



October 5, 2020

Ms. Jeanne Klinefelter Wilson  
Acting Assistant Secretary  
Employee Benefits Security Administration  
Room N-5655  
U.S. Department of Labor  
200 Constitution Avenue NW  
Washington, DC 20210

Re: Proxy Voting and Shareholder Rights NPRM: RIN 1210-AB91: Fiduciary Duties Regarding Proxy Voting and Shareholder Rights Factors in Selecting Plan Investments

Dear Assistant Secretary Wilson:

I appreciate this opportunity to provide comments to the Department of Labor (“Department”) on RIN 1210-AB91, the Employee Benefits Security Administration’s proposed rule, “Fiduciary Duties Regarding Proxy Voting and Shareholder Rights”.

I am a financial economist, a finance professor at The George Washington University, an entrepreneur, and an active investor for retirement. In addition, earlier in my career, I was an institutional investment personnel for a large asset management company. My experience spans asset management to economic impact analysis of public policies. I am currently managing partner at ndp | analytics, an economic strategic consulting firm that specializes in assessing the economic and social impact of public policies.

I applaud the Department for taking prudent steps to protect American workers and their families in their retirement years. In its proposed rule, the Department reiterated that the sole duty of plan managers making investment decisions is to provide long-term returns, and that fiduciaries have an obligation to act solely in the interest of plan beneficiaries and for the exclusive purpose of providing benefits to plan participants. The Department makes clear that fiduciaries can make proxy decisions only based on economic considerations and not based on unrelated objectives. Furthermore, the Department specifically refers to non-pecuniary environmental, social, and corporate governance (“ESG”)-driven decisions as being prohibited. The proposed rule also focuses on the costs – which are borne by ERISA-regulated pension beneficiaries – of making proxy voting decisions. I fully support these objectives.

Although mentioned in its proposed rule, the Department should explicitly prohibit the practice of robo-voting. Robo-voting, or automatic voting, is the process by which institutional asset managers vote in line with the recommendations provided by proxy advisory firms. While several large institutional investors have their own in-house experts to evaluate companies, most fund managers outsource these duties to proxy advisors. Although proxy advisors are supposed to only provide advice to asset managers, the reality is asset managers just follow the proxy advisors’ recommendations to vote on hundreds and thousands of

issues that do not directly affect the investment returns of retirement accounts. In fact, robo-voting has the potential to have an adverse impact on the financial returns of ERISA pension beneficiaries specifically when proxies and shareholder proposals advocate for non-pecuniary objectives. This robo-voting, moreover, is espoused consistently by ESG activists. Unfortunately, this activism detracts from shareholder priorities and value. As Harvard University's Professor Joseph Kalt writes, "[S]uch activism may open the door to the diversion of resources towards goals besides shareholder returns, with consequent harm to good corporate governance. It raises the question, for example, of which issues are to be considered 'significant' by whom and, thus, warrant the use of management resources and consumption of corporate assets."<sup>1</sup>

Proxy advisory firms provide comprehensive coverage of corporate proxy services, including research and analysis of proxy issues, custom policy recommendations, vote recommendations, vote execution, and governance data. The proxy advising industry in the U.S. primarily consists of five firms. But the market is dominated by just two firms: Institutional Shareholder Services Inc. ("ISS") and Glass, Lewis & Co. ("Glass Lewis"). In addition to services to institutional investors, ISS, a for-profit subsidiary of private equity firm Genstar Capital, also provides advisory and consulting services and analytical tools to corporate issuers. Three other smaller firms are Egan-Jones Proxy Services, Marco Consulting Group, and ProxyVote Plus. ISS and Glass Lewis each provide services to between 1,200 and 1,600 clients, while smaller proxy advisory firms provide their services for between 200 and 450 clients.<sup>2</sup>

Institutional investors carry out their fiduciary duties to generate the highest investment return in the best interests of the institutional investor's beneficial owners. Proxy advisory firms, however, do not have those obligations to beneficial owners. Proxy advisory firms are third-party service providers that provide research and voting recommendations on proposals to institutional investors. ISS is registered as an investment advisor with SEC while Glass Lewis is not registered with SEC.<sup>3</sup> Each year, ISS and Glass Lewis provide recommendations for tens of thousands of annual meetings and ISS alone executes 10.2 million ballots annually on its clients behalf.<sup>4</sup> In 2017, there were nearly 28,000 ballot items on the proxies of Russell 3000 companies and more than 96% of those items were routine management proposals.<sup>5</sup> Due to the large number of votes that take place during proxy season, institutional investors rely heavily on the recommendations of proxy advisors to cast their votes.

