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Office of Regulations and Interpretations  
Employee Benefits Security Administration  
Attn: Conflict of Interest Rule  
Room N-5655  
U.S. Department of Labor  
200 Constitution Ave., N.W.  
Washington, D.C. 20210

Re: *RIN 1210-AB32, Definition of the Term "Fiduciary"*

Dear Madam or Sir:

We are pleased to submit these comments on behalf of our client, Institutional Shareholder Services Inc. (ISS), regarding the Department's latest proposal to redefine the circumstances under which a person rendering investment advice to an employee benefit plan or a plan fiduciary, participant or beneficiary is deemed to be a "fiduciary" for purposes of section 3(21)(A)(ii) of the Employee Retirement Income Security Act of 1974 (ERISA) and section 4975(e) of the Internal Revenue Code of 1986 (Code).<sup>1</sup> This proposal supplants the Department's earlier attempt to extend fiduciary protections to a wider array of advice relationships than those covered under the current version of 29 CFR 2510.3-21(c) and related Code regulations.<sup>2</sup> While ISS appreciates the Department's diligent efforts to address the many comments it received on the 2010 Proposal, the company is concerned that the revised proposal, like its predecessor, could have unintended consequences that could deprive plans, participants and beneficiaries of access to critical professional guidance regarding their proxy voting decisions.

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<sup>1</sup> Definition of the Term "Fiduciary"; Conflict of Interest Rule – Retirement Investment Advice, 29 CFR Parts 2509 and 2510, RIN 1210-AB32 (April 14, 2015), 80 Fed. Reg. 21928 (April 20, 2015) ("Proposing Release"). References in this comment letter to ERISA and Department regulations include the Code and corresponding regulations as well.

<sup>2</sup> "Definition of the Term 'Fiduciary'," 29 CFR Part 2510, RIN 1210-AB32 (October 13, 2010), 75 Fed. Reg. 65263 (October 22, 2010) ("2010 Proposal").

## ***Background***

ISS, a privately held company,<sup>3</sup> is a federally registered investment adviser with over 30 years of experience in helping institutional investors meet their fiduciary responsibilities related to proxy voting. More than 1,600 clients -- including employee benefit plans, investment managers, hedge funds and mutual funds<sup>4</sup> -- rely on ISS' expertise to help them make more informed proxy voting decisions, manage the complex process of voting their shares, and report their votes to their stakeholders and regulators.

### *Governance Research and Recommendations*

Through its governance research and proxy voting recommendations, ISS helps institutional investors understand corporate governance policies and practices at their portfolio companies and take these practices into account in their proxy voting. ISS offers a wide range of proxy voting policy options to institutional investors, including vote recommendations based on a client's specific customized voting guidelines. In addition, ISS provides enhanced analysis of contentious meetings (M&A and proxy contest) as well as governance data and analytics through its QuickScore product.

### *Voting Services*

ISS' ProxyExchange application and experienced account managers provide end-to-end management of the proxy voting process. ISS clients can control their voting policy and final vote decisions while outsourcing the processing and data management elements to an experienced service provider. To this end, ISS receives clients' proxy ballots, works with custodian banks, executes votes on clients' behalf, maintains vote records and provides comprehensive reporting. By outsourcing the administrative tasks associated with the voting process, ISS' clients free themselves to devote their internal resources to making more informed investment decisions.

### *Disclosure and Other Services for Institutional Investors*

In addition to developing proxy voting policies, making vote recommendations, and processing votes, ISS also offers a Vote Disclosure Service to help investment companies comply with their regulatory disclosure obligations.

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<sup>3</sup> As of April 30, 2014, ISS is wholly owned by VISS Holdings, Inc., an affiliate of Vestar Capital Partners ("Vestar"), a private equity firm.

<sup>4</sup> ISS' clientele is strictly institutional; it does not serve the retail market.

### *Services Provided to Issuers*

Separate and apart from ISS' core business of analyzing the proxies of corporate issuers and making vote recommendations for the benefit of institutional investors, ISS' wholly-owned subsidiary, ISS Corporate Solutions, Inc. (ICS), serves the corporate issuer community by providing products and services that enable issuers to understand and implement corporate governance best practices. These products and services include web-based tools, advisory services and publications that assist issuers with executive and director compensation modeling, capital structure planning and other governance issues.

