.[22] “This paper investigates the risk-mitigation effects of engagement in corporate social responsibility (CSR) activities by using data from 1,119 non-financial U.S. firms between 2000 and 2012. We find evidence that firms with higher CSR activity scores experience lower probability-of-default. However, the credit mitigation effect of CSR is more pronounced with activities related to primary stakeholders (employee relations, product quality, diversity and governance)… This study provides robust evidence that engagement and disclosure of CSR-related activities reduces credit risk, suggesting that both management and investors can use socially responsible behavior as a pricing factor.”

Note that these are only a few of the studies produced during the last few years. There is a larger literature that comprises hundreds of papers and studies that link sustainability with superior financial performance, or at least no penalty to financial performance. The above-mentioned studies deal with the relationship between sustainability and financial performance for companies and funds, supporting the case that shareholder proposals on topics such as reporting and managing risks of climate change, environmental impact, the opioid crisis, human rights, gender pay equality and work/life benefits are relevant and material issues to investors and worthy of consideration in the boardrooms of American companies.

There are also studies that look at the longer-term results of ESG engagements. We include studies that look at the impact of engagement, not just shareholder proposals. It is becoming well established that company/investor engagements on sustainability and other issues is often positive for both parties, and there are many times when the only way to have a substantive engagement with a company is to file a shareholder proposal. While the SEC’s proposed rule includes new requirements that the filer of a proposal must provide details on that filer’s availability for dialogue, there are no similar requirements for companies. That is misguided, in our view. Over many years of engaging with companies, we find that more often than not, our attempts to engage on material sustainability and governance issues is unsuccessful because of non-response from the companies we contact. For example, in the recent past we at Pax World Funds sent letters to 66 companies in the technology and financials sectors asking for information about how they were managing gender pay equity. Ten of those 66 companies responded to our letters. Often, we file shareholder proposals after attempts to engage with a company have been met with silence. Curtailing shareholder proposals, which this proposed rule would do, could also curtail companies’ incentives to engage and, thus, reduce the substantial benefits of engagement for both companies and investors.

[21] https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3265502
[22] https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3074531

Notable papers linking engagement with financial outcomes include the following.

- Craig Mackenzie, William Rees and Tatiana Rodionova, "The FTSE4Good Effect: The Impact of Responsible Investment Indices on Environmental Management," Social Science Research Network, December 2015.[23] "This paper provides results consistent with the proposition that engagement by and threat of deletion from a responsible investment index motivated persistent improvements to corporate environmental management practices, especially for firms where the threat of exclusion from the index was likely to be costly. We use the natural experiment provided by the FTSE4Good upgrade of their environmental management criteria in 2002 **when they engaged with index member firms** that would not meet the new requirements but did not engage with non-member firms that would similarly fail. By 2005, 49% of the 388 large and internationally diverse firms that had received engagement and been threatened with exclusion from the FTSE4Good index had complied, as opposed to 23% of the 658 firms which were not subject to engagement or potential exclusion. This result is statistically significant even after controlling for environmental risk, industry, country, governance and financial performance. Further results indicate that the effect of FTSE engagement produces a difference in compliance which persists for at least five years." (emphasis added)
- Beiting Cheng, Ioannis Ioannou and George Serafeim, "Corporate Social Responsibility and Access to Finance," Harvard Business School Working Knowledge, July 22, 2011.[24] "In this paper, we investigate whether superior performance on corporate social responsibility (CSR) strategies leads to better access to finance. We hypothesize that better access to finance can be attributed to reduced agency costs, **due to enhanced stakeholder engagement** through CSR, and reduced informational asymmetries, due to increased transparency through non-financial reporting. Using a large cross-section of firms, we show that firms with better CSR performance face significantly lower capital constraints. The results are confirmed using an instrumental variables and simultaneous equations approach. Finally, we find that the relation is primarily driven by social and environmental performance, rather than corporate governance." (emphasis added)
- Robert G. Eccles, Ioannis Ioannou and George Serafeim, "The Impact of Corporate Culture of Sustainability on Corporate Behavior and Performance," Social Science Research Network, March 2012.[25] "We investigate the effect of a corporate culture of sustainability on multiple facets of corporate behavior and performance outcomes. Using a matched sample of 180 companies, we find that corporations that voluntarily adopted environmental and social policies many years ago – termed as High Sustainability companies — exhibit fundamentally different characteristics from a matched sample of firms that adopted almost none of these policies — termed as Low Sustainability companies. In particular, we find that the boards of directors of these companies are more likely to be responsible for sustainability and top executive incentives are more likely to be a function of sustainability metrics. Moreover, they are more likely to have **organized procedures for stakeholder engagement**, to be more long-term oriented and to exhibit better measurement and disclosure of nonfinancial information. Finally, we provide evidence that High Sustainability companies significantly outperform their counterparts over the long-term, both in terms of stock market and accounting performance." (emphasis added)

