September 14, 2020

Mr. Jason A. DeWitt  
Office of Regulations and Interpretations  
Employee Benefits Security Administration  
Room N-5655  
U.S. Department of Labor  
200 Constitution Ave., N.W.  
Washington, DC 20210

Via Federal eRulemaking Portal (www.regulations.gov)

Re: Fiduciary Duties Regarding Proxy Voting and Shareholder Rights  
(RIN: 1210-AB91)

Mr. DeWitt:

We at the Free Enterprise Project\(^1\) of the National Center for Public Policy Research\(^2\) appreciate the opportunity to submit this comment on the above-styled proposed rule that would confirm that investment managers of plans governed by the Employee Retirement Income Security Act

\(^1\) Launched in 2007, the National Center for Public Policy Research’s Free Enterprise Project (FEP) focuses on shareholder activism and the confluence of big government and big business. FEP is the conservative movement’s only full-service shareholder activism and education program: It files shareholder resolutions, engages corporate CEOs and board members at shareholder meetings, petitions the U.S. Securities and Exchange Commission (SEC) for interpretative guidance, and sponsors effective media campaigns to create the incentives for corporations to stay focused on their missions. More information is available [here](#).

\(^2\) The National Center for Public Policy Research is a communications and research foundation dedicated to providing free market solutions to today’s public policy problems. We believe that the principles of a free market, individual liberty and personal responsibility provide the greatest hope for meeting the challenges facing America in the 21st century. More information is available [here](#).
of 1974 (ERISA)\(^3\) must participate in the shareholder proxy voting process only when they
determine that such participation is in the material pecuniary interest of the pension fund. It
would clarify that such managers are not permitted to spend fund assets or resources to
research issues that appear unlikely to have such a material effect; must vote on materially
relevant questions in the way that will maximize the pecuniary value of the fund; and may only
rely on proxy advisory-service recommendations when those recommendations have been
sufficiently explained and supported by relevant evidence to allow fund managers, in
pursuance of their fiduciary duty, to ascertain that the recommendations are consonant with the
managers' obligations to maximize the value of the pension funds.

We commend the Department for promulgating this proposed rule. Policy-based investing has
grown more popular among institutional investors, including ERISA-governed funds, in recent
years. But ERISA fund managers owe a clear duty to maximize the value of the funds they
manage, and violate their fiduciary duties if they act otherwise. They do act otherwise, in
violation of that duty, if they expend pension fund resources to evaluate shareholder proposals
that, on their face, seem unlikely to have any material effect on the value of the pension fund.
They similarly violate their duties if they decide to vote on a shareholder proposal that has been
endorsed by a proxy advisor without an explanation of the reasons for and support of the
endorsement sufficient to permit the fund managers prudently to conclude that they are
warranted in following the proxy advisor's advice.

This problem has grown particularly acute as social-activist shareholder proposals have
multiplied even as the chief proxy advisors have taken sides politically. Institutional
Shareholder Services (ISS), for instance, one of the two firms that form an effective duopoly in
the proxy-advisory industry,\(^4\) regularly and without competent evidence recommends votes in
favor of proposals that would require surface-characteristic quotas on corporate boards\(^5\) while
recommending votes against proposals that would require viewpoint diversity on the same
boards.\(^6\) It makes these recommendations despite strong peer-reviewed evidence that
viewpoint diversity enhances corporate (and other organizational) value, while there appears to
be no evidence to suggest that surface-characteristic quotas create any enhancements that are

\(^3\) 28 U.S.C. ch. 18, §§ 1001, et seq.

\(^4\) See infra at pp. 3-4.

\(^5\) Jason Del Rey, Amazon shareholders are getting opposite advice on whether diversity should be
mandated for the company's board, RECODE (May 12, 2018), available at
https://www.vox.com/2018/5/12/17345502/amazon-jeff-bezos-rooney-rule-diversity-
proposal-board-iss-glass-lewis (last accessed Sept. 11, 2020).

\(^6\) Press Release - Free Enterprise Project, Eli Lilly Rejects Call to Increase Viewpoint Diversity on Its
Board of Directors, NATIONAL CENTER FOR PUBLIC POLICY RESEARCH (May 4, 2020), available at
https://nationalcenter.org/ncppr/2020/05/04/eli-lilly-rejects-call-to-increase-viewpoint-
diversity-on-its-board-of-directors/ (last accessed Sept. 11, 2020).
themselves not ultimately a result of increased viewpoint diversity rather than surface-characteristic difference.\(^7\)

While we will make three minor suggestions for improvement, we heartily congratulate the Office and the Department on their clear and faithful expression of the law in this area.

I. Background

Managers of private pension funds governed by ERISA have a fiduciary duty to act "solely" in the interest of maximizing the value of the plan for purposes of meeting plan obligations, primarily payment obligations to beneficiaries.\(^8\) Part of this fiduciary duty is a duty of care not to waste the assets of the funds on irrelevant or trivial pursuits.