### *ISS' Approach Regarding Conflicts of Interest*

As an investment adviser registered under the Investment Advisers Act of 1940 (Advisers Act), ISS fully appreciates the fiduciary duties of care and loyalty it owes to its clients. It also understands that these duties entail a responsibility to eliminate potential conflicts of interest where possible and to manage and disclose those conflicts that cannot reasonably be avoided. To this end, ISS takes a number of steps to safeguard the integrity of the research and services it provides to institutional investors so that it can fulfill its important role in the dialogue between corporations and their shareholders.

#### ○ Policy-Based Approach

At its core, ISS is a transparent policy-based organization; its use of a series of published voting policies provides a very practical check and balance that ensures the integrity and independence of ISS' analyses and vote recommendations. While these policies allow analysts to consider company- and market-specific factors in generating vote recommendations, the existence of a published analytical framework, coupled with the fact that vote recommendations are based on publicly-available information, allows ISS clients to continuously monitor the integrity of ISS advice.<sup>5</sup>

#### ○ Compliance Program: Code of Ethics, Training, Monitoring and Firewall

In addition to the practical check and balance supplied by the policy framework, the independence and integrity of ISS' proxy advice is further ensured by the comprehensive compliance program the company maintains pursuant to the Advisers Act and related rules. One of the primary components of this program is a Code of Ethics that prescribes standards of conduct for ISS and its employees.

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<sup>5</sup> Each ISS analysis includes a URL for a direct hyperlink to ISS' summary voting guidelines for easy access by users of the Company's research.

The Code of Ethics affirms ISS' fiduciary relationship with its clients and obligates ISS and its employees to carry out their duties solely in the best interests of clients and free from any compromising influences and loyalties. The Code also contains restrictions on personal trading designed to prevent employees from improperly trading on, or benefiting from, inside information, client information and/or ISS' voting recommendations. The Code emphasizes the requirement that all research for clients be rendered independently of employees' personal interests.

In order to ensure compliance with the Code of Ethics, ISS conducts periodic training sessions for employees and requires employees to affirm their commitment to the Code on an annual basis. Furthermore, ISS regularly monitors the sufficiency of the Code and the effectiveness of its implementation.

Another critical component of the ISS compliance program is the firewall it maintains between its institutional business and the services performed for corporate issuers by its ICS subsidiary. This firewall includes the physical and functional separation between ICS and ISS, with a particular focus on the separation of ICS from the ISS Global Research team. A key goal of the firewall is to keep the ISS Global Research team from learning the identity of ICS' clients, thereby ensuring the objectivity and independence of ISS' research process and vote recommendations.

The firewall mitigates potential conflicts via several layers of separation:

1. ICS is a separate legal entity from ISS.
2. ICS is physically separated from ISS, and its day-to-day operations are separately managed.
3. ISS Global Research works independently from ICS.
4. ICS and ISS staff are prohibited from discussing a range of matters, including the identity of ICS clients.
5. Institutional analysts' salaries, bonuses and other forms of compensation are not linked to any specific ICS activity or sale.
6. ICS explicitly tells its corporate clients that ISS will not give preferential treatment to, and is under no obligation to support, any proxy proposal of an ICS client. ICS further informs its clients that ISS' Global Research team prepares its analyses and vote recommendations independently of, and with no involvement from, ICS.

As is the case with the Code of Ethics, ISS maintains a robust training and monitoring program regarding the firewall. This program includes quarterly tests of the

firewall's integrity, new-hire orientation, and review of certain marketing materials and disclosures. In addition, there is an ethics hotline available to both ICS and ISS staff for reporting issues of potential concern.

#### ○ Disclosure Regarding Potential Conflicts

ISS provides its institutional investor clients with an extensive array of information to ensure they are fully informed of potential conflicts and the steps ISS has taken to address them. In addition to making full disclosure in the Form ADV brochure it makes available to each client, ISS supplies a comprehensive due diligence compliance package on its Web site<sup>6</sup> to assist clients and prospective clients in fulfilling their own obligations regarding the use of independent, third-party proxy voting firms.<sup>7</sup> This package includes a copy of ISS' Code of Ethics, a description of other policies, procedures and practices regarding potential conflicts of interest, a description of the ICS business, and the ISS Policy Regarding Disclosure of Significant Relationships.

