

Pension Fund Activism:

Can Labor Maintain Its Momentum in Light of Declining Defined Benefit Funds?

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Headlines have chronicled the decline of the defined benefit (DB) plans (also called pension plans) over the last few decades. “Are Defined Benefit Plans Dead?,” asks the Society of Human Resource Management,² while *The Los Angeles Times* belatedly announces “Pensions are Losing Popularity.”³ Employee Benefits Advisers announces “More firms freezing, closing DB plans,”⁴ and *The Wall Street Journal* explains “Why Pensions’ Last Defense is Eroding.”⁵

The demise of defined benefit plans has serious consequences, primarily the shifting of risk of investment loss from the employer to the employee, resulting in retirement insecurity among workers and retirees. This paper, however, asks whether the decline in defined benefit plan assets results in a corresponding decline in the power of activist union trustees to compel corporate boards to take act in the long-term economic best interests of workers and society.

The introductory section will provide statistics on the decline in pension fund assets and the corresponding rise in defined contribution (DC) and mutual fund assets. The second section will discuss the Department of Labor’s Interpretive Bulletin on shareholder activism. The final section will examine whether the decline in DB assets and funds and the interpretive bulletin will have a lasting impact on pension fund activism.

PART I: RELEVANT STATISTICS

The Decline in Defined Benefit Plans

Since 1983, employers have been shifting *en masse* from offering DB plans to DC plans. The Employee Benefits Research Institute reports that in 1975, 28% of all private sector workers participated in only a DB plan, 10% participated in both a DB and DC plan, and 7% participated

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² Joanne Sammer, *Are Defined Benefit Plans Dead?*, Society for Human Resource Management, July 1, 2012, available at <https://www.shrm.org/hr-today/news/hr-magazine/pages/0712sammer.aspx> (visited Nov. 25, 2016).

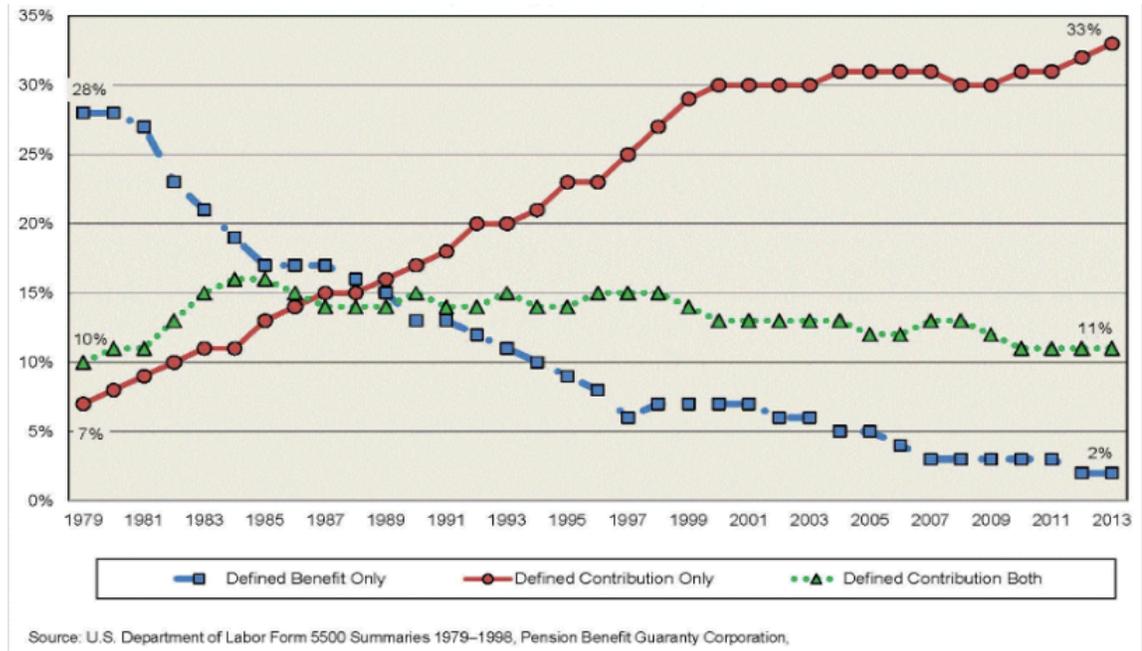
³ Liz Pulliam Weston, *Pensions are Losing Popularity*, *Los Angeles Times*, Dec. 9, 2016, available at <http://www.latimes.com/la-plan4retire-story1a-story.html> (visited Dec. 9, 2016).

⁴ Paula Aven Gladych, *Employee Benefits Advisers Announces “More firms freezing, closing DB plans,”* Nov. 28, 2016. <http://www.employeebenefitadviser.com/news/more-firms-freezing-closing-db-plans> (visited Dec. 9, 2016).

⁵ Timothy W. Martin, *Why Pensions’ Last Defense is Eroding*, *WALL STREET JOURNAL*, June 25, 2016, available at <http://www.wsj.com/articles/pension-returns-slump-squeezing-states-and-cities-1469488579> (visited Dec. 9, 2016).

in only a DC contribution plan.⁶ By 2011, only 2% of all private sector workers participated in a DB plan, 11% in a DB and DC plan, and 33% in only a DC plan.⁷ Of those who participated in both a DB and DC plan in 2011, 44% participated in a DC plan and 13% in a DB plan.⁸

Figure 1 Private Sector Workers Participating in Employment-Based Retirement Plans, By Plan Type, 1979-2013 (Among All Workers)



Source: Employee Benefits Research Institute, Table, Percentage of Private-Sector Workers Participating in an Employment-Based Retirement System, by Plan, 1979-2013, available at <https://www.ebri.org/publications/benfaq/index.cfm?fa=retfaq14fig1> (visited Nov. 25, 2016).

Willis Tower Watson reports that "[a]pproximately 90% of employers that sponsored traditional DB plans in 1998 have changed the retirement benefit for new hires since then;"⁹ by 2015, 47% froze or closed their DB plan and now offer a DC-only plan to new employees and "43% amended the traditional DB plan to a hybrid DB design."¹⁰ This has resulted in a decline in

⁶ Employee Benefits Research Institute, *Fast Facts*, #225, at Table, Private-Sector Workers Participating in an Employment-Based Retirement Plan, by Plan Type, 1979-2011 (Among All Workers) (Mar. 28, 2013).

⁷ *Id.*

⁸ *Id.*

⁹ *Id.* at 4.

¹⁰ *Id.*

DB plan assets in the private sector. In 1979, private sector DC plans held 30% of U.S. plan assets and DB plans held 70%.¹¹ By 2013, this had nearly flipped: 64% of plan assets were held in DC and only 34% in DB plans:¹²

Figure 2 DC and DB Plan Assets as a Percentage of the Whole, All Private Sector Plans, 1976-201

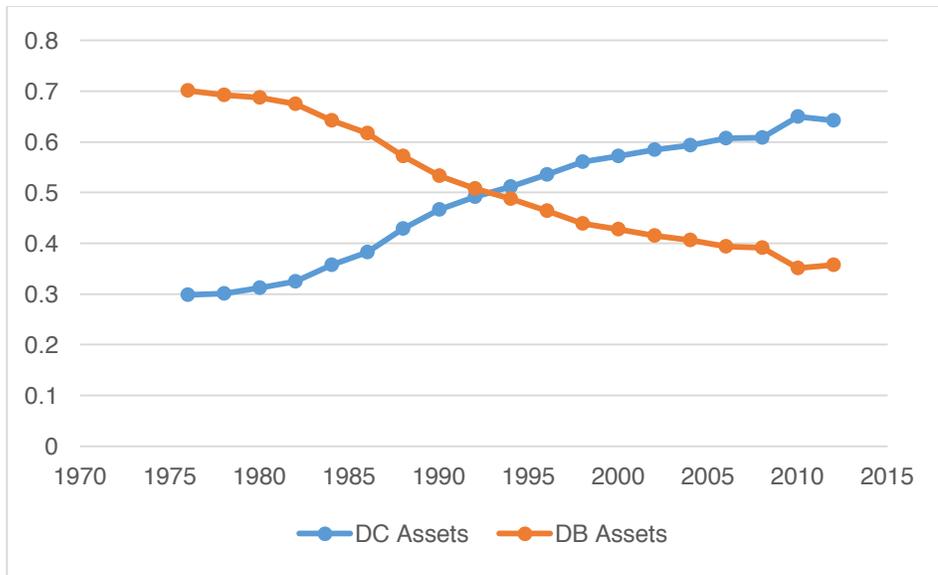


Chart Created from Data Provided in Colin Gordon, *The Pension Pinch*, Dissent Magazine, Nov. 12, 2015, at Chart: The Disappearance of Defined-Benefit Pension.

