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The Spotlight on Investors – Proposed Expansive Regulation of Institutional Investors and Shareholder Behavior – Imposing New Fiduciary Duties on Investors (and Companies)

In the absence of effective voluntary actions by companies and investors—such as those outlined in [The New Paradigm: A Roadmap for an Implicit Corporate Governance Partnership Between Corporations and Investors to Achieve Sustainable Long-Term Investment and Growth](#) (issued by the World Economic Forum in 2016) that prioritize long-term value creation benefiting all stakeholders and affirm the ability of market capitalism to benefit society—the likelihood of legislation and regulation has continued to increase. Much of the focus and concern had been on regulating corporations. But as we have been warning, **in the absence of institutional investors and asset managers decisively and comprehensively embracing stewardship, investor purpose and The New Paradigm, the spotlight would soon turn to them and short-term oriented financial activists who take advantage of their inaction.**

Now, in a [white paper](#) containing draft legislation and regulations, B Lab and The Shareholder Commons propose substantial amendments to federal law that would establish new fiduciary obligations for corporations and institutional investors and impose related substantive requirements on investors as part of implementing what the paper describes as Benefit Governance. The paper rejects as insufficient voluntary efforts by corporations and institutional investors to adopt stakeholder and ESG governance. Instead, it recommends creating a new legal structure that would fundamentally alter the fiduciary duties of corporations and institutional investors. The paper describes the actions to be taken by Congress and the Securities and Exchange Commission, the Department of Labor, the Department of Justice, the Federal Trade Commission and other agencies of the federal government to achieve the sought objectives. A wide range of federal statutes and existing regulations would be amended, including the Investment Company Act of 1940, the Employee Retirement Income Security Act of 1974 and the Securities Exchange Act of 1934. Among the proposals:

- Mandate new fiduciary duties for trustees of institutional investors regarding the economic, social and environmental effects of their decisions on the interests of their beneficiaries;

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- Implement new requirements that would push institutional investors to engage with and be responsive to their underlying beneficiaries and inform such beneficiaries in advance of planned proxy vote decisions and other actions so that the beneficiaries can provide input to the asset manager;
- Mandate that all business entities, public and private, that engage in interstate commerce operate and incorporate as benefit corporations;
- Expand disclosures for investment companies, ERISA plans, and large companies regarding social and environmental issues;
- Require compensation committees of large companies to incorporate consideration of stakeholder concerns into their decision-making processes and compensation design;
- Design tax laws and financial regulations to discourage compensation based on equity or portfolio value that does not account for systemic effects of assets under management;
- Reverse recently adopted SEC rules that may make it more difficult for shareholders to bring shareholder proposals;
- Establish safe harbors for coordinated shareholder action in pursuit of sustainability guardrails or similar restrictions on corporate behavior that preserve social, economic, and environmental systems.

These proposals, if enacted, would be a significant step toward state corporatism. They would relegate to federal regulation and enforcement the types of private ordering recommendations we made, premised on voluntary action by corporations and institutional investors, in The New Paradigm. And they would add considerably more requirements to what we proposed as voluntary actions. The New Paradigm was explicitly designed to avoid legislation and regulation. As we said in 2019 in [*It's Time To Adopt The New Paradigm*](#), failure of corporations and institutional investors to embrace The New Paradigm would lead to state corporatism.

While we disagree with implementing the proposals made in the white paper, we acknowledge that the authors have made important contributions to the debate about restoring the balance and fairness of our corporate governance system, promoting broad-based prosperity and how current investor incentives

foster short-termism and undermine sustainability and economic growth. The authors' focus on addressing "human shareholders themselves, who rely on a healthy economy, society, and environment in order to support the return on their diversified portfolios and their other interests, including jobs, health, and social stability" and their attempts to call attention to, and address, gender, racial and ethnic gaps and disparities, are priorities which we share. While we are disappointed that institutional investors and asset managers have lagged corporations in more fully embracing The New Paradigm and obviating the demand for actions like those proposed in the white paper, we continue to urge that the correct approach is The New Paradigm and not actions that lead to state corporatism.

As we have been advising for a number of years, corporations and institutional investors have in their own hands whether they are going to be subject to the type of legislation and regulation proposed by The Shareholder Commons and B Lab. In August of last year, the Business Roundtable took the key step for corporations, and corporations are working hard to follow through. It's time that institutional investors and asset managers, individually as well as through groups such as the Investor Stewardship Group and the Council of Institutional Investors, match what the Business Roundtable has done and obviate any need for new legislation or regulation.

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