October 2, 2020

Jeanne Klinefelter Wilson
Acting Assistant Secretary
Employee Benefits Security Administration
United States Department of Labor
200 Constitution Avenue, NW
Washington, DC 20210

RE: RIN 1210-AB91

Dear Acting Assistant Secretary Wilson,

In the long, dismaying history of regulatory capture, when agencies set up to provide oversight instead issue rules entrenching and subsidizing corporate insiders, disregarding the public interest in transparency, accountability, and robust market forces, it is hard to think of an example as discreditable as this proposal on proxy voting by ERISA fiduciaries.

We object to this proposal in the strongest terms, both in substance and in process. We have signed the comment letter drafted by Keith Johnson and Jon Lukomnik and endorse it fully. This letter supplements it by adding our own perspective, including those of a former head of EBSA's predecessor agency, PWBA. We note for the record that we have no financial ties to proxy advisors or ERISA fiduciaries and have not been paid by anyone to express these views. We trust EBSA will carefully scrutinize all comments for possible hidden conflicts of interest, which have been rampant in the DOL and SEC filings relating to proxy proposals and proxy voting.

EBSA, like the fiduciaries it regulates, is charged with acting for the sole benefit of pension plan participants. This shoddy, last-minute, unsubstantiated proposal, rushed through in the middle of a pandemic and at the end of a Presidential term without any evidence of adequate research, no public hearings, and a truncated comment period, is contrary to the interests of plan participants, the capital markets, and the economy as a whole.

The rhetoric claiming that it clarifies the current rule does not disguise its actual purpose, which is to destabilize shareholder oversight. If it becomes law it will drastically reduce the value of

equities held on behalf of pension plan participants, limit the ability of pension fund fiduciaries to act on behalf of beneficial owners, and impose costly new burdens on both managers and plan participants. As with EBSA's proposed ESG rules, this proposal is not supported by any credible cost-benefit analysis or estimate of the additional paperwork burden, ignoring less burdensome alternatives and failing to meet the minimum statutory requirements of the Administrative Procedure Act and the Paperwork Reduction Act. If the rule becomes final in anything like the proposed version, it will be very vulnerable to challenge in court.

This proposal subverts the interests of both plan participants and fund manager fiduciaries for the benefit of the corporate insiders at portfolio companies. The proposed rule is bad for plan participants, bad for fund manager fiduciaries, and obstructs the market forces that are the foundation of a robust economy. It does not benefit corporate employees or their shareholders. Its only beneficiaries are entrenched, entitled CEOs. These are the people who love to rhapsodize about the purity of the free market until they feel its effects. They get weak in the knees over a non-binding, advisory proxy vote on their pay or on climate change risk or disclosure of the very kind of dark money expenditures that are clearly responsible for this proposal. The millions of dollars from the corporate treasury spent on lobbyists and political contributions that led to this proposal should have been used for employees, R&D, marketing, and other expenditures that contribute to sustainable growth. This proposal will perpetuate and increase these diversions of corporate assets contrary to shareholder value.

This proposed rule is wrong on the facts, wrong on the law, wrong on the cost-benefit analysis, wrong on regulatory policy, and in every way contrary to EBSA's mission and its duty to plan participants.

The claim that there is "confusion" about the obligation of pension fund fiduciaries with regard to proxy voting is simply false and unsupported by any evidence. There is no confusion on the part of ERISA fiduciaries/fund managers. There is no belief, widespread or otherwise, that every proxy has to be voted or that every vote or non-vote has to be separately and explicitly evaluated. The pretense of confusion is merely rhetoric to attempt to justify the unjustifiable.