Moreover, each proxy analysis and research report ISS issues contains a legend indicating that the subject of the analysis or report may be a client of or affiliated with a client of ISS, ICS or Vestar and its affiliates. Each analysis and report also notes that one or more proponents of a shareholder proposal may be a client of ISS or one of its affiliates, or may be affiliated with such a party. ISS' ProxyExchange client delivery platform provides institutional clients with affirmative visibility regarding the company's significant relationships. Clients may also receive information about significant relationships through onscreen and/or email alerts and they may contact ISS' Legal and Compliance Department for relevant details about such relationships. All of this disclosure is structured in such a way as to allow ISS' proxy voting clients to receive the information they need without revealing the identity of ICS clients to research analysts as they prepare vote recommendations and other research.

ISS believes that these extensive measures provide employee benefit plans and other clients with a high degree of comfort that ISS has eliminated or is effectively managing the potential conflicts of interest its business entails.

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<sup>6</sup> <http://www.issgovernance.com/compliance/due-diligence-materials/>.

<sup>7</sup> In 2004, the SEC staff issued guidance to registered investment advisers concerning their due diligence obligations with respect to the use of third-party proxy voting firms. See Institutional Shareholder Services (September 15, 2004); Egan-Jones Proxy Services (May 24, 2004). See also, SEC Release Nos. IA-2106 (January 31, 2003)(Adopting Advisers Act Rule 206(4)-6), and IC-25922 (January 31, 2003) (adopting Rule 30b-1-4 under the Investment Company Act of 1940). This guidance was confirmed in Staff Legal Bulletin (SLB) 20, issued by the staff of the SEC's Division of Investment Management and Division of Corporation Finance on June 30, 2014. In addition to addressing issues under the Advisers Act, SLB 20 also addressed the applicability to proxy advisers of the proxy rules under the Securities Exchange Act of 1934.

### ***The Department's Revised Proposal***

#### *The Definition of "Fiduciary" Under ERISA*

ERISA defines a "fiduciary" to include, among others, a person who renders investment advice for a fee or other compensation with respect to moneys or other property of an employee benefit plan.<sup>8</sup> In its revised proposal, the Department seeks to amend a forty-year old rule that establishes the circumstances under which a person is deemed to render "investment advice" within the meaning of ERISA's fiduciary definition.<sup>9</sup> The Department contends that the existing regulation is ill-suited to the contemporary retirement plan marketplace where an increasing portion of retirement plan assets are directed by individual investors rather than being managed by professionals.<sup>10</sup> The Department expresses particular concern about the proliferation of complex investment products offered by brokers, consultants and others who operate outside the bounds of ERISA's fiduciary restrictions, and may have undisclosed and unmitigated conflicts of interest.<sup>11</sup>

The Department proposes to address these concerns by broadening the types of advice relationships governed by fiduciary standards, but doing so in a way that preserves beneficial business models that have developed to serve retail retirement needs. Under the revised version of 2510.3-21, a person would be deemed to be an investment advice fiduciary if the person, for compensation, provides a plan, plan fiduciary, plan participant or beneficiary, IRA, or IRA owner with any of four types of investment advice and if the person either acknowledges its fiduciary status under ERISA, or renders the advice pursuant to a written or verbal agreement, arrangement or understanding that the advice is individualized to or specifically directed to the recipient of the advice for consideration in making investment or management decisions with respect to securities or other property of the plan or IRA.<sup>12</sup> Unlike the 2010 Proposal, the current proposal does not link a person's status as an ERISA fiduciary to its registration status as an investment adviser under the Advisers Act.<sup>13</sup>

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<sup>8</sup> ERISA, Section 3(21)(A)(ii).

<sup>9</sup> 29 CFR 2510.3-21(c).

<sup>10</sup> Proposing Release, 80 Fed. Reg. at 21930.

