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February 3, 2011

Office of Regulations and Interpretations
Employee Benefits Security Administration
Attn: Definition of Fiduciary Proposed Rule
Room N-5655
U.S. Department of Labor
200 Constitution Avenue, NW
Washington, DC 20210

Ivan G. Seidenberg
Verizon Communications
Chairman

Kenneth I. Chenault
American Express Company
Vice Chairman

Edward B. Rust, Jr.
State Farm Insurance Companies
Vice Chairman

John Engler
President

Larry D. Burton
Executive Director

Johanna I. Schneider
Executive Director
External Relations

Re: Application of ERISA Fiduciary Rules to Proxy Advisory Firms

Dear Sir or Madam:

Business Roundtable appreciates the opportunity to present comments to the Employee Benefits Security Administration (“EBSA”) in connection with the proposed regulations that would amend the definition of “fiduciary” under the Employee Retirement Income Security Act of 1974, as amended (“ERISA”). For the reasons identified below, Business Roundtable strongly urges EBSA to confirm that ERISA fiduciary status applies to firms that provide proxy voting services to ERISA plans, either through any final regulations or pursuant to other guidance of general applicability.

At the same time, we stress that many other aspects of EBSA's proposed regulations will have profound and potentially detrimental consequences for retirement savings plans and their participants. In light of those myriad concerns and the importance of those issues, EBSA should not act precipitously. Rather, a robust and extended dialogue with the private sector and with other governmental agencies is needed. Most notably, we urge EBSA to coordinate its review with the ongoing and overlapping regulatory projects currently in process at the Securities and Exchange Commission (SEC) and the Commodities Futures Trading Commission (CFTC).

Background – Business Roundtable

Business Roundtable is an association of chief executive officers of leading corporations with a combined workforce of more than 12 million employees in the United States and nearly \$6 trillion in annual revenues. Member companies comprise nearly a third of the total value of the U.S.

stock markets and more than 60 percent of all corporate income taxes paid to the federal government. Annually, they pay \$167 billion in dividends to shareholders and the economy.

ERISA and Proxy Voting

EBSA's longstanding position, as expressed in Interpretive Bulletin 94-2 (and updated in Interpretive Bulletin 2008-2), is that proxy voting is subject to ERISA's fiduciary responsibility rules. As outlined in Interpretive Bulletin 2008-2, the fiduciary act of managing plan assets that are shares of corporate stock includes the voting of proxies appurtenant to those shares of stock. The duty to vote proxies lies with the plan trustee unless, *inter alia*, "the power to manage, acquire or dispose of the relevant assets has been delegated by a named fiduciary to one or more investment managers" pursuant to section 403(a)(2) of ERISA. When the authority to manage plan assets has been delegated to an investment manager, "no person other than the investment manager has authority to vote proxies appurtenant to such plan assets except to the extent that the named fiduciary has reserved to itself (or to another named fiduciary so authorized by the plan document) the right to direct a plan trustee regarding the voting of proxies." In addition, if the plan document or the investment management agreement does not expressly preclude the investment manager from voting proxies, the investment manager has the exclusive responsibility for proxy voting. An investment manager is not relieved of its own fiduciary responsibilities by following directions of some other person regarding the voting of proxies, or by delegating such responsibility to another person.

Interpretive Bulletin 2008-2 describes the applicable fiduciary's responsibilities in voting proxies as follows:

The fiduciary duties described at ERISA Sec. 404(a) (1) (A) and (B), require that, in voting proxies, regardless of whether the vote is made pursuant to a statement of investment policy, the responsible fiduciary shall consider only those factors that relate to the economic value of the plan's investment and shall not subordinate the interests of the participants and beneficiaries in their retirement income to unrelated objectives. Votes shall only be cast in accordance with a plan's economic interests. If the responsible fiduciary reasonably determines that the cost of voting (including the cost of research, if necessary, to determine how to vote) is likely to exceed the expected economic benefits of voting, or if the exercise of voting results in the imposition of unwarranted trading or other restrictions, the fiduciary has an obligation to refrain from voting. In making this determination, objectives, considerations, and economic effects unrelated to the plan's economic interests cannot be considered.

