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Ms. Jeanne Klinefelter Wilson
Acting Assistant Secretary
Employee Benefits Security Administration
U.S. Department of Labor
200 Constitution Ave., N.W., Room N-5655
Washington, D.C. 20210
Attn: Financial Factors in Selecting Plan Investments

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

Dear Acting Assistant Secretary Wilson:

Institutional Shareholder Services Inc. (ISS) submits these comments regarding the above-referenced proposal to amend the "Investment duties" rule under Title I of the Employee Retirement Income Security Act of 1974 (ERISA) [29 CFR §2550.404a-1] in order to drastically restrict the ability of ERISA fiduciaries to exercise proxy voting and other shareholder rights on behalf of plan participants and beneficiaries.[1] This proposal follows on the heels of an earlier proposal to amend Rule 404a-1 to discourage fiduciaries from integrating environmental, social and corporate governance (ESG) factors into their investment strategies for ERISA plans.[2] Like the ESG Proposal, the Proxy Voting Proposal, if adopted, will cause substantial and sustained harm to American workers and retirees. ISS respectfully urges the Department to terminate this indefensible rulemaking.

[1] Fiduciary Duties Regarding Proxy Voting and Shareholder Rights, 29 CFR Part 2550, RIN 1210-AB91 (August 31, 2020), 85 Fed. Reg. 55219 (Sep. 4, 2020) (Proxy Voting Proposal).

[2] Financial Factors in Selecting Plan Investments, 29 CFR Parts 2509 and 2550, RIN 1210-AB95 (June 22, 2020), 85 Fed. Reg. 39113 (June 30, 2020) (ESG Proposal). ISS' comments on the earlier proposal are available at: https://beta.regulations.gov/comment/EBSA-2020-0004-0157 (ISS ESG Comments).

Background

ISS is a federally registered investment adviser with 35 years of experience helping institutional investors meet their fiduciary responsibilities to clients. The company was founded in an era of aggressive corporate practices such as raiding, green mail and poison pills, when investors were seeking a meaningful voice in corporate governance in order to safeguard the value of their investments. Through its governance research and proxy voting recommendations, ISS today helps more than 1,600 clients—including employee benefit plans, investment managers and mutual funds—make and execute informed proxy voting decisions for approximately 44,000 shareholder meetings a year in over 110 developed and emerging markets worldwide. In so doing, ISS applies specific policy frameworks created or selected by institutional investors. ISS currently implements more than 400 custom voting policies on behalf of its clients. Investors who choose not to create their own proxy voting policies may select among a range of policy options offered by ISS. These include benchmark policies focused on promoting long-term shareholder value creation, good governance and risk mitigation at public companies and thematic policies that evaluate governance and voting issues from the perspective of sustainability and public funds, among others.

In addition to supplying data, research and vote recommendations, ISS also provides an electronic platform that automates the operational aspects of proxy voting and allows institutional investors to focus their resources on the fiduciary task of making their voting decisions. In this regard, ISS' ProxyExchange platform enables investors to prepopulate their custom or other selected voting guidelines, flag issues of their choosing for manual review, override any particular vote recommendation, and change any vote already cast, up to the issuer's vote cut-off deadline. ProxyExchange also provides clients with issuer-specific information about potential conflicts of interest and does so in a way that protects the firewall ISS has established to mitigate such conflicts.

ISS offers other value-enhancing services to institutional investors as well. For example, the company's responsible investment arm, ISS ESG, facilitates investors' integration of environmental, social and corporate governance factors into their investment decision-making process. In this regard, ISS ESG provides a comprehensive suite of climate solutions to provide investors with a better understanding of their portfolios' exposure to climate-related risks. ISS ESG's Screening & Controversies solutions identify corporate involvement in a range of controversial products, business practices and high-risk sectors, allowing clients to screen, monitor and analyze responsible investment performance. And ISS ESG Ratings & Rankings solutions provide investors with the insight to incorporate sustainability into their investment processes however they see fit.

Legal Discussion

The Shareholder's Role in Corporate Governance

A corporation is a creature of state law. State laws spell out the fundamental rights, powers and responsibilities of a corporation's officers, directors, and shareholders,[3] and give shareholders a voice in corporate governance by affording them voting rights tied to their ownership of stock. Shareholders cast their votes by appearing at a company's annual or special meetings in person or by authorizing a "proxy" to vote on their behalf.

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[3] *See* Securities and Exchange Commission (SEC) Commissioner Troy A. Paredes, Remarks at Conference on "Shareholder Rights, the 2009 Proxy Season, and the Impact of Shareholder Activism" (June 23, 2009) note 5.