[23] https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1966474
[24] https://hbswk.hbs.edu/item/corporate-social-responsibility-and-access-to-finance
[25] https://www.researchgate.net/publication/256017116_The_Impact_of_Corporate_Culture_of_Sustainability_on_Corporate_Behavior_and_Performance

- Brad M. Barber, "Monitoring the Monitor: Evaluating CalPERS' Activism," Social Science Research Network, March 2006.[26] "Many public pension funds engage in institutional activism. These funds use the power of their pooled ownership of publicly traded stocks to affect changes in the corporations they own. I review the theory and empirical evidence underlying the motivation for institutional activism. In theory, the merits of institutional activism hinge critically on two agency costs: (1) the conflicts of interest between corporate managers and shareholders, and (2) the conflicts of interest between portfolio managers and investors. This leads to two types of institutional activism — shareholder activism and social activism. While portfolio managers can use their position to monitor conflicts that might arise between managers and shareholders (shareholder activism), they can also abuse their position by pursuing actions that advance their own moral values or political interests at the expense of investors (social activism). Which of these effects dominates the actions of portfolio managers will determine the value of activism and is an empirical issue. Perhaps the most high-profile activism has been pursued by CalPERS with their annual focus list. I document that CalPERS has pursued reforms at focus list firms that would increase shareholder rights and (imprecisely) **estimate the total wealth creation from this shareholder activism to be $3.1 billion between 1992 and 2005**. Unrelated to the focus list program, CalPERS has also pursued social activism (e.g., the divestment of tobacco stocks). In general, I argue that institutional activism should be limited shareholder activism where there is strong theoretical and empirical evidence indicating the proposed reforms will increase shareholder value. At times, institutions will be forced to engage in social activism and take positions on sensitive issues. In these situations, I argue portfolio managers should pursue the moral values or political interests of their investors rather than themselves." (emphasis added)
- Elroy Dimsona, Oğuzhan Karakaş and Xi Li, "Active Ownership," Review of Financial Studies (RFS) Volume 28, Issue 12, 2015.[27] "We analyze an extensive proprietary database of corporate social responsibility engagements with U.S. public companies over 1999–2009. **Engagements address environmental, social and governance concerns. They are followed by a one-year abnormal return that averages +1.8%, comprising +4.4% for successful and zero for unsuccessful engagements**. We document outperformance following environmental/social, as well as governance, engagements. Companies are more likely to be engaged, and success of engagements is more probable, if the target firm is concerned about its reputation and if it has higher capacity to implement changes. After successful engagements, companies experience improvements in operating performance, profitability, efficiency, and governance." (emphasis added)
- Andrew Junkin, "Update to the 'CalPERS Effect' on Targeted Company Share Prices," Wilshire Associates working paper, September 24, 2013.[28] "For the three years prior to the "initiative date," the engaged companies produced returns that averaged 38.91% below the Russell 1000 Index on a cumulative basis, and 36.13% below the respective Russell 1000 sector indices. **For the five years after the "initiative date," the average engaged companies produced excess returns of 12.27% above the Russell 1000 Index and 8.90% above the respective Russell 1000 sector indices on a cumulative basis**." (emphasis added)
- Tamas Barko, Martijn Cremers and Luc Renneboog, "Activism on Corporate Social Responsibility," European Corporate Governance Institute (ECGI) Finance Working Paper No. 509/2017, TILEC Discussion Paper No. DP 2017-021, May 2017.[29] "We study investor activism promoting