Thus, EBSA has long recognized the importance of proxy voting for stocks held by ERISA-covered plans, and the possible impact of such voting on the value of the plans' investments.

Proxy Advisory Services – Background and Concerns

Use of Proxy Advisory Services by ERISA Investment Managers

The fiduciaries responsible for voting the proxies for securities held by ERISA plans -- most typically, investment managers under section 3(38) of ERISA -- often hire third-party proxy advisory firms to help them vote the plan's proxies in shareholder elections. These firms offer vote recommendations -- or, in some cases, are given direct voting authority -- on corporate director elections, as well as on company and shareholder proposals.

Many ERISA investment managers -- particularly midsize and smaller investment managers -- do not have in-house staff, or have limited in-house staff, to analyze and vote on proxy items, and so they outsource their voting decisions to proxy advisory firms or, in some cases, they generally adopt the voting policies developed by one or more of the advisory firms. Outsourcing of proxy voting decisions may result in a "one-size-fits all" approach that does not encourage voting decisions to be reached on a case-by-case basis, taking into account the particular circumstances of a company. This creates a substantial risk that proxy votes by ERISA plan investment managers may not "be cast in accordance with a plan's economic interests."

In addition, in some cases, these proxy advisory firms work with their clients to develop unique voting guidelines that are applied by the advisory firms, as a part of the services provided. In other cases, the investment manager clients accept the voting guidelines or policies developed by the proxy advisory firms. While an individual proxy advisory firm may receive input from its clients in the development of a particular voting policy, the reality is often that the proxy advisory firm suggests the policy, and voting patterns at companies suggest that many ERISA plan investors (as well as other institutional investors) vote according to those policies.

Concerns with Proxy Advisory Firms

In 2006, the New York Stock Exchange Proxy Working Group released a report on the proxy processing system.¹ One of the recommendations of the Working Group was a request that the Securities and Exchange Commission ("SEC") study the role of proxy advisory firms on account of their growing power over the voting of corporate shares in the United States:

As a part of its analysis of the proxy system, the Working Group heard a great deal of concern expressed about the increasing role and influence of shareholder voting advisory services in the proxy system. These services often have multiple roles in the proxy process, including advising issuers on various governance issues, making recommendations to institutions and other shareholders on how to vote and actually voting the shares of numerous institutions that choose to outsource their voting decisions. In light of these concerns, the Working Group recommends that the NYSE request the SEC to study the role these groups play in the proxy voting process.

¹ Report and Recommendations of the Proxy Working Group to the New York Stock Exchange, June 5, 2006, p. 29, available at http://www.nyse.com/pdfs/PWG_REPORT.pdf.

More recently, the NYSE Commission on Corporate Governance released a final report on core corporate governance principles.² With respect to proxy advisory services, the Commission stated as follows:

Although many large investors use proxy advisory services primarily as a source of information and research, that is not necessarily the practice of all institutional investors, and there is an increased level of concern regarding the impact of advisory firms. As a result, the Commission believes that the SEC should engage in a study of the role of proxy advisory firms to determine their potential impact on, among other things, corporate governance and behavior and consider whether or not further regulation of these firms is appropriate. At a minimum, such firms should be required to disclose the policies and methodologies that the firms use to formulate specific voting recommendations, as well as all material conflicts of interest, and to hold themselves to a high degree of care, accuracy and fairness in dealing with both shareholders and companies by adhering to strict codes of conduct. The advisory services should also be required to disclose the company's response to its analysis and conclusions.

The widespread use of proxy advisory services by ERISA plans and other institutional investors has resulted in these firms having a significant impact on shareholder voting. However, proxy advisory firms remain largely unregulated, are not fully transparent about their methodologies and decision-making processes, and some of their reports contain errors and inaccuracies. Unfortunately, many proxy advisory firms are not subject to any or limited regulatory oversight, required disclosures, or fiduciary obligations regarding their ability to control or influence the outcome of shareholder votes at public companies in the United States.

Proxy advisory firms may significantly influence many director elections and corporate actions, as their institutional clients -- primarily mutual funds and pension plans -- have large stock holdings compared to other investors. This influence has increased, and will continue to increase, with the recent change to New York Stock Exchange (NYSE) Rule 452, regarding broker discretionary voting.³

At least one proxy advisory firm -- RiskMetrics⁴ -- provides corporate governance and executive compensation consulting services, in addition to providing voting recommendations on

² <http://www.nyse.com/pdfs/CCGReport.pdf>.