Although the right of shareholders to affect corporate governance through suffrage is recognized as a "fundamental tenet of state corporation law,"[4] the proxy process for publicly traded companies is subject to federal regulation as well to ensure that corporate insiders do not use abusive or manipulative practices to advance their own interests at the expense of shareholders' interests. Section 14(a) of the Securities Exchange Act of 1934 (Exchange Act) makes it unlawful to solicit or permit the use of one's name to solicit a proxy, consent or authorization in contravention of the rules and regulations prescribed by the SEC. Congress enacted Section 14(a) to eliminate the kinds of abuses by corporations and their management that were deemed to have contributed to the stock market crash of 1929 and the Great Depression. The provision reflects the lawmakers' belief that, "A renewal of investors' confidence in the exchange markets can be effected only by a clearer recognition upon the part of the corporate managers of companies whose securities are publicly held of their responsibilities as trustees for their corporations."[5] Under the heading, "CONTROL OF UNFAIR PRACTICES BY CORPORATE INSIDERS," the House Committee on Interstate and Foreign Commerce said:

> Fair corporate suffrage is an important right that should attach to every equity security bought on a public exchange. Managements of properties owned by the investing public should not be permitted to perpetuate themselves by the misuse of corporate proxies. Insiders having little or no substantial interest in the properties they manage have often retained their control without an *adequate disclosure* of their interest and without an adequate *explanation* of the management policies they intend to pursue. Insiders have at times solicited proxies without fairly informing the stockholders of the purposes for which the proxies are to be used and have used such proxies to take from the stockholders for their own selfish advantage valuable property rights. Inasmuch as only the exchanges make it possible for securities to be widely distributed among the investing public, it follows as a corollary that the use of the exchanges should involve a corresponding duty of according to shareholders fair suffrage.[6]

On a record replete with tales of abuses by corporate insiders,[7] Congress adopted Section 14(a) to "protect investors from promiscuous solicitation of their proxies," "by unscrupulous corporate officials seeking to retain control of the management by concealing and distorting facts."[8]

Congress stepped in to protect the rights of shareholders again in 2010 when it added the "say on pay" provision to the Dodd-Frank Wall Street Reform and Consumer Protection Act.[9] Observing that the 2008 "economic crisis revealed instances in which corporate executives received very high compensation despite the very poor performance by their firms," Congress expressed the belief that "shareholders, as the owners of the corporation, have a right to express their opinion

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[4] SEC, *Concept Release on the U.S. Proxy System*, Exchange Act Rel. No. 62495 (Jul. 14, 2010), 75 Fed. Reg. 42982, 42984 (Jul. 22, 2010) (SEC Concept Release).

[5] H.R. Rep. No. 73-1383, at 13 (1934).

[6] *Id.* at 13-14.

[7] *See e.g.,* 78 Cong. Rec. 7923 (1934); S. Rep. No. 73-1455 at 74-75 (1934).

[8] *Id.* at 77.

[9] 15 U.S.C. §78n-1.

collectively on the appropriateness of executive pay."[10] Nonbinding votes on pay were seen as a way to give shareholders a needed "greater voice in corporate governance."[11]

Now comes the Department—like the proverbial bull in a china shop—to trample these pillars of corporate governance. The Department is not convinced that proxy voting is a worthwhile endeavor; it thinks shareholders should simply trust management to do the right thing; and it believes that precatory votes are waste of time. Responding to a 2019 Executive Order directing the Department to determine whether existing guidance on the fiduciary responsibilities for proxy voting should be rescinded, replaced or modified in order to "promote private investment in the Nation's energy infrastructure,"[12] the Department proposes to upend more than 30 years of guidance on how ERISA fiduciaries should approach the role of shareholders in the corporate governance of the public companies in which they invest.

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The Exercise of Shareholder Rights Under ERISA

Section 404 of ERISA imposes duties of loyalty and prudence on plan fiduciaries. The duty of loyalty obliges the fiduciary to discharge his duties solely in the interest of, and for the exclusive purpose of providing benefits to, plan participants and their beneficiaries and defraying reasonable expenses of plan administration. The duty of prudence requires the fiduciary to act with the care, skill, prudence and diligence under the circumstances that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character with like aims.

The Department first applied these duties to proxy voting in 1988, when it articulated the view that the fiduciary act of managing plan assets includes the management of voting rights appurtenant to shares of stock.[13] The Department subsequently instructed that where the authority to manage plan assets has been delegated to an investment manager, the manager is responsible for voting proxies (or exercising other shareholder rights) relating to those assets unless that responsibility has been specifically and properly reserved to the plan trustee or other named fiduciary.[14] A named fiduciary who delegates proxy voting responsibility to an investment manager must periodically monitor the manager's proxy voting decisions and actions; in order to permit such monitoring, the responsible fiduciary must maintain accurate records of its voting procedures and practices.[15]

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[10] S. Rep. No. 111-176 (2010) at 33.

