

October 5, 2020

The Office of Regulations and Interpretations
Employee Benefits Security Administration
Room N-5655
U.S. Department of Labor
200 Constitution Avenue, N.W.
Washington, DC 20210
Attention: Proxy Voting and Shareholder Rights NPRM

Submitted via regulations.gov

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

Ladies and Gentlemen:

Federated Hermes, Inc. (“Federated Hermes”) appreciates the opportunity to provide input on the Department of Labor’s (the “Department”) notice of proposed rulemaking (“Proposal”) regarding the investment duties that fiduciaries subject to the Employee Retirement Income Security Act (“ERISA”) must follow when exercising shareholder rights, including proxy voting. While we agree that a fiduciary must comply with the prudence and exclusive purpose duties under ERISA when exercising such rights, we believe certain points of the Proposal need to be clarified.

Who We Are:

Federated Hermes is a global investment manager of more than \$600 billion that has been focused on fiduciary principles since our founding in Pittsburgh, Pennsylvania in 1955. From the very beginning, Federated Hermes has been meeting the investment needs of fiduciaries who advise or manage assets for their clients. Fiduciary duty is central to our understanding of our role as stewards of our clients’ assets, and we take that responsibility very seriously. Even as we have grown and expanded our offerings to include a broad range of investment strategies—from liquidity solutions to high active share global and regional equities to active credit and private markets—our core principles remain the same: meeting the financial needs of our clients.

Federated Hermes has for nearly two decades devoted significant resources to developing fiduciary educational materials and programs for investment professionals and ERISA plan sponsors.¹ These programs explain the fiduciary obligations of investment advisors and plan trustees, and help them develop and implement a prudent, thorough and well-documented

¹ We specifically wish to acknowledge the invaluable, decades-long efforts in this area of our esteemed colleague, Eugene F. Maloney, who passed away last year.

investment process that complies with ERISA’s requirements. Federated Hermes values its role as a thought leader and advisor to financial professionals to help them meet ERISA’s high standards of protecting workers.

Federated Hermes also prides itself on being a committed steward of the assets we manage on behalf of clients. As a fiduciary, and as a responsible investor, we take great care to understand when and where environmental, social, and governance (“ESG”) factors, along with any other factor, may affect the value of client assets. The ability to vote is something we view as an inextricable part of our investment process. As a result, we view steps taken to remove voting rights as counter to current legal expectations of us as fiduciaries. Limiting our ability to exercise our voting rights will impair our ability to carry out the full gamut of our fiduciary obligations to our clients.

We Support Applying ERISA’s Fiduciary Standards When Exercising Proxy Voting and Other Shareholder Rights

Federated Hermes agrees that a fiduciary must comply with the prudence and exclusive purpose duties under ERISA when exercising proxy voting and other shareholder rights. We are strongly committed to these fiduciary principles. We agree that it is consistent with ERISA’s fiduciary principles, and with the Department’s past and current guidance, that a fiduciary may not subordinate the interests of the participants and beneficiaries in their retirement income or financial benefits under the plan to any non-pecuniary objective.

However, while we support this premise of the Proposal, the Proposal needs clarification before it can be effectively implemented. We are concerned that, without the further clarification we believe is required, the Proposal’s prohibition on voting any proxy unless the fiduciary determines that the matter being voted upon would have an economic impact on the plan, risks the unintended consequence of creating situations when a fiduciary should have voted on a proxy, but instead declines to vote out of fear of violating the regulation – thus effectively leading to a breach of fiduciary duties. We are also deeply concerned that the removal of voting rights from the control of fiduciaries will reduce corporate accountability.

We also note that the Department has not presented any evidence of excessive costs to plans due to proxy voting and that without this data, cannot meet its obligations to perform a proper regulatory impact analysis.

We are Concerned that the Removal of Shareholders’ Rights will Reduce Corporate Accountability

We believe that shareholder engagement, including the voting of proxies, is a key tool to ensure corporate accountability and good governance. Voting rights of shareholders are granted by state and federal law. By delineating circumstances where fiduciaries are prohibited from voting proxies on behalf of plan clients, the Proposal undermines these corporate laws.

In addition, with the purported aim of reducing costs, the Proposal would seemingly allow fiduciaries to abdicate their fiduciary duties of prudence and loyalty by adopting “permitted

practices”² whereby the fiduciary would in almost all circumstances either vote with management or not vote at all. Discussion in the preamble to the Proposal puts these permitted practices forward as a cost-saving measure, because following such practices would avoid the expenditure of plan resources, allowing a fiduciary to “refrain from researching and voting on proposals that they prudently determine have no economic impact on the value of the plan’s investment.”³ We question how a fiduciary can prudently determine that a proposal will have no economic impact on a plan without performing at least some research.