The Department's policy has been quite clear for decades. Even before the Avon letter, it should have been self-evident that like all aspects of share ownership, including the right to buy, lend, or sell, the right to file and participate in litigation, the right to submit a shareholder proposal, and the right to engage with management or obtain access to corporate records, the right to vote a proxy is a fiduciary act and must be exercised for the exclusive benefit of plan participants. If there are any examples of EBSA findings that either the casting or the failure to cast a proxy vote has been investigated as a possible violation of fiduciary duty for cost-benefit or conflict of interest reasons, that information (without identifying details) should be disclosed so that we can see how it supports to this proposal.

The issues that led to the Department's first guidance on proxy voting are even more pressing today. Back in the late 1980's, the shift from proxy votes on routine matters like votes in favor of unopposed directors and approval of the auditors to hostile takeover-era proposals from

management, activists then known as "raiders" and fiduciary institutional shareholders made it important to remind ERISA fiduciaries that proxy voting had to be conducted for the exclusive benefit of plan participants. So, let's start with some history.

Conflicts of Interest. It is important to remember that the "Avon Letter" guidance issued in 1988 was a response to a series of letters sent by CEOs to other CEOs to solicit their support in opposing shareholder proposals on the antitakeover device known as poison pills. These came just as reports from IRRC and others demonstrated the massive conflicts of interest in proxy voting by fund managers. As Vanguard founder John Bogle admitted, from the fund manager's perspective there are only two kinds of portfolio companies: clients and potential clients. And so, fund managers, including ERISA fiduciaries, would vote with management even when it was contrary to the interests of the beneficial holders, in order to ingratiate themselves with portfolio companies who were clients or potential clients. Or, they would not vote, knowing even a non-vote can be beneficial to management. This was in an era when the CEOs knew how the funds voted, but the beneficiaries did not, creating a dangerous information asymmetry that undermined market forces.

The 1988 guidance was specifically intended to address these conflicts of interest and remind pension fiduciaries of their obligation to act "for the exclusive benefit of plan participants" even when it meant that they might alienate a current or prospective customer.

Failing to recognize this dangerous conflict of interest, which history has shown will result in proxy votes cast contrary to the interest of pension plan participants, in and of itself invalidates the basis for this proposal. Without a strong statement to make it clear that voting proxies is a fiduciary act for the benefit of plan participants and not to promote business relationships and fees, fund managers' assessments of the value of a proxy vote will be tainted by the same conflicts of interest that led to the issuance of the Avon letter.

This relates to the "exclusive" statutory obligation.

Collective Choice. Equally important, is the "benefit" statutory obligation. It is essential to understand the difference between proxy voting and other share ownership rights like buying and selling when it comes to making calculations of the benefit to plan participants. This proposal entirely overlooks the foundational defining characteristic of the value of proxy voting: the mathematical concept of *collective choice*. See for example *Proxy voting and the SEC: Investor Protection Versus Market Efficiency*, John Pound, Journal of Financial Economics, Volume 29, Issue 2, October 1991, Pages 241-285, incorporated in full here by reference.

What that means is that a rational fund manager could conclude, say, that the cost of evaluating any individual CEO pay plan is greater than the pro rata share of any return from that vote, whether in favor or (an advisory only vote) against. Each individual investor, individual and institutional, could rationally decide that it is not "worth it" to evaluate any proxy issue, with results that are contrary to the interests of all of them. In a worst-case scenario, ERISA fiduciaries could rely on this rulemaking to free them from any obligation to vote proxies,

leaving portfolio companies in limbo for failure to achieve a quorum. That is just the most obvious and concrete concern.

The more serious, systemic concern is that removing any oversight from what can constitute a significant block or even a majority of the stock holdings of the nation's publicly held companies will be immensely disruptive. Instead of having proxy votes cast by massive, stable, expert, fiduciary shareholders, they will be voted by individuals who are not experts (though data show that individual investors do not vote proxies) or by activist extremists and predatory hedge fund managers. They may even be voted by activists who have no underlying holdings but merely borrow stock over the record date. In at least one case a hedge fund made just such a transaction in support of its short position. Clearly that was not in the interest of ERISA beneficiaries who might be holders of the stock. Any of these consequences would destabilize the capital markets. Indeed, we would argue that a significant part of the appeal of the US capital markets, still by far the most robust and efficient in the world, is based on the transparency and accountability of the proxy voting system, with sophisticated financial professionals subject to the law's strictest standard of responsibility, making buy, sell, and vote decisions. As other countries move in the opposite direction to improve corporate governance, the US cost of capital will be much less appealing.