[11] *Id.* at 35-36.

[12] Executive Order on Promoting Energy Infrastructure and Economic Growth (Apr. 10, 2019) *available at:* https://www.whitehouse.gov/presidential-actions/executive-order-promoting-energy-infrastructure-economic-growth/

[13] Letter from Alan D. Lebowitz, Deputy Assistant Secretary to Mr. Helmuth Fandl, Chairman of the Retirement Board, Avon Products, Inc. (Feb. 23, 1988), 1988 ERISA LEXIS 19, *5-6 (Avon Letter).

[14] Pension and Welfare Benefits Administration, U.S. Department of Labor, Proxy Project Report (Mar. 2, 1989) 8 (1989 Report); *see also* Letter from Alan D. Lebowitz, Deputy Assistant Secretary of Labor to Robert Monks, Institutional Shareholder Services, Inc. (Jan. 23, 1990).

[15] *Id.;* Interpretive Bulletin 2016-01, 29 CFR § 2509.2016-01, 81 Fed. Reg. 95879, 95882-83 (Dec. 29, 2016) (IB 2016-01).

While the Department opined that investment managers "may not, as a general policy, decline to vote proxies, or vote only non-controversial proxies,"[16] the Department never said that a fiduciary must vote every proxy that comes its way. Instead, responsible fiduciaries were told to vote on issues that "may affect the value of the plan's investment," unless voting presents out-of-the-ordinary costs or difficulties. In such cases, said the Department, the fiduciary should determine whether "the plan's vote, either by itself or together with the votes of other shareholders, is expected to have an effect on the value of the plan's investment that warrants the additional cost of voting."[17] Current guidance does not, however, oblige the fiduciary to undertake a cost-benefit analysis on each potential vote before deciding how to proceed.[18]

Finally, the Department has cautioned that in deciding how to vote a proxy, the responsible fiduciary must consider only those factors that may affect the value of the plan's investment, and may not subordinate the interests of the plan's participants and beneficiaries in their retirement income to unrelated objectives.[19]

In the instant rulemaking, the Department proposes to amend ERISA Rule 404a-1, the investment duties rule, to codify a whole new approach to proxy voting by plan fiduciaries. In so doing, the Department stands the concept of fiduciary duty on its head.

Elements of the Rule Proposal

The Department proposes to substantially expand Rule 404a-1 by adding a new subsection (e) covering proxy voting and the exercise of shareholder rights. Certain parts of the proposed addition would merely codify the Department's longstanding views in this area and are consistent with federal and state laws on the role of shareholders in corporate governance. These include: (1) a restatement of the fundamental principle that the fiduciary duty to manage plan assets that are shares of stock includes the management of attendant shareholder rights, including the right to vote proxies;[20] and (2) reminders that ERISA's exclusive purpose and prudence duties apply to the exercise of shareholder rights, including proxy voting.[21] This means that in voting proxies and exercising other shareholder rights, fiduciaries are forbidden to subordinate the financial interests of participants and beneficiaries to non-pecuniary objectives,[22] and must exercise prudence and diligence in the selection and monitoring of proxy advisers and other service providers.[23] The Department also proposes to codify the relative rights and responsibilities of plan trustees and the investment managers they appoint.[24]

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[16] 1989 Report at 8.

[17] IB 2016-01 at 95883.

[18] *Id.* at *95880-81.*

[19] *Id.* at 95882.

[20] Proposed Rule 404a-1(e)(1).

[21] Proposed Rule 404a-1(e)(2)(i).

[22] Proposed Rule 404a-1(e)(2)(ii)(C).

[23] Proposed Rule 404a-1(e)(2)(ii)(F).

[24] Proposed Rule 404a-1(e)(4)(i).

Had the Department stopped there, amended Rule 404a-1 would have served plan participants and beneficiaries very well, and the proposal would have earned ISS's support. But instead of just synthesizing existing sub-regulatory guidance regarding the exercise of shareholder rights, the Department has chosen to bury ERISA's fundamental fiduciary principles under a mass of unworkable and cost-prohibitive duties and reckless safe-harbor defaults designed to virtually eliminate plans' ability to exercise their rights of fair corporate suffrage in connection with directly held stock.