The decline in DB plans sponsored by public sector employees is less drastic. In 1987, almost 93% of government employees participated in DB plans; this decreased to 82% by 2015.¹³ During the same period, public sector DB plan participation increased from 9% to 17%.¹⁴

Historically, unions have negotiated defined benefit plans. The Bureau of Labor Statistics found that 72% of unionized workers had access to a defined benefit plan in March 2015, in

¹¹ Colin Gordon, *The Pension Pinch*, DISSENT MAGAZINE, Nov. 12, 2015, at Chart: The Disappearance of Defined-Benefit Pension, at <https://www.dissentmagazine.org/blog/pension-pinch-united-states-retirement-security-failing> (visited Dec. 9, 2016).

¹² Brendan McFarland, *A Continuing Shift in Retirement Offerings in the Fortune 500*, in Willis Towers Watson Insider, Vol. 26, No. 2 (Feb. 18, 2016), at Figure 1: Retirement Plan Sponsorship Trends: 1998-2015, at 5, Figure 7: Plans offered to new hired by industry in 1998 versus 2015.

¹³ Employee Benefits Research Institute, *Fast Facts*, #225, at Table 5.1d (National Compensation Survey) Retirement Plan Participation (updated Oct. 2015).

¹⁴ *Id.*

comparison with 13% of non-union private sector workers.¹⁵ Participation rates are highest among unionized workers: 91% compared with 52% of non-union workers.¹⁶ In 2015, approximately 20% of Fortune 500 employers offered employees a DB plan, down from 59.3% in 1998. In 2015, 80% of Fortune 500 companies offered only a DC plan almost double the 40.6% of corporations that offered only a DC plan in 1998.¹⁷

The transition from DB to DC plans is greatest in the aerospace and defense industry: all five of the Fortune 500 aerospace/defense contractors have shifted from a traditional DB plus DC plan to a DC only plan.¹⁸ Tourism companies also shifted: in 1998, 11% of companies offered traditional DB plans plus DC plans, by 2015 100% offered DC plans.¹⁹ In 1998, 74% of food and beverage companies offered a tradition DB plus a DC plan; by 2015 this had reversed: 74% now offer a DC plan only. Manufacturing companies also froze out their DB plans at an alarming rate. In 1998, 67% of Fortune 500 manufacturing companies offered a traditional DB plan plus DC plan, whereas by 2015, 79% offered DC only.²⁰ In contrast, in the utility industry, which is heavily unionized, half of the companies still offer DB plans to new employees.²¹

As assets in DC plans have increased, so have assets in mutual funds because DC plans offer participants a menu of investment funds in which they can invest their account assets; these are usually managed by mutual funds.

¹⁵ Richard Works, *Trends in Employer Costs for Defined Benefit Plans*, in Bureau of Labor Statistics, *Beyond the Numbers*, Vol. 5, No. 2 (Feb. 2016), at 3.

¹⁶ Works, at Table 3: Percentage of workers participating in defined benefit plans; select detailed provisions, private industry, March 2014, at 7.

¹⁷ McFarland, at 2, Figure 1: Retirement Plan Sponsorship Trends: 1998-2015. Of those that have a defined benefit plan, 24% offer a traditional DB plan and 76% offer a hybrid plan. *Id.*

¹⁸ *Id.* at 5, Figure 7: Plans offered to new hired by industry in 1998 versus 2015.

¹⁹ *Id.*

²⁰ *Id.*

²¹ *Id.*

Figure 3 Comparison of Largest U.S. Pension Plans and Mutual Funds by Assets (in billions), 2015

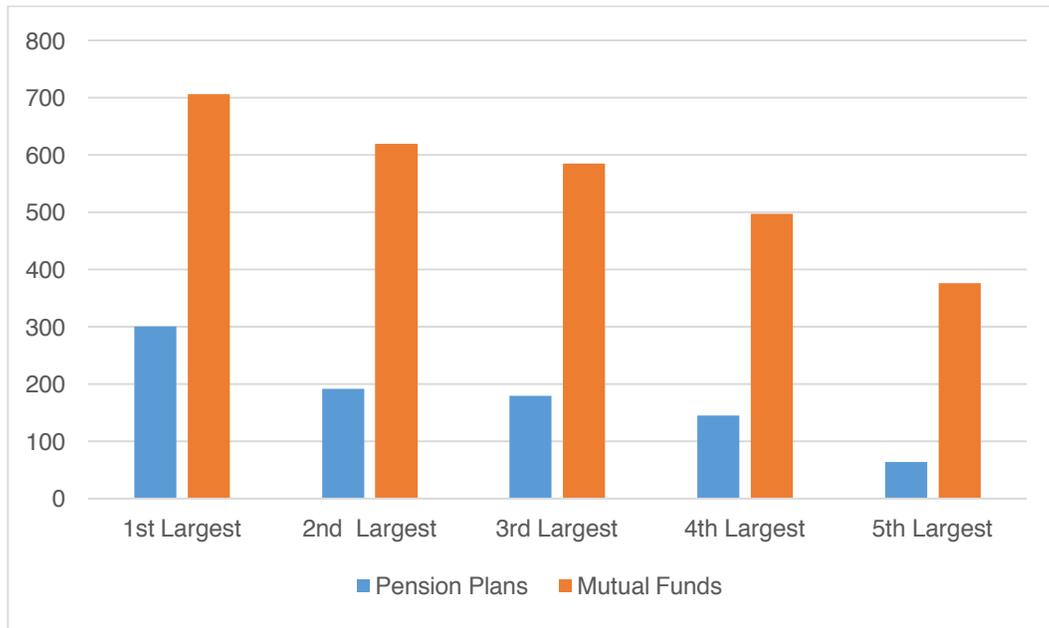


Chart Created from Data Provided by Pensions & Investment Online, 2016.

Thus, mutual fund assets now dwarf pension plan assets, making them a potentially more powerful player in the markets. As will be seen below, until the last few years, mutual funds have been reluctant to exercise this power.

The Increase in Retirement Fund Assets and Declining Investment in Equities

U.S. retirement assets totaled 24.5 trillion as of July 1, 2016.²² Of this amount, 7.5 trillion is in Individual Retirement Accounts (IRAs), 7 trillion is in 403(b) plans, 457 plans, and private DC plans, 2.8 trillion in private sector DB plans, 5.2 trillion in governmental DB plans, and 2 trillion in annuities.²³ 59% (2.9 trillion) of the funds invested in 401(k) plans and 48% of IRA assets are invested in mutual funds.²⁴

²² Investment Company Institute, *Retirement Assets Total \$24.5 Trillion in Second Quarter 2016* (Sept. 26, 2016), available at https://www.ici.org/research/stats/retirement/ret_16_q2 (visited Dec. 14, 2016).

²³ *Id.*

²⁴ *Id.*

Figure 4 Percentage of Retirement Assets, by Type, in Trillions, 2016

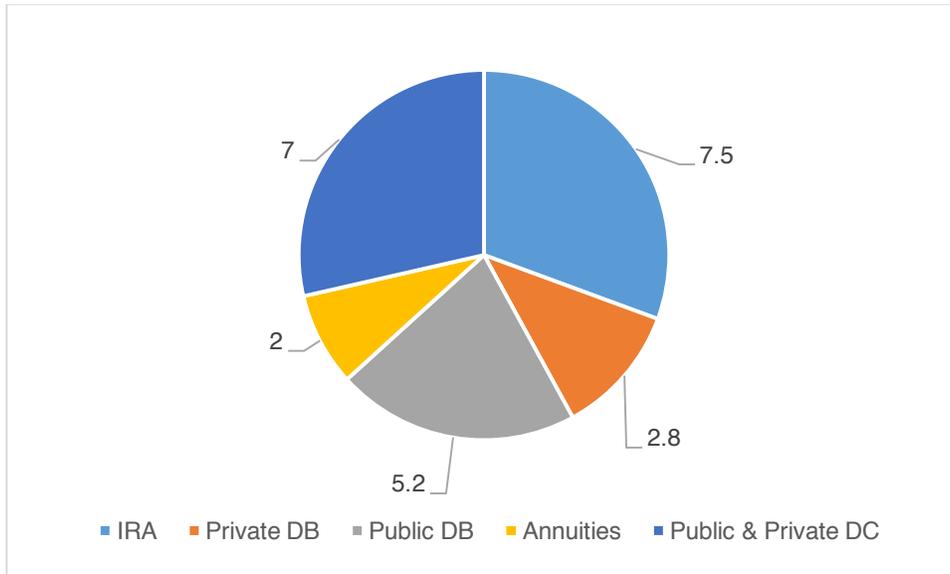


Chart Created from Data Provided by Investment Company Institute, Retirement Assets Total \$24.5 Trillion in Second Quarter 2016 (Sept. 26, 2016).