[26] https://papers.ssrn.com/sol3/papers.cfm?abstract_id=890321
[27] https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2154724
[28] https://www.sristudies.org/junkin2013
[29] https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2977219

environmental, social and governance (ESG) improvements by means of a proprietary dataset covering 660 companies globally over 2005-2014. Targets have a higher market share, analyst coverage, stock returns, and liquidity. The engagements lead to significant ESG rating adjustments. Activism is more likely to succeed for companies with a good ex ante ESG track record and with lower ownership concentration and growth. **Successful engagements positively affect sales growth, without changing profitability. Targets outperform matched firms by 2.7% over 6 months post-engagement, while the (ex ante) lowest ESG quartile earns an extra 7.5% over 1 year."** (emphasis added)

- S. Lakshmi Maaraayanan, Kunal Sachdeva and Varun Sharma, "The Real Effects of Environmental Activist Investing," Social Science Research Network, December 2019. "Using a socially-motivated activist campaign by a large pension fund, we measure the real effects of activist investing on pollution and the environment. **Targeted firms reduced their total toxic chemical releases, production-related emissions, cancer-causing pollution, environmental accidents and legal risks. These effects do not come at the expense of lower financial performance or returns.** We rule out natural alternative hypotheses while also presenting evidence supporting the external validity of socially motivated activism. These findings suggest that **shareholders can delegate their pro-social preferences onto firms to maximize their total value between their financial and non-pecuniary benefits**." (emphasis added)

The SEC's proposal is based on a flawed estimate of the costs of the shareholder proposal process

Several of the papers summarized above note that successful engagements are correlated with improved financial performance, or at least do not impair financial performance. We believe that theme in the literature is worthy of special attention, particularly in considering this rulemaking. Successful engagements are those in which the company and the shareholder are able to discuss the issue at hand and agree on a mutually acceptable course forward. Most of the shareholder proposals that are withdrawn can be considered successful engagements. We believe that most of these withdrawn proposals do not involve the company incurring the kinds of costs cited in the proposed rule: They are usually not submitted to the SEC for no-action relief, and are not included in the proxy, which avoids printing, electronic distribution and vote tabulation costs. In short, many of these withdrawn proposals involve only the investment of some time on the part of shareholder proponents and company representatives, and that investment of time is often rewarded by improved financial performance.

The SEC itself, in its 1997 amendments to rules on shareholder proposals, notes that "A company that receives a proposal has no obligation to make a submission under rule 14a-8 unless it intends to exclude the proposal from its proxy materials. Accordingly, any costs of including an additional proposal should be offset, at least partially, by not having to make a rule 14a-8 submission. No commenters responded to our request for empirical data on the potential cost savings."[30] Yet this new proposed rule makes little mention of the lack of empirical data on potential cost savings for proposals that were not submitted to the SEC for no-action relief.

That also illustrates another drawback of the proposed rule, which appears not to recognize that many of the purported costs are discretionary. Even if a company does not engage, simply putting the proposal on the proxy and allowing a vote need not incur legal expenses or a significant investment of time on the part of company management or counsel.