With respect to the permitted practice of voting with management, the Department justifies this practice, in part, because “[c]orporate directors owe their own fiduciary duties to their corporation”⁴ and a fiduciary can “maintain a proxy voting policy that relies on the fiduciary duties that officers and directors owe to a corporation based on state corporate laws.”⁵ However, it is an aberration for the Department to say that, in this context, a fiduciary can assume another entity is acting in a plan’s best interest solely because it has a separate duty to the company and shareholders. Instead, the Department has consistently provided guidance that an ERISA fiduciary’s responsibilities include the duty to monitor service providers, investments, and other fiduciaries.⁶ Although a company’s management has its own duties to the company, management’s interests do not always align with the best interests of investors, including plans. In this context, the right to vote proxies is an important check on the management of a company, which the Proposal, as currently drafted, would undermine. Although the Department indicates that a fiduciary would not be precluded by a permitted policy from voting in any particular case in which the fiduciary subsequently determines that the proxy matter being voted upon would have an economic impact on the plan,⁷ we question how a fiduciary could make that determination if it performs no research on the matter in question.

² We note that, although described as “permitted practices” it is unclear from the Proposal whether adopting any of the practices listed would operate to limit the fiduciary’s liability when voting, or not voting, proxies. The Proposal does not state that a fiduciary would be deemed to satisfy its fiduciary duties when acting in accordance with a permitted practice, although the preamble to the Proposal suggests they may be used “to reduce possible exposure to fiduciary liability.” 85 Fed. Reg. 55219, 55234 (Sept. 4, 2020). The Department should clarify whether the permitted practices will operate as safe harbors to protect fiduciaries from liability.

³ *Id.* at 55231.

⁴ *Id.* at 55224 n.52.

⁵ *Id.* at 55225.

⁶ See U.S. Department of Labor, Employee Benefits Security Administration, “Meeting Your Fiduciary Responsibilities,” Sept. 2017, <https://www.dol.gov/sites/dolgov/files/EBSA/about-ebsa/our-activities/resource-center/publications/meeting-your-fiduciary-responsibilities.pdf>.

⁷ *Id.* at 55225.

The Proposal does not Consider the Issue that it is Only After Research has been Completed, that a Proper Fiduciary View can be Developed on Whether and How to Appropriately Vote

The Proposal requires that a fiduciary must investigate material facts that form the basis for any particular proxy vote or other exercise of shareholder rights. However, the Proposal also requires that a fiduciary take into account the costs of research when determining how to vote. Given that it is only after research has been completed that it will become clear to the fiduciary whether and how a fiduciary should vote under the Proposal's rules, as noted above, these two requirements could be contradictory and should be clarified to specify the exact circumstances under which a fiduciary may ignore its obligation to perform otherwise required research. In our view, those circumstances should be very narrow, if they exist at all, to avoid a fiduciary abdicating its responsibilities.

In order to avoid the costs of research, the Proposal could push fiduciaries into adopting the "permitted practices" set out in the Proposal, including the practices of nearly always either voting with management or not voting at all. As discussed above, we believe these practices would have the unintended consequences of reducing corporate accountability.

The Proposal does not Address Situations Where There is no Additional Cost to the Plan whether the Proxy is Voted or Not

The requirement to take into account the costs of research does not take into account situations such as ours, where we absorb all the costs related to proxy voting, including voting operations and research. We receive one investment management fee that covers the costs of our services, and there is no additional cost to the plan due to proxy voting matters. The plan does not save any money if we do not vote a proxy either because we declined to vote or if there are cases where we would be prohibited from voting if the Proposal is finalized. Therefore the concern raised in the Proposal that plan assets could be used for purposes other than enhancing the value of the plan's investments by voting proxies is simply inapplicable in a case like ours (*i.e.*, where a plan engages an investment adviser that charges a single investment management fee that also covers the costs of proxy voting operations and research).