<sup>11</sup> *Id.*, 80 Fed. Reg. at 21933.

<sup>12</sup> Proposed 2510.3-21(a)(2)(ii). In order to avoid sweeping in relationships that should not be regarded as fiduciary in nature, the revised proposal includes a number of carve-outs and new prohibited transaction exemptions. Proposing Release, 80 Fed. Reg. at 21929.

<sup>13</sup> See 2010 Proposal, 75 Fed. Reg. at 65277.

ISS is pleased that a person's status as an investment adviser under the Advisers Act has been eliminated as a factor in determining that person's status as an investment advice fiduciary under ERISA. ISS believes that this change will avoid creating opportunities for regulatory arbitrage by proxy advisory firms who might decline to register under the Advisers Act to avoid being characterized as ERISA fiduciaries. Compliance with the Advisers Act and related rules substantially eliminates the type of unmitigated and undisclosed conflicts of interest that the amended ERISA fiduciary rule is designed to address.<sup>14</sup>

As it did in 2010, the Department specifically addressed the applicability of the revised proposal to proxy advisers, confirming that a recommendation as to the management of securities or other property of a plan would include a recommendation as to the exercise of rights appurtenant to shares of stock, including the right to vote proxies.<sup>15</sup> However, in response to comments received on the 2010 Proposal, the Department expressed its view that the revised version of 2510.3-21 (now to be known as 2520.3-21(a)) would apply only to individualized or specifically directed advice and recommendations on the exercise of proxy or other ownership rights. In the Department's words:

*Guidelines or other information on voting policies for proxies that are provided to a broad class of investors without regard to a client's individual interests or investment policy and which are not directed or presented as a recommended policy for the plan or IRA to adopt would not rise to the level of fiduciary investment advice.*<sup>16</sup>

Unfortunately, while the Department addressed comments regarding proxy advice that is not specifically directed to the advice recipient, it did not address comments relating to potential unintended consequences of an expanded fiduciary advice rule on proxy advisers who tailor their recommendations to clients' individual needs and interests. This omission is unfortunate, for it is this latter category of proxy advisers who bring the most value to retirement plans and their participants and beneficiaries.

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<sup>14</sup> In its Concept Release on the U.S. Proxy System, the SEC opined that proxy advisers act as investment advisers when they render advice designed to enable clients to maximize the value of their investments. The Commission went on to discuss the substantial client protections afforded by the investment adviser regulatory regime. SEC Release No. IA-3052 (July 14, 2010) at 109-110, 113-114, 75 Fed. Reg. 42981, 43010- 43011 (July 22, 2010).

<sup>15</sup> Proposing Release, 80 Fed. Reg. at 21939.

<sup>16</sup> *Id.*

*Possible Unintended Consequences of the Revised Proposal*

As ISS explained in its comments on the 2010 Proposal,<sup>17</sup> it does not object to assuming fiduciary duties under ERISA because it already owes its clients fiduciary duties of care and loyalty by virtue of its status as a registered investment adviser. However, ISS is concerned that retirement plans and their participants and beneficiaries would be harmed if the Department were to characterize a proxy vote as a “transaction” for purposes of ERISA's prohibited transaction provisions. Problems also could arise if the Department were to deem a corporation's or shareholder proponent's interests to be "adverse" to the interests of proxy voters, or if it were to deem issuers or shareholder proponents and proxy voters to "deal" with each other in connection with a proxy vote.

Section 406(b) of ERISA forbids a fiduciary to act in any transaction involving the plan on behalf of a party, or to represent a party, whose interests are adverse to the interests of the plan or its participants or beneficiaries. This section also prohibits a fiduciary from receiving any consideration for his personal account from any party dealing with the plan in connection with a transaction involving plan assets.