It does this, first of all, by requiring a plan fiduciary to conduct a cost-benefit analysis before *each* proxy vote or other exercise of shareholder rights. Such analysis must include an assessment of the impact of the planned action on the plan's investment based on factors such as the size of the plan's holdings in the issuer relative to the plan's total investment assets, the plan's percentage ownership of the issuer and cost, as well as other factors that may affect the economic value of the plan's investment.[25] The proposed rule would also require the fiduciary to document the basis for each proxy vote or other exercise of shareholder rights.[26] Where the responsibility for voting proxies has been delegated to an investment manager, or where a proxy adviser votes or provides advice relating to proxy votes, the responsible fiduciary must require the manager or proxy adviser to demonstrate that each decision or recommendation was based on the expected economic benefit to the plan and on the financial interests of the plan's participants and beneficiaries.[27]

The Department also proposes to create a rebuttable presumption against proxy voting, forbidding the fiduciary from voting "any proxy" unless the fiduciary's cost-benefit analysis—factoring in the cost of any necessary research to help determine how to vote—confirms that the vote would have an economic impact on the plan.[28] Only if the cost-benefit analysis confirms such an impact, would a vote be required.[29]

Recognizing that conducting vote-by-vote cost-benefit analyses would be resource-intensive and could "burden fiduciaries out of proportion to any potential benefit to the plan,"[30] the Department proposes to add a relief valve. Instead of analyzing the implications of each potential proxy vote, the fiduciary may adopt policies limiting the circumstances under which it will exercise its voting authority. The rule offers three examples: (1) voting with management on any vote deemed unlikely to have a significant impact on the value of the plan's investment, subject to possible exceptions; (2) voting only on a limited range of matters, such as mergers and acquisitions, dissolutions, conversions, consolidations, share issuances or buybacks, and contested elections; (3) or limiting voting to instances in which the plan's holding in a single issuer relative to the plan's total investment assets exceeds a chosen threshold.[31]

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[25] Proposed Rule 404a-1(e)(2)(ii)(A), (B).

[26] Proposed Rule 404a-1(e)(2)(ii)(E).

[27] Proposed Rule 404a-1(e)(2)(iii).

[28] Proposed Rule 404a-1(e)(3)(ii).

[29] Proposed Rule 404a-1(e)(3)(i).

[30] Proxy Voting Proposal, 85 Fed. Reg. at 55225.

[31] Proposed Rule 404a-1(e)(3)(iii).

The drastic constriction of plan voting rights would apply to directly held stock, but not plan investments in mutual funds, which are beyond the Department's jurisdictional reach. With regard to investments in other pooled investment vehicles, Rule 404a-1 would require the fund's investment manager either to require ERISA plans to accept the manager's proxy voting policy as a condition to investing in the pooled vehicle, or somehow to reflect each plan's investment policy in proportion to the plan's economic interest in the pooled vehicle.[32]

Despite the seismic shift in fiduciary practice this rule would require, the Department does not propose any transition period for implementation, instead expecting full compliance 30 days after the final rule's publication.[33]

The Department Has Failed to Articulate
A Coherent Rationale for this Rulemaking

The Department advances three reasons for undertaking this rulemaking, none of which—standing alone or taken together—comes close to justifying what the Department proposes.

First, the Department argues that changes in the way ERISA plans invest, and in the markets generally, call for a fresh look at shareholder rights and fiduciary duty. In this regard, the Department cites the decline in private plans' direct holdings of equity securities and the concomitant rise in their ownership of mutual funds, exchange-traded funds, hedge funds and the like.[34] This shift in investments has brought with it a shift in proxy voting responsibilities from ERISA fiduciaries to the managers of the collective investment vehicles.

While this may be true, it has no bearing whatsoever on a plan fiduciary's obligation to prudently and loyally manage the shareholder rights that have been entrusted to it. If a fiduciary were relieved of the responsibility to manage proxy voting rights merely because there are fewer rights today than there used to be, the fiduciary would also be absolved of the duty to prudently and loyally manage the stock to which those voting rights pertain.

The harm such fallacious reasoning would cause America's workers and retirees is not hard to see. According to the Department's admittedly incomplete data, over 30,000 ERISA plans, with approximately 86 million participants, hold common stocks or employer stocks totaling approximately $2.1 trillion.[35]

Another change in the investment landscape the Department identifies comes closer to revealing one of the true motivations behind this proposal: the fact that proxy voting is no longer seen as "a compliance exercise," but rather as a means for shareholders to have an effective voice in corporate governance.[36] In particular, the Department expresses concern that ERISA fiduciaries

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[32] Proposed Rule 404a-1(e)(4)(ii).

[33] Proposed Rule 404a-1(g).

[34] Proxy Voting Proposal, 85 Fed. Reg. at 55222.

[35] *Id.* 55230. Because only large ERISA-covered plans report data on their stock holdings, this figure does not account for the stock holdings of small plans. *Id.* at 55236. ("The Department lacks information on the number of small plans that hold stock").

