Office of Regulations and Interpretations
Employee Benefits Security Administration, Room N–5655
U.S. Department of Labor, 200 Constitution Avenue NW
Washington, DC 20210

Re: RIN 1210–AB91 Fiduciary Duties Regarding Proxy Voting and Shareholder Rights
Delivered via web upload at: www.regulations.gov
October 2, 2020

Dear Sir/Madam:

I appreciate the opportunity to provide comments to the U.S. Department of Labor (the "Department") on the "Fiduciary Duties Regarding Proxy Voting and Shareholder Rights" (the "proposed rule").

I worked in financial services from 1987 through 2007, and I rose from analyst, to broker, to trader, and finally portfolio manager. The companies for whom I worked included Citicorp, Goldman Sachs, and State Street Global Advisors. After leaving financial services, I taught graduate and undergraduate course on economics and politics for seven years. Most of this teaching was at Columbia University, and I particularly focused on how corporations interact with governments and markets. Currently, I manage my own taxable and retirement funds.

Corporate governance, including proxy voting procedures, have been a long-time interest of mine, and at many points I have voted shares either owned personally or by the funds I managed. Based on this experience and years of study, I think it is very important that the Department clarify and expand the proxy voting rules for ERISA plans. In particular, correcting the persistent misunderstanding that ERISA fiduciaries must vote all proxies, and reaffirming that fiduciaries exercising shareholder rights must be guided solely by the plan's economic interest, will improve the corporate governance process and allow ERISA managers to devote more resources to enhancing a plan's financial returns. I also think the proposed rule can be improved, if the Department, in certain situations, bans the use of pre-populated ballots (i.e., "robo-voting"), and if it prohibits proxy adviser conflicts of interest. Details are below.

The Importance of Not Having to Vote

The Department has referenced the confusion caused by the Avon letter and other guidance.[1] The mistaken presumption that ERISA funds must vote on all proxies causes many plans to incur unnecessary costs by retaining proxy advisors and by diverting management resources away from the more productive pursuit of higher returns. The voting presumption also is unhelpful since it is questionable if proxy voting as presently carried out appreciably effects corporate behavior.

Given the existing presumption of a requirement to vote, it is important that the Department expressly reject this mistaken belief. Explicitly stating that ERISA fiduciaries "must *not* vote any proxy unless the fiduciary prudently determines that the matter being voted upon would have an economic impact on the plan…"[2] is important and overdue.

[1] Fiduciary Duties Regarding Proxy Voting and Shareholder Rights. *Federal Registrar*. Sep 4, 2020. P. 55220.
[2] "Fiduciary Duties…". Ibid. P. 55225. Also see page 55221.

In the proposed rule, the Department noted that the precise cost to ERISA plans for engaging in proxy voting is unclear.[3] However, if one considers both the revenue of the two dominant proxy voting advisors, Institutional Shareholder Services, Inc. (ISS) and Glass, Lewis & Co., LLC, and the direct and opportunity costs of plan employees engaged in this activity, it is a safe assumption that these costs are in the hundreds of millions of dollars.[4] Any substantial reduction in these costs, including the opportunity costs internal to each plan, could have a significant and positive impact on ERISA plan returns. The proposed rule is intended to reduce, and will reduce, wasteful diversion of plan resources by restricting voting activity only to those issues that offer an economic return to the plan. This objective is laudable and should be maintained in the final rule.

Another reason for correcting the voting requirement misperception is that the finance literature itself raises doubts about proxy voting's effectiveness. The Department cited this literature in footnote 39 of the proposed rule and it is not necessary to repeat it. It can, however, be noted that some proponents of an expansive view of proxy voting have argued that the benefits of this type of shareholder engagement may be difficult to quantify in the short-term, but may realize gains over the long-term. This argument is weak because in the short-term the costs are non-trivial, but over the long-term any future benefits are highly speculative, at best. As the Business Roundtable said in a slightly different context:

> The current shareholder proposal process is…costing companies tens of millions of dollars and countless hours of management time through the cost of negotiating with proponents, seeking SEC no-action relief to exclude proposals from proxy statements, preparing opposition statements and other activities that are diverting from creating long-term shareholder value.[5]
>
> Increasingly, the current shareholder process fails to promote an effective channel of communication between shareholders and companies, especially with regard to matters material and of long-term value to the company. Instead, it is being used by a small number of shareholders attempting to advance litmus test issues that are not only rarely specific to the company but also largely irrelevant.[6]

Incurring high upfront costs for some uncertain or even negative payback in the future is irresponsible.