For some years, some fund managers have worked under the misapprehension that they were obliged to vote the proxies for the stocks that their funds own in any matters that came before the shareholders of the companies in which their funds had invested.\(^9\) This misunderstanding has resulted either in the fund managers employing significant assets to explore the issues implicated in the matters or in their relying on proxy-advisory services to decide for them how to vote. Both of these approaches create conflicts with and potential breaches of their fiduciary duties.

The first route – researching all of the issues with due diligence themselves, or via their staff – raises the specter of the breach of the duty of care through the misapplication of fund resources. The second raises the specter of the breach of that duty through reliance on recommendations that have been inadequately researched in general, researched for the wrong purposes (i.e., without sole reference to the single permissible purpose of maximizing shareholder value, but instead with the personal policy preferences of the researchers or the proxy advisory firms illicitly in mind), or researched without any regard to the specific and unique issues and concerns that must necessarily animate the actions of individual pension funds and their managers.

These concerns about reliance on proxy-advisory firms are magnified by the manner in which those firms operate. The industry is a duopoly of the sort that often leads to inferior service to clients and the application of market power,\(^10\) with the two primary industry players sharing 97

---


\(^8\) See 29 U.S.C. § 1104(a).


\(^10\) United States Department of Justice, COMPETITION AND MONOPOLY: SINGLE-FIRM CONDUCT UNDER SECTION 2 OF THE SHERMAN ACT, Ch. 1. Pt. II (citing Standard Oil Co. of N.J. v. United
percent of the market. This market power plays out in a variety of ways that render reliance on the firms dangerous both to the value of pension funds and to fund managers eager fully to fulfill their fiduciary duties. The number of shareholder proposals has, as the Department has noted, risen dramatically in recent years, as have the voting recommendations offered by the proxy-advisory services. But these services are insufficiently staffed and otherwise ill-suited to conduct the sort of research required under fiduciary law. The result, when fund managers rely on the recommendations of these firms, is that no one has done the necessary and appropriately focused research.

II. The Proposed Rule

The proposed rule, relevantly to the analysis in this comment, serves a series of important purposes. First, it clarifies that pension-fund managers not only are not required to vote on every proxy matter, but in fact run the risk of violating their fiduciary duty if they expend fund resources to research issues that will not or are unlikely to have a material effect on the pecuniary value of the fund regardless of the outcome of the vote, or in cases in which the pension fund’s holdings in a corporation are too small for the fund’s vote to have any likely material effect on the outcome of the vote in any case. It then expressly permits and requires managers to develop rules by which to deal with, and efficiently to dispose of, various


11 See, e.g., Proxy advisers come under fire, THE ECONOMIST (Nov. 14, 2019), available at https://www.economist.com/business/2019/11/14/proxy-advisers-come-under-fire (last accessed Sept. 9, 2020); Proxy Advisory Reform, supra note 9, at 5, 10 (citing James K. Glassman and Hester Peirce, How Proxy Advisory Services Became So Powerful, MERCATUS ON POLICY SERIES, MERCATUS CENTER AT GEORGE MASON UNIVERSITY (June 18, 2014)).

12 See, e.g., Proxy Advisory Reform, supra note 9, at 10-11; A Flawed System That Endangers Investors: Proxy Advisory Firm Failings, U.S. CH. OF COMMERCE & NAT’L ASS’N OF MANUFACTURERS (Fall 2018), available at https://proxyreforms.com/proxy-firm-failings/ last accessed Sept. 11, 2020). The latter of these sources provides additional general and specific support for most of the assertions made in this comment letter and underlying the proposed rule.

13 See, e.g., Proxy Advisory Reform, supra note 9, at 16 (citing Nicholas Donatiello & Harvey L. Pitt, Protecting Shareholders from Activist Proxies, WALL ST. J. (May 28, 2015)).

14 Consider, for instance, that proxy advisory services are under no fiduciary duty to anyone; that they seldom explain the bases for their recommendations, far less providing solid empirical support for them; and that they are implicated in conflicts of interest. See id.

categories of proposal, and other methods by which they might reasonably, safely and inexpensively make decisions about those proposals. Finally, the proposed rule requires fund managers to demand of proxy-advisory services explanations of the grounds upon which the services’ recommendations are made, sufficient to satisfy the managers’ fiduciary duty of care should the managers elect to rely on that guidance.

III. Likely Objections to be Discounted

Opponents of this rule are likely to argue that the adoption of social-activism proposals broadly raises the value of corporations, but these assertions will ignore significant evidence to the contrary, including evidence specific to corporate social activism by pension funds. Moreover, the objections will not be relevant to the question at hand, which is, in part: what are the obligations of pension-fund managers to their pension funds’ beneficiaries, and how can they safely and fully fulfill those obligations? Generalized assertions of the aggregate value of social-activism proposals say nothing about whether a pension-fund manager fulfills his fiduciary duty by using fund resources to research any specific proposal before the manager, or, having initiated research (or having relied on the research of others), whether that research is sufficiently deep and complete to permit a vote in favor of that proposal in the teeth of a conclusion by the corporation’s leading management, which also labors under fiduciary obligations to act in the best pecuniary interest of the corporation, that the proposal is not in that best interest.