[36] *Id.* at 55222.

may unwittingly be allowing 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.[37]

Stated more bluntly, the Department believes ESG proposals "have little bearing on share value or other relation to plan interests.[38] As ISS pointed out in response to the Department's ESG Proposal, the Department's position is woefully out of step with the views of qualified investment professionals who generally agree that "ESG considerations can substantially influence a company's long-term financial performance."[39] The Department's antipathy to ESG investing is also at odds with the observation of the SEC's Investor Advisory Committee to the effect that "ESG is no longer a fringe concept. It is an integral part of the larger investment ecosystem of our modern, global, interconnected world. . . . Many investors view material ESG factors as critical drivers of risk and returns in their investment making decisions, both in the short and long term."[40]

It is true that today's shareholders see issues such as board independence and accountability, executive compensation and environmental and social factors as critical to enhancing the value of their investments. That is a good thing. The fact that proxy voting has become more complex and that shareholders take it more seriously hardly justifies ordering ERISA fiduciaries to wash their hands of the whole process.

But that is precisely what this rulemaking tries to do, because the Department no longer believes that proxy voting has "reliable positive effects on shareholder value."[41] The proposing release repeatedly refers to "mixed evidence" as to the efficacy of proxy voting,[42] without any critical assessment of that evidence or any explanation as to why it has chosen to favor one side of the mix over the other. As other commenters have pointed out, there is ample evidence that proxy

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[37] *Id.*

[38] *Id.* at 55229.

[39] U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-20-530, PUBLIC COMPANIES: DISCLOSURE OF ENVIRONMENTAL, SOCIAL, AND GOVERNANCE FACTORS AND OPTIONS TO ENHANCE THEM 9 (2020), available at https://www.gao.gov/assets/710/707949.pdf, *cited in* ISS Comments, supra n. 2 at 4-5.

[40] INVESTOR-AS-OWNER SUBCOMM., INVESTOR ADVISORY COMM., RECOMMENDATION FROM THE INVESTOR-AS-OWNER SUBCOMMITTEE OF THE SEC INVESTOR ADVISORY COMMITTEE RELATING TO ESG DISCLOSURE 7-8, 9 (as of May 14, 2020), available at https://www.sec.gov/spotlight/investor-advisory-committee-2012/recommendation-of-the-investor-as-owner-subcommittee-on-esg-disclosure.pdf. *See also* INT'L MONETARY FUND, *Sustainable Finance: Looking Farther, in* GLOBAL FINANCIAL STABILITY REPORT: LOWER FOR LONGER 83 (2019) ("ESG issues can have a material impact on firms' corporate performance and risk profile, and on the stability of the financial system"); Jay Clayton, Chairman, Sec. & Exch. Comm'n, Statement on Proposed Amendments to Modernize and Enhance Financial Disclosures; Other Ongoing Disclosure Modernization Initiatives; Impact of the Coronavirus; Environmental and Climate-Related Disclosure (Jan. 30, 2020) (transcript available at https://www.sec.gov/news/public-statement/clayton-mda-2020-01-30) (noting that climate change disclosures give investors a mix of information that "facilitates well-informed capital allocation decisions").

[41] Proxy Voting Proposal, 85 Fed. Reg. at 55222.

[42] *Id.* at 55222, 55225.

voting can and does improve investment performance.[43]

More fundamentally, the Department fails to explain how it has the right to override state corporation laws which reflect a clear determination that shareholder voting does have value. After all, why would state law (and the Dodd-Frank Act) give those rights to shareholders in the first place unless shareholders had an important role to play in ensuring the accountability of management and good corporate governance? The Department cavalierly asserts that this rule proposal would not "have direct effects on the states,"[44] but that is not true. It would affect the states profoundly. While state law grants shareholders a seat at the corporate governance table, the Department views this role as insubstantial and tells ERISA investors to just step away.

Former SEC Commissioner Daniel Gallagher has repeatedly criticized such "incursions" by federal agencies into state corporate governance law.[45] Likewise, in connection with the SEC's recent amendment to the Exchange Act shareholder proposal rule, Commissioner Hester Peirce opined that "[s]tockholder-corporate relations are outside of [SEC] jurisdiction," and she questioned whether the rule "improperly interjects the Commission into matters of state corporate law."[46] ISS urges the Department to address the glaring federalism problem with the instant rulemaking before proceeding any further. This intrusion into corporate governance matters is as unprecedented as it is unwarranted—there is no other circumstance in which a federal agency has sought to dictate the criteria or circumstances under which shareholders may exercise the corporate governance rights conferred by state law.

In addition to the so-called "changes in the investment landscape,"[47] the second purported justification for this rulemaking is the need to correct "a persistent misunderstanding" that ERISA imposes an absolute duty to vote all proxies related to a plan's equity shares.[48] The Department offers no evidence for this assertion, and in fact, repeatedly contradicts itself by arguing that the proposal will impose only minimal costs because "the activities described in the proposal already are reflected in common practice."[49]

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[43] Letter of Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors (Sep. 24, 2020) 2-3.