Whether or not a vote will affect the economic value of a plan's investment portfolio should be paramount in determining a fiduciary's obligations under ERISA to vote or abstain from voting. Reducing the need to vote proxies with di minimis or no economic value to the plan is warranted and beneficial. The Department's proposals for "permitted practices"[7] is an excellent way to provide fiduciaries with clear criteria of when they must, or must not vote. The quantitative thresholds are particularly sensible since a materiality standard based on a percentage of plan assets is an unambiguous way for fiduciaries to determine their responsibility. Additionally, the five percent threshold suggested by the Department is reasonable, and carving out nonbinding proposals with no significant economic impact on the value of the plan's holding also is sensible.

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[3] "Fiduciary Duties…". Ibid. P. 55225. Also see page 55229.

[4] The 2018 revenue of ISS alone was reported by Dun and Bradstreet to be approximately $79 million. See, Institutional Shareholder Services, Inc. Dun & Bradstreet. Access Sep. 25, 2020.

[5] Business Roundtable. Responsible Shareholder Engagement and Long-Term Value Creation. P.

[6] Ibid. P. 12.

[7] Fiduciary Duties…". Op. Cit. Pp. 55225-55226; 55231-55235.

Fiduciary Action Must be Guided Solely by the Plan's Economic Interest

It is important for the Department to reiterate in the proposed rule that "…use of plan assets for purposes other than enhancing the value of the plan's investments—through proxy voting or otherwise—violates the fiduciary duties of loyalty and care under ERISA."[8] The large increase in social and environmental activism, especially as expressed thorough shareholder proxies has increased pressure on some fund managers to sacrifice economic returns in the name of a personally defined social or political agenda.

Keeping ERISA fiduciaries focused on the goal of enhancing plan value is critical since there is an increasing temptation for fiduciaries to vote or expend plan funds on engagement activities that do not have an economic impact on the plan.[9] Ensuring that plan fiduciaries select investments solely on financial considerations relevant to the risk adjusted economic value of a particular investment is paramount. The experience with environmental, social and governance (ESG) investing over the last decade demonstrates that these strategies do not deliver consistently higher returns and involve greater risk.[10] Burton G. Malkiel, investment pioneer and Professor of Economics at Princeton University, recently summed this up as follows:

> Some ESG providers have also claimed that social investing can enhance returns. During particular periods, some funds with specific ESG mandates have outperformed. In the first half of 2020 funds with no oil but high tech stocks did well as the price of oil plummeted and tech stocks soared. But no credible studies show that ESG investing offers consistently higher long-term returns. Such funds are less diversified than broad-based index funds and thus are riskier. They also have higher expense ratios, which tends to lower investment returns.[11]

The historical experience and the current data do not justify arguing that ESG strategies can beat the market for any prolonged period of time in the future. Risking the financial future of scores of millions of ERISA plan members on such an assertion is reckless. This is why the Department's proposed rule stating the principle of ''exclusive purpose''[12] of securing economic benefits for plan participants and beneficiaries is critical.

Proxy Advisor Use Undermines Fiduciary Responsibility

The Department's suspicion that fiduciaries "…may sometimes rely on third-party advice without taking sufficient steps to ensure that the advice is impartial and rigorous…"[13] is well founded. The irony of the present situation is that the mistaken belief that fiduciaries had to vote all proxies contributed to the creation and growth of the proxy advisory industry that now undermines good corporate governance.

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[8] Fiduciary Duties…". Op. Cit. P. 55222.

[9] Fiduciary Duties…". Op. Cit. Pp. 55221, 55222, 55225.

[10] Wayne Winegarden. Environmental, Social, and Governance (ESG) Investing: An Evaluation of the Evidence. PRI. May, 2019; Eric Balchunas. "ESG ETFs: Your Socially Conscious Fund Probably Has Some Holes." Bloomberg. January 27, 2020; International Monetary Fund. Chapter 6: "Sustainable Finance: Looking Farther" in *Global Financial Stability Report, October, 2019*;

[11] Burton Malkiel. 'Sustainable' Investing Is a Self-Defeating Strategy. *The Wall Street Journal*. Sep 18, 2020.

[12] Fiduciary Duties…". Op. Cit. P. 55223.

[13] Fiduciary Duties…". Op. Cit. P. 55228.

Proxy voting advisers have inadvertently and increasingly come to assume a sub-optimal role in the equity markets. A study by Paul Rose of The Ohio State University, Moritz College of Law, reported as follows:

> the lack of diligence with which many managers use the services of the advisors is cause for concern, particularly when many of the governance recommendations of proxy advisors are based on thin (or no) empirical evidence. Also of concern is whether investment advisers are providing transparent disclosure regarding their use of those proxy advisors, and whether that disclosure is matched by how reliant they are on proxy advisors' recommendations. Despite public statements that these advisors are merely data aggregators and independent providers of information, it appears that some institutional investors have become overly reliant on the recommendations of proxy advisors, often outsourcing analysis and voting decisions to the two largest firms in the market without adequate disclosure of that reliance.[14]