³ On July 1, 2009, the SEC approved an amendment to NYSE Rule 452 that will prohibit brokers from having the discretion to vote uninstructed shares of beneficial owners in uncontested director elections. In addition, Section 957 of the Dodd-Frank Wall Street Reform and Consumer Protection Act further limits discretionary voting by brokers. It requires all national securities exchanges to adopt standards prohibiting discretionary broker voting in elections, as well as in connection with executive compensation or any other "significant matter," as determined by SEC rulemaking. The NYSE submitted a revised Rule 452 to the SEC on September 8, 2010, which was approved by the SEC on September 9, 2010. The SEC approved a similar change by the Nasdaq on September 21, 2010.

⁴ RiskMetrics was recently acquired by MSCI Inc., a publicly-traded company that formerly was part of Morgan Stanley. In 2009, "[d]espite the challenges we faced, I am pleased to report that [MSCI was] able to generate

proposals submitted in shareholder elections. For example, RiskMetrics offers a consulting service to help companies determine if their equity plans meet RiskMetrics' approval criteria; and it provides a service to evaluate "corporate sustainability," which involves a review of certain environmental and social issues facing a company. This may create conflicts of interest between RiskMetrics' servicing of its institutional clients and the corporate consulting services it also provides. In addition, a conflict of interest affecting all proxy advisory firms may arise when a client of a proxy advisory firm is also the proponent of a shareholder proposal -- or instigates a "vote no" campaign against directors or a company proposal-- that will be subject to a voting recommendation by that same proxy advisory firm.

Proxy advisory services also vary in their approaches to providing companies with the opportunity to review draft reports to correct errors and inaccuracies. Some services provide certain issuers with draft reports to review on expedited time schedules, while others will not even speak with company representatives. They also vary in their practices with respect to the issuance of revised reports to notify their institutional clients of changes in their recommendations.

Academic Studies of the Proxy Voting Service Industry

A number of academic studies and reports have been conducted on the proxy advisory industry. Some of these studies and reports have been critical of the "one-size-fits-all" governance ratings that are used by some of the proxy advisory firms to evaluate corporate performance.⁵

Other studies and reports identify problems within the proxy advisory industry, and recommend policy and regulatory solutions. For example, the Millstein Center for Corporate Governance and Performance at the Yale School of Management has developed two policy briefing papers about the proxy advisory industry. These policy papers contain recommendations for addressing conflicts of interest and other problems with the current structure of the industry:

record revenues and profits, adding another year to our long history of consecutive annual revenue growth." MSCI Annual Report 2009, available at http://files.shareholder.com/downloads/MSCI/964469765x0x356730/D4544168-EE59-4839-BD8E-41C4F2A44763/2009_Annual_Report.pdf.

⁵ Two of the more prominent papers and studies on this subject are: (a) Sanjai Bhagat, Brian Bolton and Roberta Romano, The Promise and Peril of Corporate Governance Indices, 108 Colum. L. Rev. 1803 (2008), available at http://www.columbialawreview.org/assets/pdfs/108/8/Bhagat_Bolton_Romano.pdf (concluding that there is no consistent relationship between corporate governance indices and future corporate performance and that the most effective approaches to governance depend on context and a company's specific circumstances); and (b) Robert Daines, Ian Gow and David Larcker, Rating the Ratings: How Good Are Commercial Governance Ratings?, Arthur and Toni Rembe Rock Center for Corporate Governance, (2008), available at <http://www.gsb.stanford.edu/cldr/cgrp/documents/dgl6-26-2008.pdf> (concluding that the level of predictive validity of corporate governance ratings is well below the threshold necessary to support claims about the ability of ratings to predict future corporate performance and risk).