Willis Towers Watson reports that globally, over the ten-year period ending in 2015, assets of DC plans have grown at a rate of 7.1% per year compared with DB plan annual growth rate of 3.4%.²⁵ U.S. plans invested approximately 47% of assets in equities,²⁶ down from 61% in 2005.²⁷

Table 1 Percentage of U.S. Pension Assets Invested in Equities, 2005-2015

Year	2005	2010	2015
Percent	61	48	47

Table Created from Data Provided in Willis Towers Watson, Global Pension Assets Study, 2016.

Increased Concentration of Corporate Stock by Institutional Investors

Institutional investors have held an increasingly concentrated share of the U.S. equity market since 1950, when they held 6.1% of the market.²⁸ This amount increased tenfold to

²⁵ Willis Towers Watson, *Global Pension Assets Study*, 2016, at 5 (2015).

²⁶ *Id.* at 7, Asset Allocation Table.

²⁷ *Id.* at 28, Table: Pension Asset Allocation, U.S.

²⁸ The Conference Board, *The 2007 Institutional Investment Report: Trends in Institutional Investor Assets and Equity Ownership of U.S. Corporations*, at Table 10: Institutional investor holding of outstanding equity, 1950-2005.

61.2% in 2005.²⁹ In 2005, institutional investors owned 59.5% of the Top 100 U.S. corporations and 67.9% of the 1000 largest U.S. corporations.³⁰ On average, in 2015, the 10 largest institutional shareholders of an S& P 500 company own 44.7% of the company's stock.³¹ Ownership of a 5% block of corporate stock is widely recognized as the "required threshold for shareholder activist to be able to exert influence over target companies."³² JPMorgan notes that ownership of as little as 1% of a corporation may be enough for an activist to pressure corporate boards to make changes.³³

In 2005, five pension funds were ranked among the top 25 largest institutional holders of the top 25 Fortune 100 companies.³⁴ By 2016, only the New York State Common Retirement Fund was one of the largest 25 holders of the stock of the Fortune 25 companies.³⁵

Table 2 Pension Plans that Are Ranked in Top 25 Institutional Investors of Top 25 Fortune 100 Companies, 2003 and 2016

	2003	2016
<i>NYS Common Retirement Fund</i>	5	1
<i>NYS Teachers Retirement Fund</i>	6	0
<i>CalPERS</i>	11	0
<i>CalSTERS</i>	2	0
<i>Texas Teachers</i>	2	0

Table Created from Data Provided by Mergent Online, 2016.

In 2003, the top 4 mutual funds by assets (Vanguard, Barclays, Fidelity and State Street) were the largest institutional holders of the Fortune 25 companies.³⁶ Only Fidelity held the stock of 24 of the Fortune 25 companies. By 2016, the top 4 funds (Vanguard, State Street, BlackRock, and Fidelity) were the largest holders and all except Fidelity held stock of 24 of the top 25 companies.³⁷

²⁹ *Id.*

³⁰ *Id.* at Table 18: Institutional investor concentration of ownership in the top 1,000 U.S. corporations, 1987-2005.

³¹ David Benoit & Kirsten Grind, *Activist Investors' Secret Ally: Big Mutual Funds*, WALL STREET JOURNAL, Aug. 9, 2015.

³² J.P. Morgan, *The activist revolution: Understanding and navigating a new world of heightened investor scrutiny*, at 6 (Jan. 2015), available at <https://www.jpmorgan.com/jpmpdf/1320693986586.pdf> (visited Dec. 15, 2016).

³³ *Id.*

³⁴ See Jayne Zanglein and Ethan Schlisserman, *Pension Fund Capitalism: The Pension Revolution Wall Street Noticed*, NYU REVIEW OF EXECUTIVE COMPENSATION AND EMPLOYEE BENEFITS (2004).

³⁵ Mergent Online, accessed Dec. 13, 2015.

³⁶ *Zanglein & Schlisserman*, at x.

³⁷ Mergent Online, accessed Dec. 13, 2015.

Table 3 Top 4 Largest Mutual Funds that Are Ranked in Top 25 Institutional Investors of Top 25 Fortune 100 Companies, 2003 and 2016

	2003	2016
<i>Vanguard</i>	24	24
<i>Barclays</i>	20	*
<i>Fidelity</i>	18	21
<i>State Street</i>	23	24
<i>Blackrock</i>	*	24

* Not in top 4 for relevant year

Table Created from Data Provided by Mergent Online, 2016

Nearly 30% of mutual funds are indexed.³⁸ These funds own 11.6% of the S&P 500, an increase of 7% since 2006.³⁹ In 2016, 22.4% of S&P companies had more passive mutual fund holders than active ones, up from 2.4% in 2015. Because index funds own a portfolio that mirrors a particular stock index, they cannot sell shares and so they rely on shareholder engagement to effect change.

In the last five years, the percentage of corporate equity held by retail investors has decreased from 35% in 2012 to 30% in 2016.⁴⁰ Sullivan and Cromwell notes that “a critical difference between retail and institutional funds is their voting participation level.”⁴¹ In 2016, 28% of retail-held shares voted, whereas 91% of institutionally-held shares voted.⁴² Because discretionary broker voting is prohibited in uncontested director elections, executive compensation matters, and certain corporate governance measures, Sullivan and Cromwell concludes that these restrictions have increased the influence of institutional investors on the removal of antitakeover provisions.⁴³

PART II: THE DEPARTMENT OF LABOR’S INTERPRETIVE BULLETIN

Fiduciary Duties of Pension Trustees with Respect to Stock Holdings

The Employee Retirement Income Security Act (ERISA) governs the investment of private pension plan assets. Under ERISA, pension fund trustees must act solely in the interest of plan participants and beneficiaries and for the exclusive purpose of providing benefits to

³⁸ *Id.* at 3

³⁹ *Id.*

⁴⁰ Sullivan & Cromwell, *2016 U.S. Shareholder Activism Review and Analysis*, Nov. 28, 2016, at 2, Table: Retail Ownership of Public Company Shares.

⁴¹ *Id.* at 3.

⁴² *Id.*

⁴³ *Id.*

participants and their beneficiaries.⁴⁴ Trustees must also act prudently, that is, “with the care, skill, prudence and diligence under the circumstances then prevailing” that a prudent trustee would use.⁴⁵ This prudence rule extends to trustees’ duties to vote on management and shareholder proposals in their capacity as stockholders.

The Department of Labor has stated that trustees have the duty to vote proxies because the “fiduciary act of managing plan assets that are shares of corporate stock includes the management of voting rights appurtenant to those shares of stock.”⁴⁶ This duty may be delegated to other fiduciaries in accordance with ERISA Section 403(a)(2).⁴⁷ If proxy voting has been delegated to an investment manager, then the investment manager has the exclusive right to vote those proxies, unless the named fiduciary has reserved the right to vote proxies or has delegated this authority to another fiduciary.⁴⁸ If a named fiduciary has retained the right to vote proxies, then the trustees must follow the direction of the named fiduciary in voting the proxies.⁴⁹

In voting proxies, the fiduciary “shall consider only those factors that relate to the economic value of the plan’s investment and shall not subordinate the interests of the participants and beneficiaries in their retirement income to unrelated objectives. Votes shall only be cast in accordance with a plan’s economic interests.”⁵⁰ The fiduciary cannot vote the proxy if “the responsible fiduciary reasonably determines that the cost of voting (including the cost of research, if necessary, to determine how to vote)⁵¹ is likely to exceed the expected economic benefits of voting,⁵² or if the exercise of voting results in the imposition of unwarranted trading or other restrictions. In making this determination, objectives, considerations, and economic effects unrelated to the plan’s economic interests cannot be considered.”⁵³ In particular, the “named fiduciary must carry out this responsibility solely in the participants’ and beneficiaries’ interest in the economic value of the plan assets and without regard to the fiduciary’s relationship

⁴⁴ ERISA Section 404(a)(1)(A). Although public funds are excluded from ERISA coverage, these standards are still applicable as they are contained in the Internal Revenue Code, the Uniform Management of Public Employees Retirement System Act, and state laws, which generally incorporate these duties.

⁴⁵ ERISA Section 404(a)(1)(B).

⁴⁶ Employee Benefits Security Administration, U.S. Department of Labor, Interpretive Bulletin 08-2 (2008), codified at §2509.08-2 (quoting letter from the Department of Labor to Helmut Fandl, Chairman of the Retirement Board of Avon Products, Inc., dated February 23, 1988).