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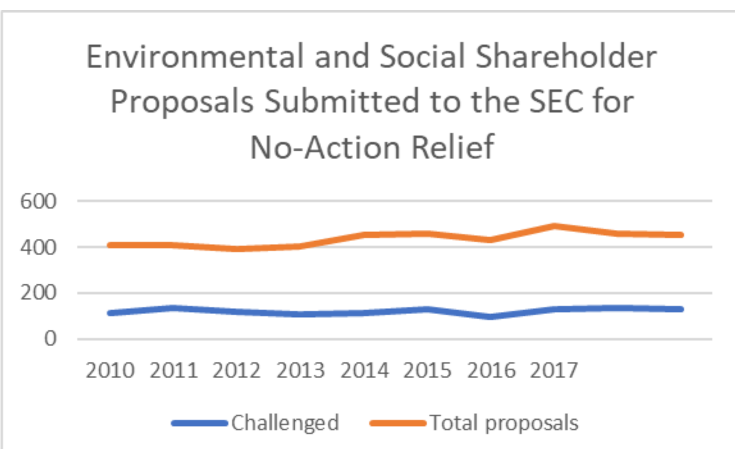
[30] "Final Rule: Amendments to Rules on Shareholder Proposals," 17 CFR Part 240, Release No. 43-40018; IC-23200; File No. S7-25-97. https://www.sec.gov/rules/final/34-40018.htm

Evidence is lacking and atypical

There is very little empirical evidence for the *average* cost companies incur to deal with a shareholder proposal in the proposed rule. The SEC's guidance on economic analysis for rulemakings states that the cost estimates should include essentially all costs: direct, indirect and compliance costs, as well as distributional and competitive effects, collateral consequences, and opportunity costs. Yet the proposed rule relies almost entirely on a very small number of anecdotes and previous studies and surveys conducted more than a decade ago, and based on a sample that is not representative of more than half of all shareholder proposals filed. This does not fulfill the guidance that stipulates consideration of a wider range of costs.

Footnote 312 alludes to letters from various firms and associations, several of which refer to an earlier estimate that companies spend an average of $87,000 on each shareholder proposal.[31] What most of them fail to mention is that this estimate has a caveat: It assumes that every company that received one or more of the 1,042 proposals submitted in 2003 sought to have them excluded by the SEC. That inconsistency is also overlooked by the author of the paper, who says, "Corporations currently must expend considerable sums on shareholder proposals under Rule 14a-8." The author seems not to understand that companies are not obliged to seek an SEC determination on whether to include proposals in their proxies. We do not have information about how many companies sought no-action relief in 2003, but we do have more recent figures. In 2018, there were 788 shareholder proposals filed,[32] and 256 of them were submitted to the SEC for no-action relief.[33] About 36% of companies asked to omit these proposals from their proxies. Of the social and environmental shareholder proposals filed over the past 10 years, between 23% and 33% have been submitted to the SEC for no-action relief. (See figure below.) In all cases, deciding to ask for this relief, and spending money on legal costs to support the request, is a discretionary expense, not a mandatory one. Applying the estimated cost figures developed *only* by looking at a sample of companies that did appeal for no-action relief to all shareholder proposals, where in all cases a majority do *not* ask to omit the proposals from the proxies, is quite inappropriate.



Data provided by Heidi Welsh, Sustainable Investments Institute, 2019.

At Pax World Funds, we have filed many shareholder proposals, and the majority of the time we are able to withdraw these proposals by reaching a mutually acceptable agreement with management. We have never asked for legal help in conducting these dialogues, and we are not aware that the company representatives

[31] Stephen M. Bainbridge, "Corporations: A Comment on the SEC's Shareholder Access Proposal," 2003. https://www.sec.gov/comments/4-537/smbainbridge7785.pdf

[32] "Shareholder Proposal Developments During the 2018 Proxy Season," Gibson Dunn, July 12, 2018.

[33] "Our Perspective: SEC Should Truly Take "No Action" on Rule 14a-8 Shareholder Proposal Requests," Jones Day, Aug. 2019. https://www.jonesday.com/en/insights/2019/08/our-perspective-sec-should-truly-take

that we spoke with were doing so on the advice of counsel; most of the time, it takes only one or two conversations, over a short period of time, to reach an agreement with a company. Similarly, when we have submitted shareholder proposals to companies that do not wish to dialogue, we have never had any indication that they were acting on the advice of counsel; they simply put the proposals on their proxies for shareholders to vote on. In short, nothing in our experience with shareholder proposals gives us any indication that companies are spending tens of thousands of dollars to deal with those proposals. We know this is not comprehensive data, but since the rule proposal cites many individual-company anecdotes, it seemed appropriate for us to include our own experience as well.