The Department Should Clarify When a Fiduciary Will Be Prohibited from Voting a Proxy

The Department should clarify the circumstances under which a matter being voted upon would have no economic impact on the plan, given that in such circumstances the Proposal would prohibit a fiduciary from voting a proxy.⁸ In our experience, once we have completed our

⁸ The Department requested comments on whether additional direction on voting, such as on the distinction between not voting and abstaining, would be beneficial to fiduciaries. *Id.* at 55235. We believe such additional direction is needed. The Proposal provides that a fiduciary "must not vote" a proxy unless the fiduciary prudently determines that the matter being voted upon would have an economic impact on the plan. *Id.* at 55242. However, the preamble to the Proposal discusses situations where a fiduciary has an obligation to "vote or abstain from voting." *Id.* at 55228. Not voting and abstaining from voting are two different actions, with impacts such as whether a quorum is met.

research into any particular proxy matter, a situation where there is no economic impact to the plan is more a theoretical possibility than a reality. Either our research will show that the matter being voted on will strengthen the company if implemented, or that it will not. At a base level, a matter that would strengthen or otherwise improve the company is likely to result in an economic benefit in connection with the plan's investment, when considered in the long-term. If the matter being voted on will not result in a net positive to the company (and thus the plan's investment), then our position is that we, as a fiduciary, should vote "against" the proxy, not that we should decline to vote. Prohibiting fiduciaries from voting in circumstances where they would otherwise vote "against" may have the unintended consequence of allowing more frivolous proxy voting matters to be successfully approved, resulting in decreased corporate accountability as discussed above.

The Proposal seems aimed at restricting a fiduciary's judgment of the long-term value to a company of particular factors, particularly ESG factors.⁹ Although the Department's recent proposal on "Financial Factors in Selecting Plan Investments" (the "ESG Proposal") acknowledges that ESG factors may have economic impacts to a plan,¹⁰ both the ESG Proposal and this Proposal fail to contemplate the many ways ESG factors can be determinative in the long-term health and performance of a company, and therefore the long-term health and performance of a plan's investment in such company. Evaluating such matters on behalf of the plan should be left to the fiduciaries, as investment professionals, who should not be swayed from their fiduciary duty to act in the plan's best interest by fear of violating an ambiguous regulation.

There certainly may be proxy proposals that seek to prioritize a special social or environmental goal from the company or a shareholder proponent that may not be appropriate for an ERISA plan. However, it is those cases where, again, the fiduciary should be free to cast an "against" vote, rather than be prohibited from voting.

The Proposal's Regulatory Impact Analysis is Insufficient

The Department has not presented any evidence of excessive costs to plans due to proxy voting. In fact, in 2016, the Department found that "[i]n most cases, proxy voting and other shareholder engagement does not involve a significant expenditure of funds by individual plan investors."¹¹

⁹ *Id.* at 55222 ("The Department is now concerned that some fiduciaries and proxy advisory firms . . . may be acting in ways that unwittingly allow plan assets to be used to support or pursue proxy proposals for environmental, social, or public policy agendas that have no connection to increasing the value of investments used for the payment of benefits or plan administrative expenses, and in fact may have unnecessarily increased plan expenses.").

¹⁰ 85 Fed. Reg. 39113, 39116 (June 30, 2020) ("...a company's improper disposal of hazardous waste would likely implicate business risks and opportunities, litigation exposure, and regulatory obligations. These would be appropriate economic considerations that qualified investment professionals would treat as material under generally accepted investment theories. Dysfunctional corporate governance can likewise present pecuniary risk that a qualified investment professional would appropriately consider on a fact-specific basis.").

¹¹ Interpretive Bulletin Relating to the Exercise of Shareholder Rights and Written Statements of Investment Policy, Including Proxy Voting Policies or Guidelines, 81 Fed. Reg. 95879, 95881 (Dec. 29, 2016).

The Department acknowledges that its economic assessment of the Proposal's effects is subject to uncertainty and that the Department currently lacks the data to judge the attendant costs and benefits.¹² Without this data, the Department cannot meet its obligations to perform a proper regulatory impact analysis.

Conclusion

Federated Hermes supports the application of strong fiduciary principles when voting proxies and exercising other shareholders rights on behalf of an ERISA plan. However, we do not believe there should be a prohibition on a fiduciary voting a proxy based on the theoretical possibility that there may be some circumstance in which the matter being voted upon would have no economic impact on the plan. We are concerned that the Proposal, as written, will lead many fiduciaries to avoid voting proxies, even in circumstances where the prudent action is to vote either "for" or "against." We object to the removal of voting rights from a fiduciary's discretion. Prohibitions on voting, particularly in situations where the fiduciary may be required to bypass proper research to determine what is in the best interest of the plan, impair a fiduciary's ability to carry out its obligations to clients and undermine corporate accountability.

We would be happy to meet with you at your convenience to discuss these or any other issues related to the Proposal, and we look forward to working with you to strength ERISA's fiduciary protections.

Sincerely,



Anne H. Kruczek
Executive Vice President
Head of Responsible Investing Office
Federated Advisory Services Company

¹² 85 Fed. Reg. 55219, 55233.