This proxy voting rule does not require that investment advisors to undertake all of the proxy voting responsibilities. In fact, the Securities and Exchange Commission ("SEC") in 2019 issued a guidance regarding investment advisors' proxy voting responsibilities that an investment advisor and its client may agree that: (1) the investment advisor would not exercise voting authority on certain types of matters where the cost of voting would be high or the benefit to the client would be low; (2) the investment advisor is not required to accept the authority to vote client securities, regardless of whether the client undertakes to vote

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<sup>1</sup> Joseph Kalt, Ph.D. Political, Social, and Environmental Shareholder Resolutions: Do They Create or Destroy Shareholder Value? May 2018. [https://corpgov.law.harvard.edu/wp-content/uploads/2018/06/ESG-Paper-FINAL\\_reduced-size-002.pdf](https://corpgov.law.harvard.edu/wp-content/uploads/2018/06/ESG-Paper-FINAL_reduced-size-002.pdf)

<sup>2</sup> GAO. Corporate Shareholder Meetings. Report to the Chairman, Subcommittee on Economic Policy, Committee on Banking, Housing, and Urban Affairs, U.S. Senate. November 2016. <https://www.gao.gov/assets/690/681050.pdf>

<sup>3</sup> GAO. Corporate Shareholder Meetings. Report to the Chairman, Subcommittee on Economic Policy, Committee on Banking, Housing, and Urban Affairs, U.S. Senate. November 2016. <https://www.gao.gov/assets/690/681050.pdf>

<sup>4</sup> The Wall Street Journal. The Proxy Protection Racket. November 10, 2019. <https://www.wsj.com/articles/the-proxy-protection-racket-11573417818>

<sup>5</sup> Blackrock. The Investment Stewardship Ecosystem. July 2018

the proxies itself; and (3) the investment advisor will focus resources only on particular types of proposals based on the client's preferences.<sup>6</sup> In its supplemental guidance concerning proxy voting responsibilities of investment advisers issued in July 2020, the SEC adopted amendments to assist investment advisers to make informed voting decisions on behalf of clients and to comply with their obligations in connection with proxy voting in a client's best interest. Specifically, the SEC provided guidance on three areas: (1) for issuers to have access to proxy advisory firm recommendations and to provide responses with additional information that may be material to a voting decision in a more systematic and timely manner; (2) for investment advisers to assess the additional information resulting from the amendments that become more readily available to them, including times when investment advisers use proxy advisory firms' electronic vote management system and/or for voting execution services; and (3) for investment advisers to address disclosure obligations and considerations that may arise when investment advisers use voting executing services for voting.<sup>7</sup>

Although investment advisers do not need to vote on all issues, the proxy advisory firms have gone beyond pecuniary issues to vote for all other corporate matters. The proxy advisors have included voting issues that are not directly improving financial returns for ERISA pension beneficiaries. For example, ESG issues have become increasingly popular in recent years. Although they might be of interest for individual investors, ESG issues are not considered as pecuniary, nor should they be appropriate, factors for ERISA pension beneficiaries. In fact, the Department has clarified that ESG factors may or may not be related to a participant's long-term financial best interests. Individual investors may care deeply about ESG issues. As such, they may evaluate corporations' ESG disclosures publicly to make decisions based on their own social values to determine their own asset allocations.

Moreover, with hundreds and thousands of issues being voted within a short period of time in a nontransparent fashion thanks to automatic voting, there is ample evidence of proxy advisory firms making errors in their recommendations. As Chris Netram, vice president of tax and domestic economic policy at the National Association of Manufacturers ("NAM"), stated in a comment letter to the SEC earlier this year:

"Proxy firms often engage in the automatic submission of proxy votes (a practice sometimes known as "robo-voting") on behalf of their clients, meaning that the flaws intrinsic to their recommendations are translated immediately into voting power, completely cutting investment advisers and their clients out of the process and depriving issuers of a chance to correct the record or provide investors with additional information."<sup>8</sup>

It is estimated that institutional investors own 70%, while individual investors own 30%, of shares outstanding in U.S. public companies. About 91% of institutional investors voted their shares compared with only 28% of retail investors. Because many institutional investors use the services of proxy advisory firms, increased institutional ownership has resulted in greater market demand for these firms.<sup>9</sup> The proxy

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<sup>6</sup> Securities and Exchange Commission. Commission Guidance Regarding Proxy Voting Responsibilities of Investment Advisers. Release Nos. IA-5325; IC-33605. September 10, 2019. <https://www.sec.gov/rules/interp/2019/ia-5325.pdf>