This problem was bluntly condemned by Jamie Dimon, Chief Executive Officer of J.P. Morgan when he told investors:

> God knows how any of you can place your vote based on ISS or Glass Lewis…If you do that you, are just irresponsible…And, you probably aren't a very good investor, either. I know some of you here do it because you are lazy.[15]

A recent study by The American Council for Capital Formation asked companies to report the increase in shares voted within one, two and three business days of the publication of an advisers' adverse recommendation. For the 2017 proxy season, "…participating companies reported an average of 19.3% of the total vote is voted…" within this period. For the 2016 proxy season, the companies reported "…an average 15.3% of the total vote being [voted within] the same three-day period."[16] *This indicates that a substantial number of asset managers automatically follow proxy advisory recommendations blindly and that this number is increasing.* This was confirmed by a USC Marshall School of Business researcher who found that "the fraction of ISS customers blindly following its recommendations grew from 12 percent in 2006 to 23 percent in 2017."[17]

A Stanford University survey of portfolio managers in 2015 found that fund managers are only "moderately involved in voting decisions."[18] In fact, at large institutional investment firms, portfolio managers are only involved in 10% of the voting decisions.[19] A 2016 academic survey found that as much as 25% of all proxy voting outcomes is determined by proxy advisory firm recommendations.[20] A 2018 study noted that an "…extensive sample of the voting record of 713 institutional investors in 2017…shows that institutional investors are significantly likely to vote in accordance with proxy adviser recommendations across a broad spectrum of governance issues.[21] A 2018 survey undertaken by four

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[14] Paul Rose. Robovoting and Proxy Vote Disclosure. SSRN. November 13, 2019.

[15] Simon Bowers. JP Morgan takes advice from firm that its chief attacked. *The Guardian*. June 15, 2015.

[16] Frank M. Placenti. "Are Proxy Advisors Really a Problem?" ACCF. October, 2018. Pp. cit. P. 8.

[17] Chong Shu. The Competitive Lanscape of the Proxy Advice Market. The CLS Blue Lion logo Sky Blog. June 25, 2020.

[18] David F. Larcker, Ronald Schneider, Brian Tayan, Aaron Boyd. "2015 Investor Survey: Deconstructing Proxy Statements — What Matters to Investors." Stanford University, RR Donnelley, and Equilar. February, 2015. P. 2

[19] Ibid.

[20] Nadya Malenko and Yao Shen. "The Role of Proxy Advisory Firms: Evidence from a Regression-Discontinuity design." *Review of Financial Studies.* December 2016. Pp. 3394-3427.

[21] James R. Copland, David F. Larcker, and Brian Tayan. "Proxy Advisory Firms: Empirical Evidence and the Case for Reform." Manhattan Institute, May 2018. P. 12

major law firms found that hundreds of investment managers rely on the voting advice of proxy advisers almost all of the time. [22] Specifically, it found that:

- "175 asset managers managing over $5.0 trillion in assets have historically voted consistently with ISS recommendations 95% of the time, whether the matter at issue was a management proposal or a shareholder proposal, and
- 82 of the asset managers with over $1.3 trillion of assets under management voted consistently with ISS' recommendations 99% of the time..."

In order to repair this shirking of fiduciary responsibility by managers, the Department needs to restrict how managers use proxy advisors.

Proxy Advisory Conflicts of Interest

According to a NASDAQ / Chamber of Commerce survey in 2019, 19% of companies identified significant conflicts of interest by proxy advisers, and this is up from 10% in 2018.[23] These conflicts can range from advocating for board candidates who represent proxy advisory clients, to making voting recommendations on proxy proposals when the sponsor is a paying proxy advisory client or even its owner. The conflicts at ISS are particularly egregious. ISS rates corporate governance, but it also tries to sell consulting services to issuers to "help" them improve this very same corporate governance score. As the NASDAQ / Chamber of Commerce survey noted, "A striking 58% of companies reported being approached by ISS Corporate Solutions during the same year in which the company received a negative vote recommendation."[24] The contrast with Glass Lewis, which does not sell consulting services, is striking. Below is Glass Lewis' explanation of why they do not sell consulting services to issuers:

> We believe the provision of consulting services creates a problematic conflict of interest that goes against the very governance principles that proxy advisers like ourselves advocate. By not providing consulting services to the subjects of our reports, Glass Lewis ensures we have no financial incentive to develop policies or issue recommendations that make companies feel they need to pay for consulting services in order to achieve a favorable outcome. Further, a consulting business is not only in conflict with the interests of our clients, but in conflict with the interests of the companies who are entitled to a fair, reasonable and independent assessment.[25]

The ISS consulting conflict is reminiscent of the accounting/consulting conflicts of the early 2000s. The SEC (and Congress) dealt with this problem by banning accounting firms from selling consulting services to companies they are auditing. The Department should deal with proxy adviser conflicts of interests similarly to how the accounting / consulting conflicts were handled in the early 2000s.