[44] Proxy Voting Proposal, 85 Fed. Reg. at 55239.

[45] D. Gallagher, Activism, Short-Termism, and the SEC: Remarks at the 21st Annual Stanford Directors' College (June 23, 2015), *available at* https://www.sec.gov/news/speech/activism-short-termism-and-the-sec.html#_edn8 at n. 8 and accompanying text; Remarks at the 26th Annual Corporate Law Institute, Tulane University Law School: Federal Preemption of State Corporate Governance, (Mar. 27, 2014), *available at* https://www.sec.gov/news/speech/2014-spch032714dmg.html; Remarks at 12th European Corporate Governance & Company Law Conference (May 17, 2013), *available at* https://www.sec.gov/news/speech/2013-spch051713dmghtm.

[46] H. Peirce, Statement at Open Meeting on Procedural Requirements and Resubmission Thresholds under Exchange Act Rule 14a-8 (Sep. 23, 2020), *available at* https://www.sec.gov/ news/public-statement/peirce-14a-8-09232020 (citation omitted).

[47] Proxy Voting Proposal, 85 Fed. Reg. at 55221.

[48] *Id.* at 55220, 55230, 55231.

[49] I*d.* at 55232; *see also id.* at 55233 ("the common practices of most plans related to proxy voting are generally consistent with the standards in the proposal"); 55237 ("the activities that would be required by the proposed rule are reflected in common practice"); 55240 ("while the Department believes that the common practices of most plans related to proxy voting are generally consistent with the standards in the proposal, we do not know with any level of precision, the percent of plans that are not currently meeting

Even if there were a misconception about the circumstances under which a fiduciary could justifiably abstain from voting proxies, the appropriate response would be to clear up the misconception, not create a rebuttable presumption *against* voting out of whole cloth. The chasm between not having to vote everything and being allowed to vote almost nothing is wide and deep.

Finally, the Department asserts that a new rule addressing proxy voting under ERISA is warranted in light of recent actions the SEC has taken in this area, including guidance regarding investment advisers' proxy voting responsibilities, and a new rule (currently being challenged in court) that purports to regulate three of the five U.S. proxy advisers as though they were proxy *solicitors* under the Exchange Act.[50] Here, too, the Department's justification is pure sophistry.

Like ERISA, the Investment Advisers Act of 1940 (Advisers Act) is, at heart, a fiduciary law, imposing duties of care and loyalty on any party who fits within the statute's definition of "investment adviser."[51] The SEC addressed the fiduciary implications of proxy voting in 2003, when it adopted Rule 206(4)-(6). This rule requires advisers to adopt written policies and procedures—including procedures addressing material conflicts of interest— reasonably designed to ensure that the adviser monitors corporate actions and votes client proxies in the clients' best interests. The adviser must describe its proxy voting policies and procedures to clients, and must furnish clients with a copy of same, upon request. The adviser must also tell clients how they can obtain information about how their securities were voted. These obligations are in addition to the obligations imposed under the Advisers Act's general compliance rule, which also was adopted in 2003.[52] Among other things, the compliance rule requires advisers, at least annually, to test the sufficiency of their policies and procedures and the effectiveness of their implementation.

While the Department cites guidance the SEC issued in 2019 and supplemented in 2020 as an impetus for the instant rulemaking, the concepts addressed in this guidance, like the Advisers Act proxy and compliance rules, are hardly new.[53] More significantly, there is nothing in either

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such standards").

[50] *Id.* at 55232.

[51] SEC Concept Release *supra* note 4, 75 Fed. Reg. at 43010; *Applicability of the Investment Advisers Act to Financial Planners, Pension Consultants, and Other Persons Who Provide Investment Advisory Services as a Component of Other Financial Services,* Advisers Act Rel. No. 1092 (Oct. 8, 1987), 52 Fed. Reg. 38400 (Oct. 16, 1987).

[52] Rule 206(4)-7.

[53] As far back as 2004, the SEC staff explained that an adviser who hires a proxy advisory firm must scrutinize that firm's "competency to adequately analyze proxy issues" and ability to make "recommendations for voting proxies in an impartial manner and in the best interests of the adviser's clients," and must have a thorough understanding of the nature of the proxy advisory firm's conflicts of interest and its procedures to address same. Letter from Douglas Scheidt, Associate Director and Chief Counsel, SEC Division of Investment Management to Kent S. Hughes, Egan Jones Proxy Services, 2004 SEC No-Act. LEXIS 636 (May 27, 2004); letter from Douglas Scheidt, to Mari-Anne Pisarri, Pickard and Djinis LLP, Counsel for Institutional Shareholder Services Inc., 2004 SEC No-Act. LEXIS 736 (Sep. 15, 2004) at *4-5. The SEC withdrew these letters in 2018, ostensibly "in order to facilitate the discussion" at an upcoming roundtable on proxy issues. SEC Division of Investment Management, IM Information Update, IM-Info-2018-02 (Sep. 2018). By that time, however, this guidance had been embedded in subsequent staff guidance, which remains in effect today. SEC Division of Investment Management, Division of Corporation Finance, *Proxy Voting: Proxy Voting Responsibilities of Investment Advisers and Availability of Exemptions from the Proxy Rules for Proxy Advisory Firms,* Staff Legal Bulletin No. 20 (IM/CF) (June 30 2014), *available at*