Finally, we take great exception to the SEC's characterization of the opportunity costs of shareholder proposals. The proposed rule states, "In addition, companies and their shareholders may bear opportunity costs associated with considering proposals that are ultimately not supported by a majority of shareholder or implemented by a company instead of engaging in other value-enhancing activities." In fact, there is abundant evidence that the issues most shareholder proposals deal with—matters such as poison pills, proxy access, majority voting, board diversity, climate risk, environmental impact, product liability and political spending—are material to many shareholders, and the time spent by shareholders reading shareholder proposals (which are limited by regulation to 500 words, approximately a page) may help to acquaint them with the impact of that issue on company performance and risk. That may very well be value-enhancing, and while it is not possible to evaluate that proposition empirically, it is similarly empirically impossible to demonstrate that time spent reading and voting on shareholder proposals is less-value enhancing than all the other things investors and company representatives do with their time.

The example of climate risk is pertinent here. Investors have been growing increasingly concerned about the risks that climate change poses to companies and investments: Regulatory risk, litigation risk, reputational risk, physical risk and transition risk are all important considerations for investors these days. There are various estimates of the value at risk from climate change, nearly all of them measured in the trillions or tens of trillions of dollars in the long term, and often are hundreds of billions of dollars in real time.[34] The Bank for International Settlements warned in January 2020 that central banks should be aware of and should prepare for the risks climate change poses to the financial system, saying "Both physical and transition risks … can increase systemic financial risk. Thus, their potential consequences have implications for central banks' financial stability mandate."[35] Investors who are unaware of this burgeoning set of risks may not be pricing those risks correctly in portfolio construction, and to the extent that they learn of the potential for such risks to occur through reading shareholder proposals, those proposals are more likely to protect shareholder value than diminish it. Over the past three years, shareholders have filed 238 proposals related to climate risk with

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[34] See, for example, "The Cost of Inaction: Recognizing the Value At Risk from Climate Change," The Economist Intelligence Unit, 2015. https://eiuperspectives.economist.com/sites/default/files/The%20cost%20of%20inaction_0.pdf; "How Rising Carbon Prices Could Cut Company Profits," Schroders, https://www.schroders.com/en/ch/asset-management/literature/climate-change-dashboard/carbon-var/; "Getting Physical: Assessing Climate Risks," BlackRock Investment Institute, April 2019. https://www.blackrock.com/us/individual/insights/blackrock-investment-institute/physical-climate-risks; "Climate Risk and Response: Physical Hazards and Socioeconomic Impacts," McKinsey Global Institute, 2019. https://www.mckinsey.com/~/media/McKinsey/Business%20Functions/Sustainability/Our%20Insights/Climate%20risk%20and%20response%20Physical%20hazards%20and%20socioeconomic%20impacts/MGI-Climate-risk-and-response-vF.ashx; and "Weathering the Storm: Integrating Climate Resilience Into Real Assets Investing," 2018. https://www.morganstanley.com/pub/content/dam/msdotcom/ideas/climate-resilience/CRC-2638838_Weathering-Storm-2019.pdf.

[35] Graham Cooper, "BIS Warns of 'Green Swan' Events," Environmental Finance, Jan. 21, 2020. https://www.environmental-finance.com/content/news/bis-warns-of-green-swan-events.html?utm_source=220120na&utm_medium=email&utm_campaign=alert; and Bank for International Settlements, "The Green Swan," January 20, 2020. https://www.bis.org/publ/othp31.pdf

publicly traded companies (90 in 2017, 85 in 2018, and 63 in 2019), of which 88 were included in company proxies and voted.[36] Reading 88 500-word proposals and voting on them over a three-year period is not an onerous burden for investors, and may well have significant educational value.