As noted above, ISS helps many of its clients develop custom proxy voting policies and makes vote recommendations based on clients' specific voting guidelines. Some of these guidelines focus solely on economic factors, while others emphasize environmental, social, faith-based or other issues. Because ISS' advice is tailored to the specific needs and preferences of its clients, the Company may recommend that some clients support a proxy proposal while advising other clients to reject that same proposal. Furthermore, in some cases, ISS may provide a vote recommendation relating to an issuer that owns one of the Company's institutional clients, or relating to a contested solicitation or shareholder proposal involving an institutional client. If a proxy vote is deemed to be a "transaction" and rendering advice about that vote is deemed to be "acting in a transaction;" or if an issuer or shareholder proponent is deemed to be “adverse to” or “dealing with” proxy voters, Section 406(b) might effectively preclude ISS and other proxy advisers from offering individualized advice to an ERISA plan, its participants or beneficiaries or an IRA or its owner.

This cannot possibly be the intended result of ERISA's prohibited transaction provisions. The legislative history behind these provisions does not address the meaning of “transaction,” but lexicons<sup>18</sup> and case law suggest that the term should be construed in

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<sup>17</sup> Letter dated February 2, 2011 from Steven E. Friedman, General Counsel, ISS to Office of Regulations and Interpretations, EBSA, DOL.

<sup>18</sup> For example, Black's Law Dictionary instructs that a transaction “may involve selling, leasing, borrowing, mortgaging or lending.”



its normal commercial sense to encompass loans,<sup>19</sup> transfers of funds;<sup>20</sup> or purchases of securities<sup>21</sup> or insurance,<sup>22</sup> and the like.

The complexity of relationships among parties in the proxy voting chain means that the potential for conflict of interest is always present for advisory firms that provide individualized proxy voting recommendations. A broad prohibition of these relationships would essentially make it impossible for plans and their participants and beneficiaries to receive such critically important advice. The Department's failure to address this issue in response to ISS' comments on the 2010 Proposal may signal a tacit acknowledgement that a proxy vote is not a transaction within the meaning of Section 406(b). However, the lack of an express confirmation of that interpretation exposes proxy advisers to uncertainties that could lead them to pull back from the retirement plan market.

Therefore, ISS requests that before the Department amends Section 2510.3-21, it take steps to ensure that plans and their participants and beneficiaries continue to have access to individualized professional guidance regarding their proxy votes. The Department could achieve this by confirming -- either in the rule itself or in an adopting release -- that a proxy vote is not a "transaction" for purposes of ERISA Section 406(b). In the alternative, the Department could add another prohibited transaction exemption to the ones it has proposed in this rulemaking to permit proxy advisers to continue to serve the retirement plan market.<sup>23</sup>

### **Conclusion**

ISS appreciates the Department's efforts to modernize and improve its fiduciary regulations. However, ISS asks the Department to ensure that its actions do not deprive the intended beneficiaries of this rulemaking of critically important proxy voting advice.

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<sup>19</sup> *Donovan v. Mazzola*, 716 F.2d 1226 (9<sup>th</sup> Cir. 1983) (plan fiduciary found to have violated 406(b)(2) by acting on both sides of a loan).

<sup>20</sup> *Parker v. Bain*, 68 F.3d 1131 (9<sup>th</sup> Cir. 1995) (406(b)(2) violated where plan fiduciary who was also officer of plan sponsor transferred plan funds to the sponsor's account).

<sup>21</sup> *Haddock v. Nationwide Financial Services, Inc.*, 419 F. Supp.2d 156 (D. Conn 2006) (violation of 406(b)(3) could be found where plan fiduciary received payments from mutual fund companies in exchange for making the funds available to plan participants).

<sup>22</sup> *Reich v. Lancaster*, 55 F.3d 1034 (5<sup>th</sup> Cir. 1995) (fiduciary's receipt of commissions from insurance company for purchasing insurance products with plan assets violated 406(b)(2) and (3)).

<sup>23</sup> In order to ensure that proxy advisers establish and enforce robust conflict controls, the Department might consider conditioning any relief in this area on the proxy adviser's being registered as an investment adviser under the Advisers Act or similar state laws.

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We would be happy to supply the Department with additional information regarding any of the matters discussed herein. Please direct any questions about these comments to the undersigned.

Respectfully submitted,

A handwritten signature in black ink that reads "Mari-Anne Pisarri". The signature is written in a cursive style with a large, looping initial 'M'.

Mari-Anne Pisarri

Cc: Steven E. Friedman