Failing to recognize, much less address this essential underlying issue is in and of itself grounds for overturning the rule should it go into final form when it is challenged in court.

Portfolio Theory. ERISA's sole substantive requirement is diversification. Yet this proposed rule shows no understanding of modern portfolio theory, particularly with respect to the particular issues pertaining to long-term, essentially permanent holders like pension funds. Jon Lukomnik's work is of particular importance in this area and we incorporate by reference the article he wrote with Jim Hawley, *The Long and Short of It: Are We Asking the Right Questions? Modern Portfolio Theory and Time Horizons*, 41 SEATTLE U. L. REV. 449 (2018). Basically, it shows that long-term holders get more reliable long-term returns from including beta analysis as a better way to create value over the kind of time horizon a working person with decades until retirement needs. To use an extreme but prevalent example, index funds cannot manage risk by trading; their only options if a company is underperforming are engagement, from proxy voting to shareholder proposals to direct communication with board members or executives or doing nothing and watching it fall off of the index. Actively managed funds must consider the costs and benefits of selling a stock versus communicating with management via proxy vote, letter, request for meeting or coordinating with other investors. This proposed rule puts that calculus out of whack in a manner that depresses value for plan participants and the market as a whole.

Furthermore, this proposed rule is contrary to the facts of fund management and shareholder engagement as it has evolved over the past 40 years. It was the era of EBSA's Avon letter that marked the beginning of shareholder engagement as an essential part of fund management, the result of two powerful forces. First, the development of securities that made any size of takeover possible created opportunities for massive damage to shareholder interests by both

corporate raiders (for example, coercive two-tier tender offers) and entrenched insiders (for example greenmail and outsize golden parachutes). The second was the creation, through ERISA itself and vehicles like mutual funds and index funds, of investors smart enough to understand these abuses, big enough to respond effectively, and, as fiduciaries, required to do so when it was the most effective way to protect share value.

Over the past few decades, as proxy issues have become even more significant and even more complicated, institutional investors have become much more sophisticated about using share ownership rights, including proxy voting and shareholder proposals, to protect and increase the value of securities, especially as their positions have grown too large to sell efficiently and pervasive corporate governance concerns mean that even if they could justify the transaction costs of a sale it is far more cost-effective to engage on those issues. Any rulemaking by EBSA must reflect that.

Cost-benefit Analysis and Paperwork Reduction. The signers of this comment met while working on President Ronald Reagan's Task Force on Regulatory Relief. We are very familiar with what an authentic cost-benefit analysis looks like. There is no evidence of any evidence-based cost-benefit analysis supporting this proposal. Preposterously, the proposal itself imposes massive new expenses that undermine its stated goal. If the proposed rule goes into effect, the cost of performing the analysis and documentation of literally hundreds of thousands of proxy votes is so staggering it is difficult to imagine any fund manager finding the time and resources to justify any votes at all. Instead, they may well conclude that other forms of communication are more cost effective, meaning more shareholder proposals and requests for meetings.

This proposal is not just inadequately justified in terms of cost-benefit analysis; there is no foundation for it whatsoever. How many times does a fund manager have to determine that there is value in whether a CEO compensation package should be voted on annually or every two or three years? In approving the same auditor who failed to identify a massive fraud? A shareholder proposal calling for more diversity on the board? One annual determination that proxy voting is cost-effective should be more than adequate.