<sup>7</sup> Securities and Exchange Commission. Supplement to Commission Guidance Regarding Proxy Voting Responsibilities of Investment Advisers. Release Nos. IA-5547; 17 CFR Part 276. July 22, 2020. <https://www.sec.gov/rules/policy/2020/ia-5547.pdf>

<sup>8</sup> Chris Netram. SEC Comment Letter. February 3, 2020. <https://www.sec.gov/comments/s7-22-19/s72219-6735396-207626.pdf>

<sup>9</sup> GAO. Corporate Shareholder Meetings. Report to the Chairman, Subcommittee on Economic Policy, Committee on Banking, Housing, and Urban Affairs, U.S. Senate. November 2016. <https://www.gao.gov/assets/690/681050.pdf>

advisory firms suddenly have become important for companies. Although these proxy advisors are not affected by the financial performance of these companies, they have a significant say on company operations.

Since asset managers “blindly” follow proxy advisors’ recommendations when they robo-vote, this practice unintentionally damages companies, which in turn affects the financial returns of retirement accounts. Proxy advisory firms have significant influence on companies, which might not be positive for pension beneficiaries. In its report, the Government Accountability Office (“GAO”) concluded that proxy advisory firms have substantial influence on shareholder voting and corporate governance practices; this influence is more often viewed negatively.<sup>10</sup> A proxy advisor’s recommendation may create new requirements for companies that add cost and burden beyond that which is required by regulators.

In sum, proxy advisory firms provide advisory services and recommendations to institutional investors. Unlike investment advisors, proxy advisory firms do not have fiduciary duties to pension beneficiaries. The two dominant proxy advisory firms each year process hundreds and thousands of shareholder proposals and robo-vote millions of ballots concerning corporate governance issues that many have no impact on the financial returns of beneficiaries. Due to this vast sum of information, proxy advisory firms are inevitably making errors and false recommendations. Since institutional investors tend to vote along ISS and Glass Lewis recommendations, proxy advisory firms have significant influence on small and large U.S. corporations. The robo-voting practice magnifies the role of proxy advisory firms and, consequently, their voice on corporate issues. Nonetheless, pension beneficiaries do not necessarily gain monetarily from non-pecuniary votes. Rather, pension beneficiaries, in effect, must pay for the proxy advisory services that are outsourced by their investment advisors.

Specifically, I hope the Department’s final ruling considers my analysis of the following solicitations contained in the proposed rule. The below points will not only enhance the Department’s efforts to strengthen the SEC’s guidance on robo-voting, but also, more importantly, further protect ERISA pension plan beneficiaries.

1. Page 40 of the proposed rule states, “The Department invites comments on whether, to what extent, and under what circumstances plans’ proxy votes are likely or unlikely to increase the value of their shares or otherwise advance their participants’ economic interest.” In response, plan fiduciaries’ votes, when they are executed automatically, are indeed likely to decrease the value of shares held by their beneficiaries when the automatic vote is cast on a non-financial proxy matter. In that light, the Department should prohibit robo-voting in cases where ERISA investment advisors are normally allowing proxy advisory firms to cast their votes without proper due diligence on non-pecuniary votes.
2. Page 51 of the proposed rule states, “The Department also invites comments on whether the proposed rule, if finalized, would enable plans to retain proxy advisory firms at lower cost or with more attractive fee arrangements, since a much narrower range of responsibilities might be encompassed, and on whether the proposed rule would lead to new, narrower advisory

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<sup>10</sup> GAO. Corporate Shareholder Meetings. Report to the Chairman, Subcommittee on Economic Policy, Committee on Banking, Housing, and Urban Affairs, U.S. Senate. November 2016. <https://www.gao.gov/assets/690/681050.pdf>



engagements or new services.” This particular solicitation regarding cost and benefit analysis of the rule caught my attention. This ruling, if finalized, would thankfully lead to a narrower set of engagements for proxy advisors when companies have responded to one of their proxy recommendations. It is hoped that, in all instances when a company offers such a rebuttal to a recommendation – which it already does within a tight timeframe – the Department will codify in this ruling the prohibition of robo-voting.

In conclusion, I encourage the Department to take the above additional steps to protect millions of hard-working Americans and their families. ERISA fiduciaries should not be able to select investments, nor robo-vote, based on non-pecuniary factors when plan participants’ retirement savings are at stake. The practice of robo-voting should be restricted, as it does not add economic value to pension funds or retirement security.

Sincerely,

A handwritten signature in blue ink that reads 'Nam Pham'.

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