⁴⁷ *Id.* at (1)

⁴⁸ *Id.*

⁴⁹ *Id.*

⁵⁰ *Id.*

⁵¹ The fiduciary must consider the costs of “deciding whether and how to exercise their shareholder rights, including the voting of shares. Such costs include, but are not limited to, expenditures related to developing proxy resolutions, proxy voting services and the analysis of the likely net effect of a particular issue on the economic value of the plan’s investment.” *Id.*

⁵² The costs can be analyzed independently or in conjunction with collective action by other shareholders. *Id.*

⁵³ *Id.*

to the plan sponsor.” This last requirement was added at the urging of the Chamber of Commerce in 2008, when it challenged unions that it believed were using fund assets to achieve union goals.⁵⁴

The Department has noted that ERISA’s exclusive benefit and prudence rules require the named fiduciary to monitor the proxy votes made on the plan’s behalf.⁵⁵ This includes reviewing documentation of proxy voting decisions, any cost-benefit analysis relating to the vote, the investment manager’s proxy voting procedures, and “the actions taken in individual proxy voting situations.”⁵⁶ The Department recommended that fiduciaries adopt a proxy voting policy as part of the plan’s statement of investment policy.⁵⁷ Trustees can condition the hiring of an investment manager on its willingness to follow the plan’s proxy voting policy as long as the guidelines are consistent with ERISA and do not “subordinate the economic interests of the plan participants to unrelated objectives.”⁵⁸ The Department clarified that an investment policy is a plan document that fiduciaries must follow to comply with ERISA’s plan document rule.⁵⁹ In the absence of an investment policy statement with proxy voting guidelines, the investment manager would have the authority to manage assets and vote proxies in its own discretion.⁶⁰

Interpretive Bulletin 08-2 thus allows a trustee take shareholder action if he or she “concludes that there is a reasonable expectation that such monitoring or communication with management, by the plan alone or together with other shareholders, will enhance the economic value of the plan’s investment in the corporation, after taking into account the costs involved.”⁶¹ Shareholder activism is particularly appropriate where a stock portfolio is being held on a long-

⁵⁴ U.S. Department of Labor, Employee Benefits Security Administration, Advisory Opinion No. 2008-05A (June 27, 2008).

⁵⁵ *Id.*

⁵⁶ *Id.*

⁵⁷ *Id.* at (2).

⁵⁸ *Id.*

⁵⁹ *Id.* The Department clarified that:

If the investment manager determines that compliance with one of the conflicting voting policies would violate ERISA Sec. 404(a)(1), for example, by being imprudent or not solely in the economic interest of plan participants, the investment manager would be required to ignore the policy and vote in accordance with ERISA’s obligations. If, however, the investment manager reasonably concludes that application of each plan’s voting policy is consistent with ERISA’s obligations, such as when the policies reflect different but reasonable judgments or when the plans have different economic interests, ERISA Sec. 404(a)(1)(D) would generally require the manager, to the extent permitted by applicable law, to vote the proxies in proportion to each plan’s interest in the pooled investment vehicle. An investment manager may also require participating investors to accept the investment manager’s own investment policy statement, including any statement of proxy voting policy, before they are allowed to invest, which may help to avoid such potential conflicts.

⁶⁰ *Id.*

⁶¹ *Id.* at (3).

term basis or where the plan cannot easily dispose of the stock without affecting the stock's value.⁶² Specifically, the Department encourages trustees to monitor and influence corporations on the:

- Independence of corporate directors;
- Expertise of directors;
- Adequacy of board members' access to information necessary to monitor management;
- Appropriateness of executive compensation;
- Prudence of merger and acquisition policies;
- Extent of debt financing and capitalization;
- Nature of the corporation's long-term business plans;
- Extent of the corporation's investment in workforce training;
- Workplace practices; and
- Financial and non-financial measures of corporate performance that are reasonably likely to affect the economic value of the plan.⁶³

The Department has suggested that trustees can engage in shareholder activism by corresponding and meeting with corporate directors, voting on proxies, sponsoring shareholder proposals, and filing shareholder litigation.⁶⁴ The purpose of the activism, according to the Department, however, must not be "to promote myriad public policy preferences."⁶⁵

Finally, the Department clarified its position on social issues, warning that "fiduciaries risk violating the exclusive purpose rule when they exercise their fiduciary authority in an attempt to further legislative, regulatory or public policy issues through the proxy process."⁶⁶ Before expending plan assets on exercising their rights as shareholders, fiduciaries must "articulate a clear basis for concluding that the proxy vote, the investment policy, or the activity intended to monitor or influence the management of the corporation is more likely than not to enhance the economic value of the plan's investment."⁶⁷ Trustees violate ERISA when they use plan assets to pursue political or policy issues that are not designed to enhance the economic value of the plan's investment in the corporation's stock. For example, the Department said that the use of the proxy process to compel a director to reveal political contributions would likely violate ERISA.

⁶² *Id.* This is especially true where large funds own so great an amount that divestiture of that stock would cause the shares' value to fall.

⁶³ *Id.*

⁶⁴ *Id.*

⁶⁵ *Id.* (quoting Advisory Opinion No. 2008-05A (June 27, 2008) and letter from Department of Labor to Jonathan P. Hiatt, General Counsel, AFL-CIO (May 3, 2005)).

⁶⁶ *Id.* at (4).

⁶⁷ *Id.*

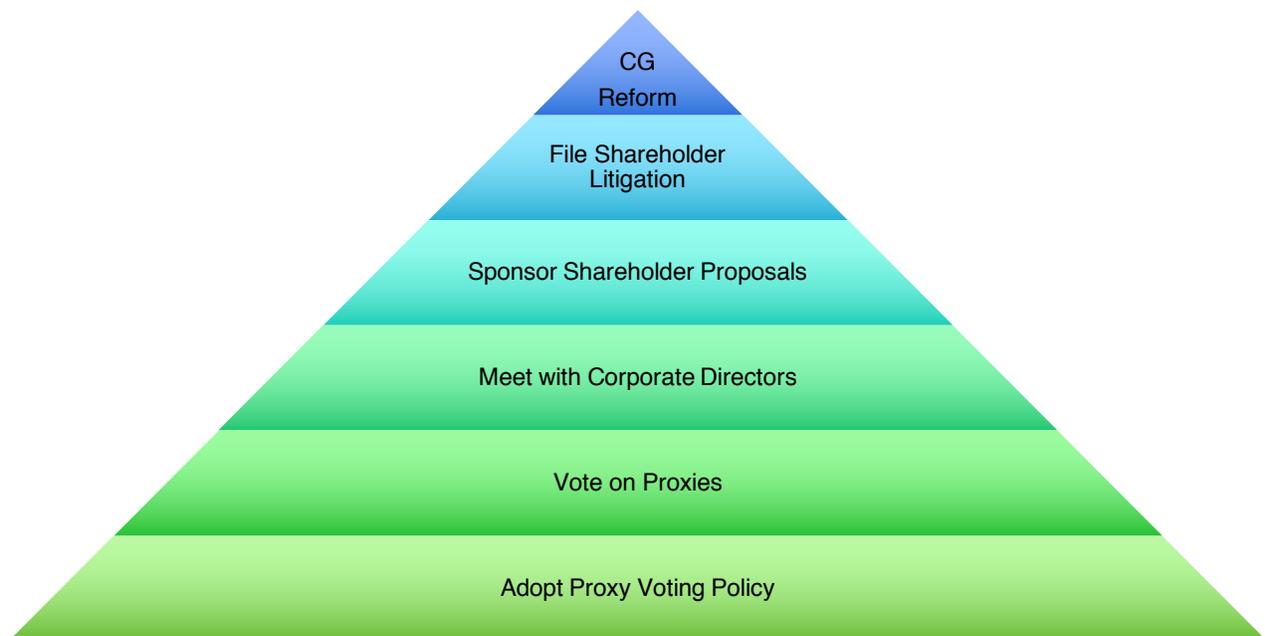
PART III: THE IMPACT OF THE INTERPRETIVE BULLETIN AND DECLINING DB ASSETS ON PENSION FUND ACTIVISM

Pension Fund Activism Under Interpretive Bulletin 08-2

Pension fund activism falls along a continuum. The pressure exerted on corporations ranges “from quiet behind-the-scenes discussions to public no-confidence vote campaigns.”⁶⁸ Some pension funds vote with management on all issues and take no steps to actively monitor corporations. Many funds, however, engage in active monitoring of corporations and lobby for legislative reform. Most funds fall somewhere in the middle—active on some issues and inactive on others.