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[22] Frank M. Placenti. Squire Patton Boggs. "Are Proxy Advisors Really a Problem?" Harvard Law School Forum on Corporate Governance. October, 2018. P.2. The full report can be found at: Frank M. Placenti. "Are Proxy Advisors Really a Problem?" ACCF. Oct 2018.

[23] NASDAQ / U.S. Chamber of Commerce. "2019 Proxy Season Survey." Nov 21, 2019. P. 10.

[24] Ibid. P. 12.

[25] Katherine Rabin. "Response to U.S. Senate Banking Committee." June 1, 2018. P. 2.

Measures to Improve Corporate Governance Through the Proposed Rule

There are several areas in the proposed rule that could benefit from further clarification/development by the Department. Specifically, the Department should:

- **clarify precisely how a plan determines whether a vote will have a positive economic impact**
- **require that investment professionals validate that proxy votes have an economic impact, and**
- **provide specific language that ERISA fiduciaries should not use plan resources to take part in ESG-related proxy voting or shareholder activism, if these engagements do not strengthen the financial value for participants and beneficiaries.**

In the proposed rule, the Department recognized many of the aforementioned problems and it wrote supportively[26] of the recent Security and Exchange Commission's (SEC) final rule: Amendments to Exemptions from the Proxy Rules for Proxy Voting Advice. However, it is unclear from the Department's proposed rule how prominently the SEC's final rule will be incorporated into the Department's rule. In order to avoid confusion and promote an effective rule, the Department should explicitly incorporate the key sections of the new SEC rule into its rule on "Fiduciary Duties Regarding Proxy Voting and Shareholder Rights." This is especially important because there is a subset of ERISA plans that are outside SEC's jurisdiction and therefore not subject to the SEC rule.

The specific SEC provisions that are particularly worthy of incorporating into the Department's rule concern:

- **the due diligence required by fiduciaries when considering the use of a proxy firms' automatic vote submission services**
- **the degree of disclosure necessary when a proxy advisory firm is hired, and**
- **the requirement that asset managers consider issuer information before voting, especially issuer responses made available to a proxy adviser after a vote recommendation is published.**

The Department should improve on the SEC rule by better regulating robo-voting and conflicts of interests and by increasing the general transparency of the proxy voting advisory process. Specifically, it should:

- **prohibit the use of pre-populated ballots when the proxy firm's recommendation is contested by the issuer**
- **mandate disclosure of investment adviser voting records including the percentage of proxy advised votes that were reviewed before being cast, and how all votes cast compare (in percentage terms) to the voting recommendations received from proxy advisers**
- **mandate disclosure of fees paid by fund managers to proxy voting advisers**
- **prohibit proxy advisory firms from consulting with companies when they also make recommendations on voting issues for that company**
- **establish a baseline disclosure standard to which all proxy voting advice businesses must adhere.**

While it is possible that compliance with the proposed rule and these proposals may increase internal costs for some plans, any higher costs should be offset by lower proxy advisory expenditures. If proxy advisory firms are retained with a smaller range of responsibilities and narrower engagements, it is

[26] Fiduciary Duties Regarding Proxy Voting and Shareholder Rights. *Federal Registrar*. Sep 4, 2020. P. 55223.

logical that these costs will decrease. Additionally, if the Department establishes minimum standards for deciding when not to vote, the actual internal costs should be lower, too.

Conclusion

Some of the public discussion around the proposed rule almost seems nostalgic for the Avon letter and early corporate governance pioneers like Robert Monk. Unfortunately, the evolution of proxy voting and advisory services since that time has demonstrated that the financial service sector cannot, as presently designed, adequately handle this responsibility. Structural changes to the market and advances in information and communications technology have caused the process to devolve into a situation where some fiduciaries violate their duties of loyalty and care under ERISA, especially when voting proxies. Prepopulated ballots and automatic voting, in particular, have become a “check-the-box” legal dodge for some to avoid a very serious responsibility. The Department’s final rule should remedy this situation.

Additionally, there is a need to depoliticize the shareholder voting process by removing it as an arena for some groups to pursue their wider social and environmental goals. If environmental or social activists want to campaign for change, they should address the issue with the appropriate legislative bodies, not corporations through the shareholder proxy process. Plan fiduciaries should not be sponsoring or campaigning for shareholder proposals that deliver little or no economic benefit to ERISA plan participants and beneficiaries. The Department has it within its powers to rectify this situation, and I hope it will do so.

Thank you for your consideration.

Sincerely,

Jonathan A. Chanis

Jonathan A. Chanis, Ph.D.