The paperwork required by this proposed rule alone is a massive new cost as well as a violation of the Paperwork Reduction Act. Has it been cleared by OMB as a new imposition of extensive new record-creating and keeping requirements? There is no possible way to move forward with this rulemaking without establishing a public record with hearings to establish what it costs to vote proxies -- and what it costs not to vote them.

We note that if it goes final, this rule will certainly be a bonanza for proxy advisory firms as fund managers outsource the calculus on proxy voting to reduce costs and ensure independent analysis.

Contrary to EBSA History and Policy. Since the enactment of ERISA, EBSA and its predecessor agency PWBA have wisely regulated process, not substance for ERISA fiduciaries. This proposed

rule crosses the line into substance by shifting the burden of proof to fund managers to justify proxy voting. This is a decision that should be left entirely to the judgment of the sophisticated financial professionals who are acting as fiduciaries. This proposed rule, making each vote a potential violation and creating a safe harbor for failing to vote, means EBSA is not just putting a thumb on the scale; it is shoving an elephant onto it. Without a single example of a pension fund fiduciary making a "wrong" call on whether or how to vote any proxy, there is simply no justification for this nanny state intrusion into decisions made by sophisticated financial professionals subject to both market forces and the strictest standard ever developed by our legal system.

EBSA, like the fund managers it oversees, must act for the exclusive benefit of plan participants. It is in the interests of working people hoping for retirement income security to have proxies voted on their behalf and for their benefit; even if the benefit to any individual fund is not clear within the context of its own percentage of shares, in part because the manager does not know and has no say over the votes of other investors, the benefit is inarguable if all fiduciary fund managers vote.

Return to the Avon letter, for example. The issue there was shareholder proposals asking that the recently developed antitakeover provisions known as "poison pills" should not be adopted without shareholder approval. The CEOs who wrote to each other urging them, acting as ERISA fiduciaries for their employees' plans, to vote against these proposals, did not even try to pretend that it was for the benefit of plan participants. If poison pills had to be put to a shareholder vote, then only provisions like a "chewable pill" that benefited shareholders would be approved. It would avoid the most virulent, insider-entrenching versions.

It was clear that a vote in favor of shareholder approval was moderate, valuable, and in the interest of shareholders, including plan participants. But without Avon letter-style reminders that voting proxies is a fiduciary act, a manager could decide not to bother. On an individual basis, that might be a rational choice, but taken as a whole, the result for the shareholders is a loss of value. The same applies to the issues on proxies today, from stock-based compensation to business combinations, approval of auditors, and shareholder proposals. Failure to consider this essential element of proxy voting invalidates the rationale for this proposed rule.

It was his experiences as the head of EBSA's predecessor agency, PWBA, that led one of the signers of this comment to found Institutional Shareholder Services, specifically to address the collective choice and conflict of interest problems by making independent analysis and recommendations on proxy issues available to a wide range of fund managers. He understood that while there was a premium for exclusivity in buy/sell recommendations, with proxy issues the opposite was the case. Access to a proxy advisory service greatly reduced the cost of analyzing proxy issues and the more fund managers who had access to the analysis, the more likely the votes would reach critical mass and have an effect. [We note that we left ISS in 1989 and 1990, respectively, and have had no financial interest in the company or in any other entity connected with proxy voting for decades.]

As with the proposed ESG rule, this is a cynical, rushed, superficial, unsubstantiated proposal with rhetoric that does not match its real-life consequences. It fails to meet the most basic regulatory requirements of cost-benefit analysis, public disclosure of the basis for the rule, and consideration of other alternatives. A rulemaking this significant should not be conducted without extensive research and hearings, and without disclosure of all meetings and memoranda submitted by outside groups that were considered in preparing the proposal or without the typical 90-day comment period for rulemakings of even a fraction of this level of controversy and impact. We ask you to withdraw the proposal and do some real-world cost-benefit analysis based on data on proxy voting by pension fund professionals.

Sincerely,

Robert A.G. Monks, Chairman (and former Administrator of PWBA)

Nell Minow, Vice Chair

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