Significant stakes

The proposed rule also conveys the impression that the only threshold that matters is 50%: If shareholder proposals do not pass, it is suggested that they are therefore not of interest to shareholders. That is not necessarily appropriate; there are many other thresholds in the world of investing that are used as indicators of significant interest. Moreover, many companies have implemented things suggested in shareholder proposals despite not achieving a majority vote. Consider, for example, that there have only been a handful of climate-risk proposals that have passed, but more and more companies are responding to the risks and opportunities that climate change poses; as just one example, 785 organizations, including some of the world's largest banks, asset managers and pension funds, are supporters of the Task Force on Climate-Related Financial Disclosure (TCFD), and more than 1,100 companies from 142 countries have produced TCFD reports over the past three years. The supporters of TCFD alone are responsible for assets totaling more than $118 trillion.[37] If a majority vote were the only indicator of significant investor interest in climate risk, it is impossible to explain the large and growing investor interest in the topic.

In fact, there are many ownership thresholds that are commonly used to identify significant interest and stakes in a company. For example:

- Schedule 13D: An investor that acquires or has the right to acquire within 60 days beneficial ownership 5% of a class of voting equity is required to file a 13D report
- Shareholders who own more than 10% of an issuer's equity or otherwise possess significant influence over management may not resell their shares unless the resale is registered under the Securities Act of 1933 or is subject to an exemption from its registration requirement.
- An investor may need to file a form 8-K if it pays for securities that exceed 10% of the company's consolidated assets.
- An investor that owns 20% or more of a company's voting stock, but less then 50%, is presumed to have significant influence over the company and is usually required to use the equity method in its accounting.[38]

These examples illustrate that having an interest that companies should pay attention to is not limited to majority ownership alone.

Finally, it is also worth noting that the 50% threshold may be subject to tampering. A 2017 paper by Bach and Metzger notes that "it is well known that corporate elections do not even closely resemble political elections of modern democracies (Bebchuk, 2007). Managers of public corporations have considerably greater ability to constrain the set of choices made available to voters. They also have more discretion over the amount and the quality of information that voters can access. What is somewhat less known is that the management of big U.S. corporations also has an extraordinary advantage in the campaigning process, as it holds privileged access

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[36] Data were provided by Heidi Welsh, Sustainable Investments Institute.

[37] "Task Force on Climate-related Financial Disclosures: Status Report," 2019. https://www.fsb-tcfd.org/wp-content/uploads/2019/06/2019-TCFD-Status-Report-FINAL-053119.pdf.

[38] These examples are taken from B Jeffrey Bell, "Checkpoints: The Consequences of Crossing Various Ownership Thresholds When Investing," Morrison Foerster LLP, October 3, 2013. https://www.jdsupra.com/legalnews/checkpoints-the-consequences-of-crossin-18329/

to the identity of voters and to partial vote tallies in real time." Since 2003, there have been approximately 75% more shareholder proposals rejected by a margin of one percent of shares outstanding than those that pass by the same narrow margin. The paper estimates that about 11% of the proposals that have been rejected by a margin of less than 10% would have passed if management hadn't had its thumb on the scale.[39] Bach and Metzger identify several mechanisms by which management may influence the voting process.

Finally, even when shareholder proposals do get a majority vote, they need not be implemented, and sometimes are not. While this is not common, it has happened several times. We suggest that the SEC considering eliminating refiling thresholds for companies that have had a majority of shareholders vote for a shareholder proposal on their proxy, but have not implemented the changes the proposal asked for.

Thank you for your attention to these matters. In sum, we believe that the shareholder process functions well to bring important, timely issues worthy of company and shareholder concern to the attention of company management and boards. The system is not broken; it is not onerous; the costs are not burdensome even as overestimated in the proposed rule; and the benefits, real and potential, are substantial.

Sincerely,

Julie Gorte

[39] Laurent Bach and Daniel Metzger, "Are Shareholder Votes Rigged?" Harvard Law School Forum on Corporate Governance, Jan. 4, 2017. https://corpgov.law.harvard.edu/2017/01/04/are-shareholder-votes-rigged/, and Laurent Bach and Daniel Metzger, "How Close Are Close Shareholder Votes?", Swedish House of Finance Research Paper No. 17-3, rev. Nov. 2018.