Interpretive Bulletin 08-2 suggests several types of shareholder activism, ranging from adopting proxy voting policies to initiating shareholder litigation:

Figure 5 Hierarchy of Pension Shareholder Activism



⁶⁸ Harry Wessel, *Disney Vote Underscores Growing Clout of State Pension Plans*, KNIGHT RIDDER TRIBUNE BUSINESS NEWS, Apr. 12, 2004, at 1.

Table 5 Continuum of Pension Fund Activism That May Be Consistent With ERISA

Inactive trustees	Management oriented trustees	Trustees who focus on corporate governance issues	Trustees who encourage corporate accountability	Pension fund activists
<ul style="list-style-type: none"> • No effort to comply with fiduciary standards relating to proxy voting • Has not adopted proxy voting guidelines 	<ul style="list-style-type: none"> • Votes in support of management proposals • Votes for management slate of directors • Uses policy guidelines developed by investment professionals • Delegates proxy voting and corporate governance responsibility to investment professionals • Does not monitor proxy voting by professionals 	<ul style="list-style-type: none"> • Drafts and adopts own proxy voting guidelines • Monitors executive pay • Monitors directors' performance • Monitors proxy voting by professionals 	<ul style="list-style-type: none"> • Adopts principles such as the CERES Principles or the CommonSense Corporate Governance Principles • Encourages corporations to comply with basic workplace standards such as ILO standards • Considers social impact of board decisions • Supports corporate governance legislative reform • Encourages pay for performance 	<ul style="list-style-type: none"> • Engages corporate directors in a dialog about corporate governance issues • Sponsors shareholder proposals • Uses focus lists to encourage better corporate performance • Uses litigation to remedy unlawful corporate conduct • Works toward legislative reform on corporate accountability and financial transparency

These will be examined below.

1. *Proxy Voting Policies*

Although not required by law, it is prudent for every pension fund that invests in corporate equities to adopt a proxy voting policy. Such guidelines are widely available, such as through the AFL-CIO,⁶⁹ Institutional Shareholder Services/GlassLewis,⁷⁰ and CalPERS.⁷¹ Likewise, all pension fund trustees should ensure that fiduciaries vote on shareholder proposals. They should monitor their investment managers to make sure that they are voting in accordance with the proxy guidelines, as this is a plan document.

Recognizing that many trustees do not vote proxies, the AFL-CIO publishes an annual Key Votes Survey which “rates the voting practices of investment managers by surveying how they voted on proposals representing a worker-owner view of value.”⁷² This view “emphasizes management accountability and good corporate governance.”⁷³ The 2015 AFL-CIO’s Key Votes Survey focused on the voting results at 29 companies and found that 19 investment advisors voted 100% in accordance with the AFL-CIO proxy voting guidelines.⁷⁴ 57 companies fell within a middle tier, meaning that they voted from 50-99% in accordance with the AFL-CIO policy.⁷⁵ The bottom tier, consisting of 64 companies, had a voting record of less than 50% in accordance with the AFL-CIO’s guidelines.⁷⁶ 23 investment managers voted for less than 5 proposals, making it impossible to place them in a tier.⁷⁷

The difficulty trustees face is that many of the largest mutual funds do not vote on shareholder proposals. For example, the AFL-CIO Key Votes Survey found that the top 4 mutual fund providers ranked by assets under management all ranked in the bottom tier.

⁶⁹ AFL-CIO, Proxy Voting Guidelines (2012), available at <http://www.aflcio.org/Corporate-Watch/Capital-Stewardship/Proxy-Voting> (visited Dec. 14, 2016).

⁷⁰ Glass Lewis, 2017 Proxy Paper Guidelines, United States, available at http://www.glasslewis.com/wp-content/uploads/2016/11/2017_Guideline_US.pdf (visited Dec. 14, 2016).

⁷¹ The California Public Employees Retirement System, *Global Governance Principles* (Mar. 16, 2015), available at <https://www.calpers.ca.gov/docs/forms-publications/global-principles-corporate-governance.pdf> (visited Dec. 14, 2016).

⁷² AFL-CIO, Proxy Voting, available at <http://www.aflcio.org/Corporate-Watch/Capital-Stewardship/Proxy-Voting> (visited Dec. 14, 2016).

⁷³ *Id.*

⁷⁴ AFL-CIO, *AFL-CIO’s Key Votes Survey, How Investment Managers Voted in the 2015 Proxy Season*, at 11, available at <http://www.aflcio.org/content/download/65871/1747351/2015+AFL-CIO+Key+Votes+Survey+Report.pdf>, (visited Dec. 14, 2016).

⁷⁵ *Id.* at 2, 11-13.

⁷⁶ *Id.* at 2, 13-15.

⁷⁷ *Id.* at 2, 15.

Table 4 AFL-CIO Scorecard for the Top 4 Mutual Fund Providers

<i>Mutual Fund Providers</i>	<i>Number of Key Shareholder Proposals They Voted On</i>	<i>% Voted in Accordance with AFL-CIO Guidelines</i>	<i>Tier</i>
<i>Blackrock</i>	26	30.7	Bottom
<i>Vanguard</i>	27	17.2	Bottom
<i>State Street</i>	19	31	Bottom
<i>Fidelity</i>	3	10.7	Too Few To Rank

Table Created from Data Provided by Mergent Online, 2016.

In 2011, the AFL-CIO created the AFL-CIO Equity Index Fund, a collective investment fund that “promotes good corporate governance through proxy voting and shareholder activism.”⁷⁸ The fund votes all proxies in accordance with the AFL-CIO Proxy Voting Guidelines.⁷⁹ As of December 12, 2016, 124 plans participated in the fund and assets totaled almost \$7 billion.

1. Meetings with Corporate Directors

Larger pension plans may choose to correspond with or meet corporate directors to discuss issues that impact the value of their plan-held stock. For example, since 1987 CalPERS has annually published a focus list of corporations whose corporate governance practices are below standard.⁸⁰ The goal is to improve the stock performance of those companies.⁸¹ In 2014, CalPERS amended the program to focus on domestic and global corporations in which CalPERS has significant share holdings.⁸² CalPERS engages in a dialogue with the directors of these corporations on issues such as board quality, transparency, investor rights, risk management, and executive compensation practices.⁸³ Anne Simpson, director of global governance at CalPERS has helped lead CalPERS away from the more aggressive approach it adopted in the 1990s when

⁷⁸ AFL-CIO Equity Index Fund, *Outperforming the Competition* (Sept. 2013), available at <http://aflcio-indexfund.com/?m=201309> (visited Dec. 14, 2016).

⁷⁹ *Id.*

⁸⁰ CalPERS, Focus List Program, available at <https://www.calpers.ca.gov/page/investments/governance/corporate-engagements/focus-list-program> (visited Dec. 14, 2016).

⁸¹ *Id.*

⁸² *Id.*

⁸³ *Id.*

it wasn't "shy about flexing its muscles."⁸⁴ She says, "We want to engage companies quietly behind the scenes."⁸⁵ Wilshire analyzed the stock performance of the 188 corporations that were been targeted by CalPERS between 1999 and 2013 and found that after being placed on the focus list, the targeted corporations performed 15.27% higher than the Russell 1000 index and 11.90 percent better than their respective Russell 1000 sector indices.⁸⁶ This has been referred to as the "CalPERS effect."⁸⁷

During this shareholder engagement process, the pension fund notifies the firm that they have been targeted and the reason for the target, and requests a meeting. If the firm is cooperative, the pension fund may not file a shareholder proposal, or if a proposal has already been submitted by another shareholder, the fund may withdraw the proposal.⁸⁸ For example, in 2014, the California State Teachers' Retirement System sent letters to one hundred companies to propose changes on compensation and corporate governance issues.⁸⁹ If a corporation did not agree to make the change, CalSTRS filed a shareholder proposal. Most corporations agreed and CalSTRS filed only 4 shareholder proposals, 3 of which garnered majority vote at the next annual shareholder meeting.⁹⁰

A shareholder advocate describes the process: "we engage in dialogue with the company, and if we feel that it isn't being particularly productive, then we use a shareholder resolution as leverage to get the company to the table."⁹¹ Oftentimes, "companies quietly change their policies to avoid public criticism and mollify investors."⁹² *The Economist* says that shareholder activism is "arguably the biggest preoccupation of America's boardrooms."⁹³

The California Public Employees Retirement System, the largest public plan, illustrates the power of large pension plans. In the 1980s, CalPERS "couldn't get the secretary to return our phone calls, much less [get] the director of investor relations to return our phone calls."⁹⁴ By the

⁸⁴ Tracie Woitke, Leonard Bierman, & Christopher Tuggle, *Reining in Activist Funds*, HARVARD BUSINESS REVIEW (Mar. 2003).