guidance document that supports the Department's proposal to create a rebuttable presumption against exercising shareholder rights conferred by state law and protected by Congress. Nor does the SEC guidance support the Department's proposal to create a safe harbor for fiduciaries who either vote in accordance with the recommendations of management or refuse to vote altogether. In fact, as explained in more detail below, the SEC declined to adopt such a safe harbor, even though a large public energy company specifically asked it to do so.[54]

Likewise, there is no logical nexus between the SEC's new rule regulating certain proxy advisers as proxy solicitors (which ISS is currently challenging in court)[55] and the proposed changes to ERISA Rule 404a-1—except that both rulemakings reflect thinly disguised hostility toward proxy advisers.

The Department says it "has reason to believe that responsible fiduciaries may sometimes rely on third-party advice without taking sufficient steps to ensure that the advice is impartial and rigorous."[56] This belief reportedly is based on questions raised by "*some stakeholders*" as to whether third-party proxy advice is impartial, sufficiently transparent or rigorous enough.[57] The Department cites the SEC's proposing release on the proxy adviser rule as proof of "concerns" about the adequacy of proxy advisers' conflict of interest disclosures as well as the factual and analytical accuracy of their voting advice.[58]

This "eyes-half-shut" description of the SEC's rulemaking does not justify the proposed amendments to Rule 404a-1. The Department omits to state that the only "stakeholders" who expressed these "concerns" were public companies (*i.e.,* the subjects of the proxy advice) and their well-paid spokesmen. The *consumers* of proxy voting advice—including public pension

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http://www.sec.gov/interps/legal/cfslb20.htm.

[54] Letter from Neil A. Hansen, Vice President, Investor Relations and Corporate Secretary, ExxonMobil, to Vanessa Countryman, Secretary, SEC (Jul. 26, 2019), *available* at: https://www.sec.gov/comments/4-725/4725-5879063-188728.pdf (ExxonMobil Letter).

[55] *ISS v. SEC,* NO. 1:19-cv-3275-APM (D. D.C.)

[56] Proxy Voting Proposal, 85 Fed. Reg. at 55228. The Department also cites "concerns" about asset managers "robo-voting" in accordance with proxy advisers' recommendations as evidence of the managers' lack of diligence. *Id.* at note 54.

[57] *Id*. at 55229.

[58] *Id.* at 55229-30.

plans,[59] mutual funds,[60] hedge funds,[61] trade associations[62] other investment advisers,[63] labor groups,[64] faith-based groups[65] and even a majority of the Commission's own Investor Advisory Committee[66]—flatly rejected such "concerns."

Investor-centric commenters characterized the conflict of interest aspect of the SEC's proposal as "a solution to an academic problem that poses no practical threat,"[67] and confirmed that proxy advisers already provide adequate conflict disclosures to meet the needs of investors.[68] They also disputed the need for SEC intervention to address "errors" in proxy advice, with one

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[59] *See e.g.,* letters from Thomas P. DiNapoli, New York State Comptroller (Feb. 3, 2020); Karen Carraher, Executive Director, and Patti Brammer, Corporate Governance Officer, Ohio Public Employees Retirement System (Feb. 3, 2020); Ron Baker, Executive Director, Colorado Public Employees' Retirement Association (Feb. 3, 2020) ("CoPERA Letter"); Aeisha Mastagni, Portfolio Manager, California State Teachers' Retirement System (Feb. 3, 2020) ("CalSTRS Letter"); Marcie Frost, Chief Executive Officer, California Public Employee Retirement System (Feb. 3, 2020) ("CalPERS Letter"); Jocelyn Brown, Senior Investment Manager, RailPen (Jan. 31, 2020).

[60] *See e.g.,* letters from letter from William J. Stromberg, President and CEO, T. Rowe Price (Jan. 29, 2020); and Chris C. Meyer, Manager of Advocacy and Research, Everence and the Praxis Mutual Funds (Jan. 31, 2020).

[61] *See e.g.,* letters from Richard B. Zabel, General Counsel and Chief Legal Officer, Elliott Management Corporation (Jan. 31, 2020); and Barbara Novick, Vice Chairman, BlackRock, Inc. (Feb. 3, 2020).