- Voting Integrity: Practices for Investors and the Proxy Industry. This 2008 working draft by Millstein Center Visiting Research Fellow Meagan Thompson-Mann discusses the processes by which investors make voting decisions and provides a draft code of professional practices for the proxy advisory industry.⁶
- Voting Integrity: Practices for Investors and the Global Proxy Advisory Industry. On March 2, 2009, a second paper⁷ was released by the Millstein Center on the practices of the proxy advisory industry. This paper recommended the development of an industry-wide code of ethics and urged the SEC to take steps to modernize the U.S. proxy voting system.

In addition, other recent academic papers released highlight the lack of accountability and oversight enjoyed by the proxy advisory industry under current rules.⁸ These academic papers highlight the need for improved regulatory oversight and transparency of proxy advisory firms.

Recommendations

Proxy advisory firms that provide voting recommendations to ERISA investment managers and other fiduciaries responsible for voting proxies should be subject to more robust oversight by EBSA. We urge EBSA to confirm that ERISA fiduciary status applies to entities that provide proxy voting services, either through final regulations or other guidance of general applicability. EBSA also should issue guidance addressing the implications under section 406(b) of ERISA if a proxy advisory firm offers consulting services to any public company for which it is providing recommendations on how ERISA plan fiduciaries should vote the shares held by ERISA plans.

Additionally, EBSA should issue enhanced guidance regarding the duties of ERISA investment managers and other fiduciaries responsible for proxy voting decisions. Such guidance should emphasize their oversight responsibilities with respect to any delegation, express or implied, of their voting rights to a proxy advisory firm. As a part of their due diligence process for making proxy voting decisions, ERISA fiduciaries should use, whenever appropriate, methodologies that evaluate the facts and circumstances of each public company and avoid “one-size-fits-all” or “check the box” methodologies. This would increase the likelihood that ERISA fiduciaries are

⁶ Millstein Center for Corporate Governance and Performance, Policy Briefing No. 2/Voting Integrity: Practices for Investors and the Proxy Industry (June 5, 2008), available at <http://millstein.som.yale.edu/2008%2006%2005%20voting%20integrity2.pdf>.

⁷ Millstein Center for Corporate Governance and Performance, Policy Briefing No. 3/Voting Integrity: Practices for Investors and the Global Proxy Advisory Industry (March 2, 2009), available at <http://millstein.som.yale.edu/Voting%20Integrity%20Policy%20Briefing%2002%2027%2009.pdf> (hereinafter “Millstein Policy Briefing No. 3”).

⁸ See Tamara C. Belinfanti, The Proxy Advisory and Corporate Governance Industry: The Case for Increased Oversight and Control, 14 Stan. J.L. Bus. & Fin. 384 (2009); and Stephen Choi, Jill Fisch and Marcel Kahan, Director Elections and the Role of Proxy Advisors, 82 S. Cal. L. Rev. 649 (2009), available at <http://weblaw.usc.edu/why/students/orgs/lawreview/documents/ChoiforWebsite.pdf>.

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meeting their responsibilities outlined in Interpretive Bulletin 2008-2 and that they are acting in accordance with the economic interests of the plan.⁹

In addition, we urge EBSA to coordinate its review of the proposed regulations with ongoing and overlapping regulatory projects at SEC and the CFTC. We note that the Executive Order issued by the President on January 18, 2011, requires coordination, not simply notifying other agencies of pending projects. The Order decries regulatory requirements that are “inconsistent or overlapping” and requires agencies to attempt to promote “coordination, simplification, and harmonization.” Significantly, the January 2011 SEC staff study addressing fiduciary issues with respect to investment advisers and broker-dealers, specifically concludes that the existence of differing standards harms and confuses investors. Similarly, the CFTC's December 22, 2010 proposed rules on business conduct for swaps have a significant interaction with EBSA's proposed regulations that could deny some defined benefit plans access to this important tool for managing investment and liability risks.

On behalf of Business Roundtable, we again thank you for the opportunity to comment on the application of ERISA's fiduciary rules to proxy advisory services and other issues raised by EBSA's proposed regulations on the fiduciary definition. We are happy to discuss these issues at your convenience.

Sincerely,

A handwritten signature in black ink that reads "John Engler". The signature is written in a cursive, flowing style.

John Engler

⁹ Of course, an individual who merely takes direction and passes along, unchanged, the yeas and nays should not be treated as a fiduciary for this purpose since they are simply acting as a conduit without the ability to influence the action.