⁸⁵ Liz Hoffman & Timothy W. Martin, *Largest U.S. Pensions Divided on Activism*, WALL STREET JOURNAL, May 18, 2015.

⁸⁶ *Id.*

⁸⁷ Tessa Hebb, *No Small Change: Pension Funds and Corporate Engagement*, at 45 (2009).

⁸⁸ *Hoffman and Martin*.

⁸⁹ Steve Marlin, *CalSTRS Plays Role of Shareholder Activist*, MARKETSMEDIA, June 2, 2014, available at <http://marketsmedia.com/calstrs-plays-role-shareholder-activist/> (visited Dec. 15, 2016).

⁹⁰ Georgeson, *ANNUAL CORPORATE GOVERNANCE REVIEW 2014*, at 33 (2014).

⁹¹ Richard Haugh, *Getting the Attention of Big Pharma*, HH & N, Oct. 2003, at 44, 46.

⁹² *Id.*

⁹³ *An investor calls*, THE ECONOMIST, Feb. 7. 2015, available at <http://www.economist.com/news/briefing/21642175-sometimes-ill-mannered-speculative-and-wrong-activists-are-rampant-they-will-change-american>

⁹⁴ Dale Kasler, *California Retirement System Tackles Issues*, KNIGHT RIDDER TRIBUNE BUSINESS NEWS, Dec. 21, 2003, at 1 (quoting CalPERS' spokesperson Pat Macht).

1990's, CalPERS "had become so [large and] powerful that it could make its point with a discreet call."⁹⁵ *Business Week* reported that "Wall Street tends to listen when CalPERS speaks out."⁹⁶

In 2012, the four largest mutual fund families owned 17.4% of S&P 500 companies, by 2016, they owned 21.1%, an increase of 3.7%.⁹⁷ Historically, mutual funds have not engaged in activism or voted against management.⁹⁸ Index managers are regarded as "lazy money," because they follow the market rather than set trends and. Until recently, funds such as BlackRock and Vanguard have not felt the "need to worry about how the firms they invest in are run."⁹⁹ Some mutual funds, such as Fidelity, actively manage their portfolios but "they would rather sell their shares in a struggling firm than face the hassle of fixing it."¹⁰⁰ The *Wall Street Journal* reports that large mutual funds "have long been seen as friends of management who buy stock because they liked what a company is doing. A decade ago, they would rarely even pick up the phone to talk with activists."¹⁰¹

This trend seems to be changing. A 2015 survey found that half of mutual funds surveyed had been contacted by an activist during the last year and 45% of those contacted agreed to support the activist.¹⁰² Other funds, however have expressed concern that they will lose "access to management at companies in which they hold stakes" if they collaborate with activists.¹⁰³

In 2012, Vanguard sent a letter to the companies in its portfolio advising them not to confuse its "'predominantly passive management style' with a 'passive attitude toward corporate governance.'"¹⁰⁴ In 2015, BlackRock sent a letter encouraging directors to engage directly with their shareholders on corporate governance issues.¹⁰⁵ BlackRock also urged CEOs not to take

⁹⁵ *Id.*

⁹⁶ Christopher Palmeri, *A "Landmark Lawsuit" Hits the NYSE, CalPERS, the largest U.S. pension fund, is out to "recover losses and to right a serious wrong" in its claims of fraud at the Big Board*, BUSINESSWEEK ONLINE, Dec. 17, 2003, available at businessweek.com (visited Mar. 9, 2004).

⁹⁷ Sullivan & Cromwell, *2016 U.S. Shareholder Activism Review and Analysis*, at 4 (Nov. 28, 2016).

⁹⁸ Daniel Gross, *Some Mutual Funds Are Joining the Activist Bandwagon*, THE NEW YORK TIMES (Jan. 15, 2006).

⁹⁹ *An investor calls*, The Economist, Feb. 7, 2015, available at <http://www.economist.com/news/briefing/21642175-sometimes-ill-mannered-speculative-and-wrong-activists-are-rampant-they-will-change-american>.

¹⁰⁰ *Id.*

¹⁰¹ David Benoit & Kirsten Grind, *Activist Investors' Secret Ally: Big Mutual Funds*, WALL STREET JOURNAL, Aug. 9, 2015.

¹⁰² *Id.*

¹⁰³ *Id.*

¹⁰⁴ *Sullivan & Cromwell*, at 5.

¹⁰⁵ *Id.* at 4.

short-term measures that might pump up shareholder gains but “impair long-term value.”¹⁰⁶ Likewise, in 2016, State Street criticized “[s]ettlement agreements that are entered into quickly and without appropriate consultation with other shareholders [because they] deprive shareholders of the opportunity to express their views.”¹⁰⁷ State Street stated that such “agreements should include terms that protect the interests of long-term investors.”¹⁰⁸ Thus, it appears that after several decades of ignoring the corporate governance of the companies in which they invest, mutual funds are now following the trend of unions and pension funds in voting their proxies. As discussed earlier and as evidenced by the AFL-CIO’s Key Votes Survey, they do not always vote in the best interests of workers.

2. *Sponsoring Shareholder Proposals*

Pension funds may file a shareholder proposal under Rule 14a-8 of the Securities Exchange Act, possibly triggering a formal request from the corporation for a no-action letter from the Securities and Exchange Commission.¹⁰⁹ If a majority of shareholders approves the proposal, it passes but in almost all cases the vote is nonbinding. Therefore, the corporate directors are not required to adopt the shareholders’ precatory proposals. Although this sounds “like a harmless and largely symbolic form of owner participation [b]ut because funds often own large blocks of a company’s shares, the proposals can nonetheless pressure boards of directors to make policy changes, even without large voter turnouts.”¹¹⁰

If the corporate directors agree to the shareholder proposal before the meeting, then the shareholder will withdraw the proposal so it does not go to the shareholders for a vote. In 2016, most of the proxy access shareholder proposals filed by the New York City pension funds were withdrawn after the funds negotiated with the targeted corporation.¹¹¹ All but 15 of the 72 proposals the NYC Funds filed were settled.¹¹²

Labor- and pension-related shareholder proposals reached an all-time high in 2003 when 215 proposals were filed. By 2015, the number of proposals filed by each group was nearly equal.

¹⁰⁶ *Id.* at 5.

¹⁰⁷ *Id.*

¹⁰⁸ *Id.*

¹⁰⁹ For a more detailed explanation of the shareholder proposal process see Jayne Zanglein, *From “Wall Street Walk” to “Wall Street Talk”: The Changing Face of Corporate Governance*, 11 DEPAUL BUS. L. J. (1999).

¹¹⁰ Tracie Woidtke, Leonard Bierman, & Christopher Tuggle, *Reining in Activist Funds*, HARVARD BUSINESS REVIEW (Mar. 2003).

¹¹¹ Georgeson, ANNUAL CORPORATE GOVERNANCE REVIEW 2016, at 4 (2016).

¹¹² *Id.* at 4, 28.

Figure 6 Union & Pension Fund Sponsorship of Corporate Governance Shareholder Proposals, 1995 - 2016

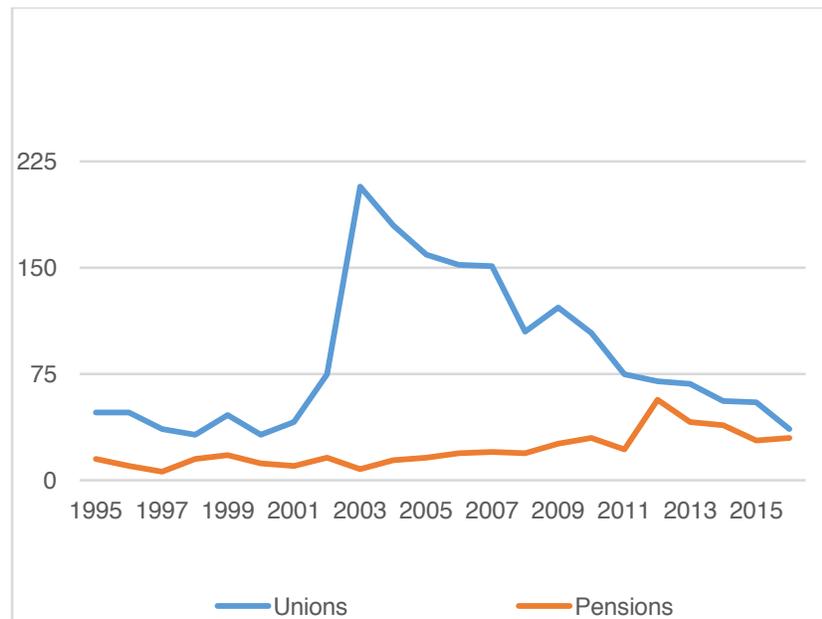


Table Created from Data Provided in Georgeson's Annual Corporate Governance Reviews, 1995-2016.