Opponents will also likely argue that the proposed rule will increase, rather than decrease, pension-fund expenses in dealing with shareholder proposals because it will decrease the extent to which proxy-advisory firms will issue guidance, and therefore will increase the amount of work that pension-fund managers and their staffs will have to perform themselves. But this objection will miss both the peril in which pension-fund managers currently act and the nuanced approach taken by the proposed rule. When fund managers now rely on the unexplained or insufficiently explained and supported guidance of proxy advisory firms, they

---

16 See id.
17 See id.
19 See, e.g., Tracie Woidtke, Public Pension Fund Activism and Firm Value, MANHATTAN INSTITUTE LEGAL POLICY REPORT NO. 20, (Sept. 2015), available at https://www.manhattan-institute.org/html/public-pension-fund-activism-and-firm-value-7871.html (last accessed Sept. 10, 2020). Note that the study focuses on public pension-fund activism while the proposed rule would apply to ERISA-governed private pension funds, so the relevance is only high, not complete.
may well commit, each time, a per se violation of their duty of care by making decisions the basis for which they know little about. Even if the violation is not per se, it will in many, many cases constitute a violation in fact. Fund managers should not be putting themselves into that sort of danger.

This rule saves them from that danger by both permitting and requiring the managers to develop, in effect, safe-harbor provisions that will guide their actions in ways that will keep them firmly within the obligations of their fiduciary duty almost costlessly, in most instances. These safe-harbor provisions will help them quickly to dispose of most shareholder proposals without investing any more than the most cursory of resources to identify into which safe-harbor category the proposal falls.

This feature of the rule may also help to render proxy-advisory firm guidance more useful to all parties who make use of it, even if (and in fact perhaps because) it makes that guidance less voluble. By paring down the sorts of proposals for which pension-fund managers turn to those firms, while providing valuable guidance about the sorts of evidence fiduciaries of all sorts (i.e., all institutional-investment managers, not just pension-fund managers) must in safety demand from those firms before relying on their recommendations, the proposed rule may have the salutary effect of improving the quality and transparency of all of the guidance offered by proxy-advisory firms. Given the constraints on those firms' resources that were noted above, this may result in fewer recommendations overall, but to the extent that those recommendations were made without complete research and analysis, they should never have been relied upon by any actor with a fiduciary duty to maximize shareholder value. All parties will therefore be well served by their curtailment.

IV. Suggested Emendations

While we enthusiastically endorse the proposed rule in its current form, we would like respectfully to propose three small alterations to the rule, as it makes its way to final form, that we believe will marginally increase its value to all parties.

First, we would like to suggest that pension-fund managers be encouraged to establish a rule that they will not vote on any shareholder proposal the value of which depends materially on exogenous variables that remain contingent. We offer this proposal in response to "the Department[s]' request[ for] comment on whether the proposed permitted practices should contain additional examples regarding when advance proxy voting directions may be exercised pursuant to specific parameters designed to serve the plan's economic interest and, if so, what situations those examples should cover."20

Many shareholder proposals, for example, call for companies to change their investment programs so that they will completely have divested from carbon-producing activities by 2050. But the proponents' claims about the pecuniary value to the corporations of this proposal assume that the United States will have outlawed carbon production by 2050, thus rendering all carbon-producing assets "stranded," and therefore lost. But this assumption is both deeply contingent and entirely beyond the control of the corporation. Assessing, and then correctly monetizing, the probability that this long-distant expectation will actual occur as presumed, then comparing it against other possibilities that then must also be probablized and monetized is, if not effectively impossible, at least very complicated and therefore immensely expensive, if done properly. Managers would thus be best served simply to establish a safe-harbor rule refusing to engage with shareholder proposals that implicate material and contingent variables that lie outside of the control of the companies targeted by the proposal.

Second, we would like to suggest that the Department explicitly clarify that for proxy-advisory firm guidance to be sufficiently explained to permit fund-manager reliance on it, the explanation must demonstrate that the proxy advisors had competently and completely researched and analyzed sources and evidence that would tend to the conclusion contrary to the one reached by the advisory firm. The advisory firm should also be obliged to explain in sufficient detail why this contrary evidence was discounted and/or why the supporting evidence overbore it.

Finally, we propose that the Department clarify that in instances in which guidance from a proxy-advisory service sufficiently addresses all other details, but does not connect its guidance to the specific and unique characteristics of the individual pension fund to which the guidance has been issued, the managers of that fund cannot decide to vote on the proposal in question without themselves completing the analysis to render it directly applicable to the unique conditions of that fund, but can on the basis of the guidance provided and upon due consideration of the costs involved in the further required analysis, decide not to take any position on the proposal, and so not vote on it.

---


Thank you for your consideration of this comment. Please feel free to contact us if we can be of any further assistance in this matter.

Sincerely,

[Signature]

Justin Danhof

Scott Shepard
Free Enterprise Project
National Center for Public Policy Research
The National Center
20 F Street NW
Suite 700
Washington, DC 20001
(202) 507-6398