In 2016, labor unions and pension funds filed 132 corporate governance shareholder proposals out of a total of 418 proposals or 31%.¹¹³ Labor- and pension-sponsored proposals reached an all-time high in 2003, when they filed 229 corporate governance proposals out of a total of 273 proposals (84%). In contrast, mutual funds, whose assets far exceed that of pension funds, filed no proposals in 2016 and seven in 2003, an unusually high number. Mutual funds do not typically file shareholder proposals;¹¹⁴ however, they will support activists under certain circumstances, as discussed earlier.¹¹⁵ For example, they consistently support majority voting and proxy access proposals at large companies.¹¹⁶

¹¹³ Georgeson, Annual Corporate Governance Review 2016, at Figure 4 (2016). Most shareholder resolutions are initiated by individuals.

¹¹⁴ William Bratton, Joseph A. McCahery, *Institutional Investor Activism: Hedge Funds and Private Equity*, ECONOMICS AND REGULATION, at 161 (2015).

¹¹⁵ *Sullivan & Cromwell*, at 1.

¹¹⁶ *Id.*

Figure 7 Comparison of Union-related & Pension Fund Governance Shareholder Proposals Filed with Mutual Fund Proposals Filed, 1996-2016

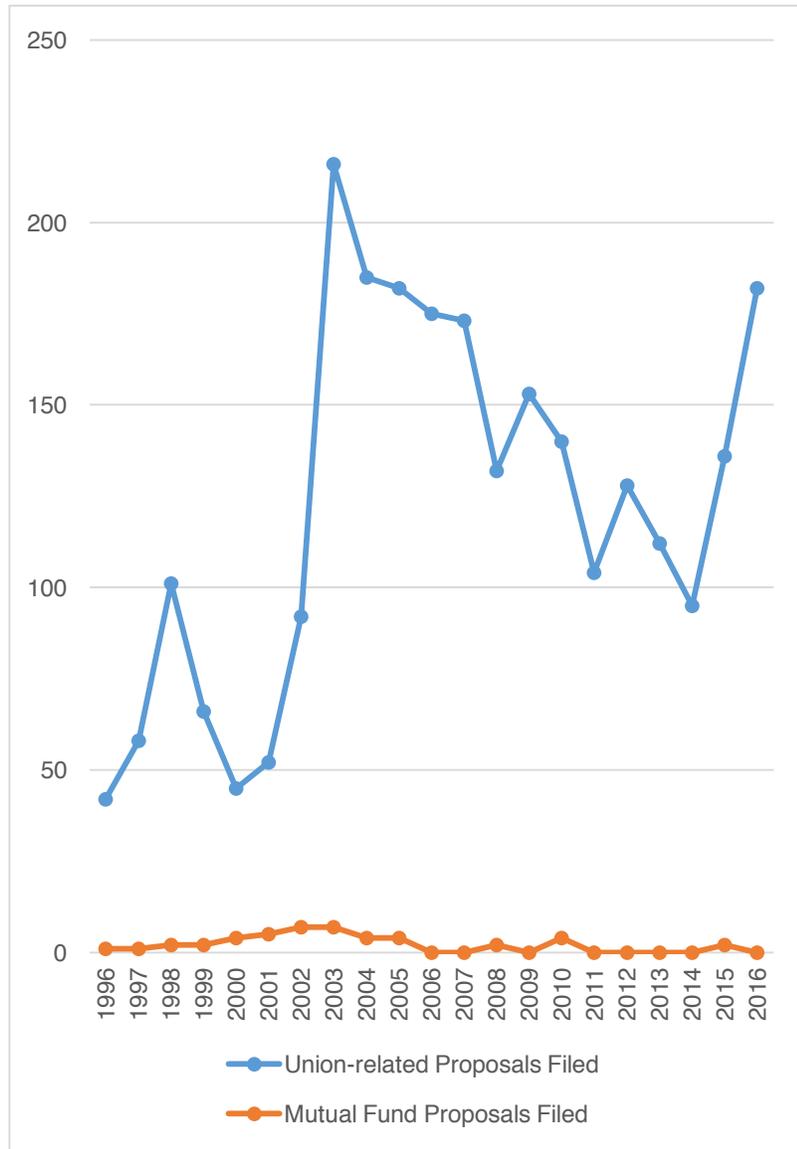


Table Created from Data Provided in Georeson’s Annual Corporate Governance Reviews, 1995-2016.

The pass rate for public funds typically exceeds the pass rate for private sector pension funds and unions. On occasion, mutual funds have had the highest pass rate, but in the years that this occurred, mutual funds filed less proposals than union and pension funds. For example, in 2001, mutual funds won 40% (2 of 5) of the corporate governance shareholder proposals filed, while unions and pensions won 3.8% (2 of 52). 2011 was a record year for unions and pension funds: they won nearly 33% (34 of 104) of shareholder proposals filed.

Figure 7 Percentage of Governance Shareholder Resolutions Passed, by Type of Sponsor (Union-Related Funds vs. Mutual Funds), 1996-2016

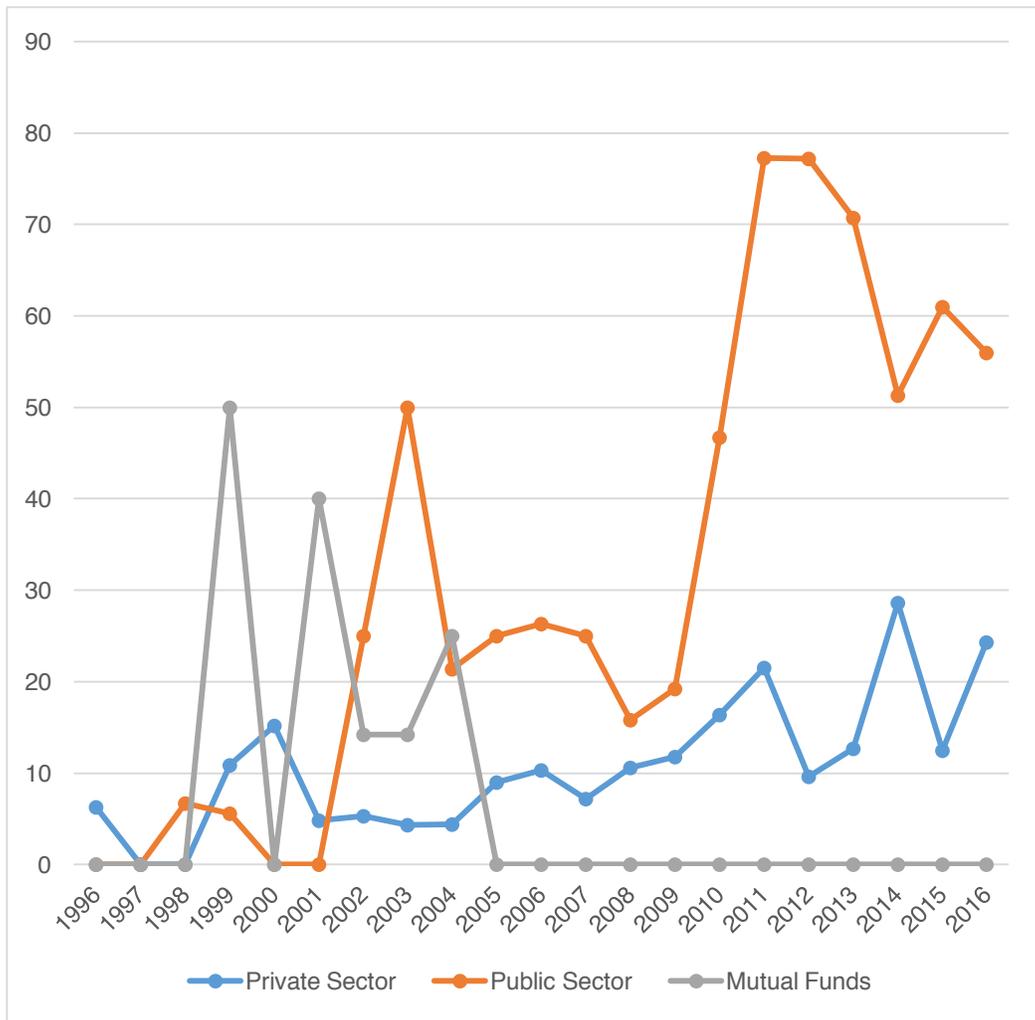


Table Created from Data Provided in Georeson’s Annual Corporate Governance Reviews, 1995-2016.

Most corporate governance proposals filed in 2016 related to the board and proxy access (47%), and executive compensation (20%). 64% of proposals went to shareholders for vote, and the remaining 36% were either omitted by the corporation as withdrawn after negotiation or as a duplicate proposal or a proposal that need not be submitted to the shareholders.¹¹⁷ In 2003, proposals primarily focused on executive compensation (38%), poison pill rescissions (18%), and the board of directors (12%). 59% of proposals went to shareholders for vote, and the remaining 41% were either omitted withdrawn.¹¹⁸

¹¹⁷ Georeson, *Annual Corporate Governance Review 2016*, at 19 (2016).

¹¹⁸ Georeson, *Annual Corporate Governance Review: Shareholder Proposals and Proxy Contests*, at 5 (2003).

Figure 8 Corporate Governance Shareholder Proposals Voted On, By Type, 2003-2016

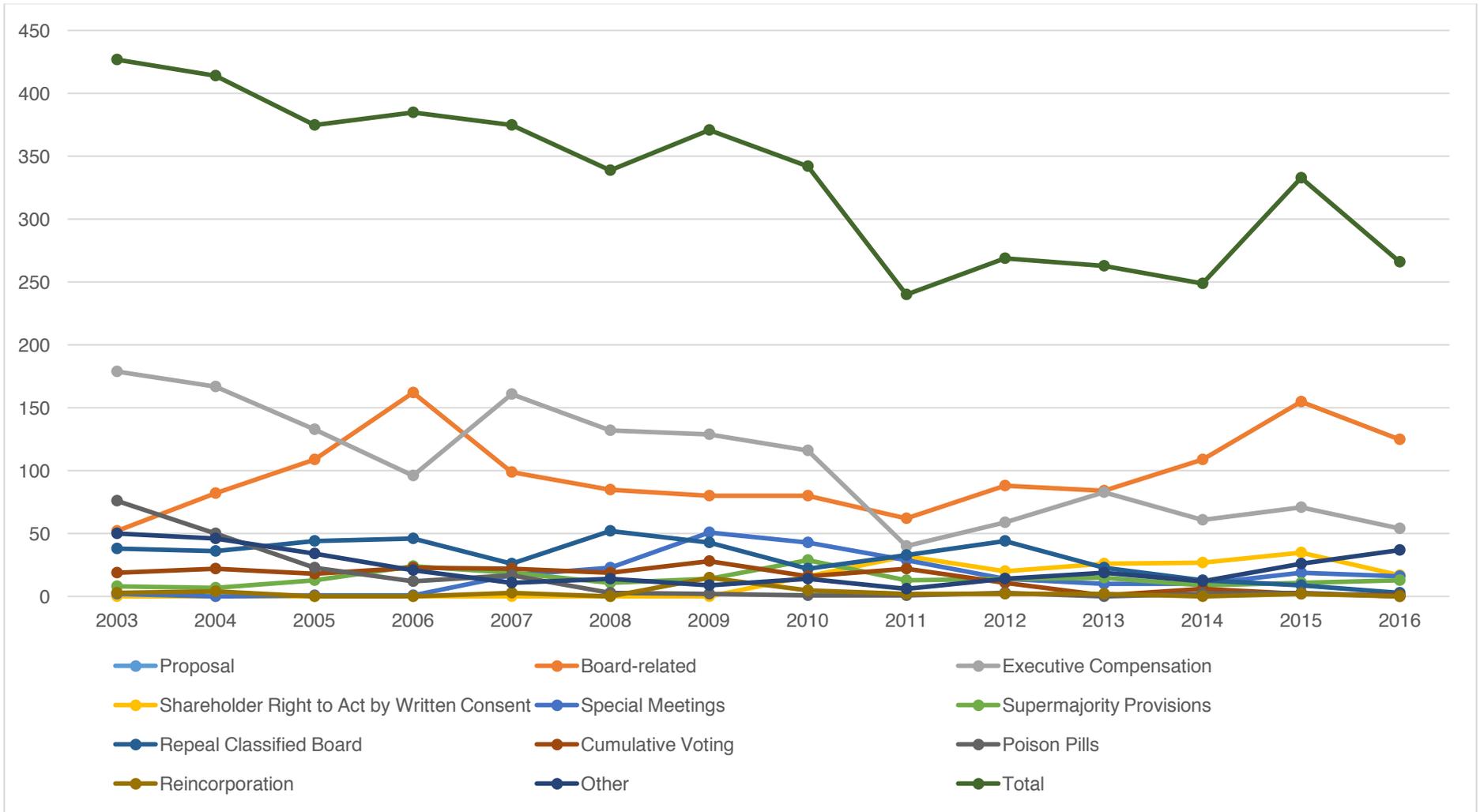


Table Created from Data Provided in Georeson's Annual Corporate Governance Reviews, 2003-2016.

Finally, the issue may be resolved by shareholder vote. Even if the proposal passes, however, it is non-binding and management is not required to implement the proposal. Given the financial power of institutional investors such as pension funds, however, it has become increasingly likely that directors will implement shareholder resolutions.

3. Proxy Fights

A proxy fight occurs when an activist or corporate raider challenges the incumbent directors and seeks to run against them. The challenger will attempt to gather enough shareholder votes to vote out the incumbents. The Department of Labor does not recommend this kind of shareholder activism as it tends to be very expensive, costing upwards to several millions depending on the size of the corporation.¹¹⁹ This has largely been the realm of corporate raiders and activist hedge funds. Activist hedge funds have grown from \$12 billion in 2003 to \$112 billion in 2014.¹²⁰ They target companies that are underperforming, that have excess liquidity, that are prime for spin-offs, merger or acquisitions, or need corporate governance reform.¹²¹

Activists investors like GAMCO and Starboard Value launched campaigns against U.S. corporations designed to maximize shareholder value, wrest control of the board, remove officers or directors, or raid the corporation.¹²² According to Sullivan & Cromwell, in 2015, 73 proxy contests were waged.¹²³ Of these, 25% went to shareholder vote (65% of these proxy fights failed), 53% were settled, and 22% were withdrawn.¹²⁴

The California State Teachers' Retirement Fund (CalSTRS), which is not governed by the Department of Labor, and Legion Partners Holdings launched a proxy fight at Perry Ellis International, Inc. in 2015.¹²⁵ CalSTRS and Legion owned 6.3% of the corporation.¹²⁶ Between the time they acquired 5% of Perry Ellis' stock and filed a Schedule 13D with the Securities and Exchange Commission and the date the parties came to agreement eleven months later, the company's stock price rose by 52%.¹²⁷ As a result of the threatened proxy fight, the corporation

¹¹⁹ Michael Ide, *Proxy Fights Cost U.S. Companies \$4.6 Million On Average*, VALUEWALK, Sept. 10, 2104, available at <http://www.valuewalk.com/2014/09/proxy-fights-costs/> (visited Dec. 15, 2016).

¹²⁰ J.P. Morgan, *The activist revolution: Understanding and navigating a new world of heightened investor scrutiny*, at 1 (Jan. 2015), available at <https://www.jpmorgan.com/jmpdf/1320693986586.pdf> (visited Dec. 15, 2016).

¹²¹ *Id.* at 5.

¹²² Andrew Birstingl, 2016 Shareholder Activism Trends, Insight, Dec. 12, 2016, available at <http://insight.factset.com/2016-shareholder-activism-trends> (visited Dec. 15, 2016).

¹²³ *Id.*

¹²⁴ *Id.* at 18, 20.

¹²⁵ Barry Burr, *CalSTRS, Legion drop proxy solicitation fight at Perry Ellis, Pensions & Investments* (May 26, 2105).

¹²⁶ *Id.*

¹²⁷ *Id.*

agreed to replace two independent directors and announced a succession plan.¹²⁸ The board's independent directors praised CalPERS' efforts saying, "[We] appreciate the constructive dialogue we have had with our shareholders on a variety of issues."¹²⁹

Conclusion

In the 1990s, more pension funds and unions engaged in shareholder activism. At the same time DB plan assets were declining, technically giving pension fund activist less clout. While it initially seemed that this would have a significant impact on union-sponsored activism, mutual funds have recently begun to actively engage with management of their portfolio companies on corporate governance issues. However, these funds do not vote in the manner recommended by the AFL-CIO. It remains to be seen whether the decline in DB plans will negatively impact pension fund activism.

¹²⁸ *Id.*

¹²⁹ *Id.*