[62] *See e.g.,* letters from Kenneth A. Bertsch, Executive Director, and Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors (Jan. 30, 2020); Karen L. Barr, President and CEO, Investment Adviser Association (Feb. 3, 2020); Paul Schott Stevens, President and CEO, Investment Company Institute (Feb. 3, 2020); James Allen, Head, and Matt Orsagh, Senior Director; Capital Markets Policy, CFA Institute (Feb. 3, 2020) ("CFA Institute Letter"); and Christopher Gerold, President, North American Securities Administrators Association (Feb. 3, 2020).

[63] *See e.g.* letters from Amy D. Augustine, Director of ESG Investing, and Timothy H. Smith, Director of ESG Shareowner Engagement, Boston Trust Walden (Jan. 31, 2020); David Harris, President & Chief Investment Officer, and Casey Clark, Director of ESG Research & Engagement, Rockefeller Asset Management (Jan. 31, 2020); Joseph V. Amato, President and Chief Investment Officer, Neuberger Berman (Jan. 27, 2020); Duane Roberts, Director of Equities, Dana Investment Advisors (Dec. 5, 2019); Medhi Mahmud, President & CEO, First Eagle Investment Management, LLC (Feb. 14, 2020); and Sharon Fay, Co-Head Equities, and Linda Giuliano, Head of Responsible Investment, AllianceBernstein (Feb. 3, 2020).

[64] *See e.g.,* letter from Brandon J. Rees, Deputy Director, Corporations and Capital Markets, AFL-CIO (Feb. 3, 2020).

[65] *See e.g,* letters from Sister Sandra Sherman, O.S.U., President, Ursuline Convent of the Sacred Heart (Nov. 26, 2019); N. Kurt Barnes, Treasurer and CFO, The Episcopal Church (Feb. 12, 2020); Regina McKillip, OP, Promoter of Peace and Justice, Dominicans of Sinsinawa (Feb. 3, 2020); Kathryn McCloskey, Director, Social Responsibility, United Church Funds (Feb. 3, 2020); and Josh Zinner, CEO, Interfaith Center on Corporate Responsibility (Feb. 3, 2020).

[66] Letters from SEC Investor Advisory Committee (Jan. 24, 2020); J. Coates, Professor of Law and Economics, Harvard Law School, and Barbara Roper, Consumer Federation of America (Jan. 30, 2020).

[67] CalPERS Letter at 4.

[68] *See e.g.,* letter from Simon Frechet, Chair, Pension Investment Association of Canada (Jan. 23, 2020) 2; CalSTRS Letter at 4.

commenter observing:

> The only supporting 'proof' [of factual inaccuracies and methodological weaknesses] contained in the proposing release are the self-serving (and we believe to be factually incorrect) statements by consultants-of-hire to the issuer community. These claims of errors. . . seem more like proof of the absence of a problem rather than the basis for regulation. . . . Globally, we understand that [these companies] cover something approaching 26,000 companies and have less than a 1% error rate").[69]

To be clear, ISS is fully committed to transparency, integrity, and accuracy. As a registered investment adviser, we are a fiduciary with our own duties of care and loyalty. We take our obligation to render proxy voting advice in the best interests of our clients very seriously and we welcome rigorous due diligence by those who use our services. Indeed, it is that fiduciary commitment that fuels our objection to the Department's attempt to prevent ERISA plans from exercising the shareholder rights that the states and Congress have granted them.

Mandating a Vote-by-Vote Cost-Benefit Analysis is Arbitrary and Capricious and Not in the Best Interest of Plan Participants and Beneficiaries

As it stands today, prudent and loyal fiduciaries—believing that the shareholder rights ERISA constrains them to manage have value—implement policies and procedures to ensure that they manage plans' proxy votes in the best interest of participants and beneficiaries. Many fiduciaries utilize the services of proxy advisory firms for the research, analysis and administrative support they need to carry out this task, which often entails consideration of a daunting volume of ballot issues in a very compressed time frame.

Claiming, without evidence, that this existing practice is too expensive, the Department proposes to derail the process by requiring the responsible fiduciary to conduct a vote-by-vote cost-benefit analysis and to refrain from voting unless the fiduciary determines that doing so will have an economic impact on the plan's investment. In undertaking such analysis, the fiduciary would be obliged to consider a range of factors, including the relative size of the plan's holdings, the plan's percentage ownership of the issuer and costs, including the costs of necessary research to determine how to vote.

In the event the fiduciary decides to vote, she must document the rationale for that decision and be prepared to articulate the anticipated economic benefit derived from the vote. A responsible plan fiduciary must demand such documentation from any investment manager who has been

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[69] Letter from Carl C. Icahn (Feb. 7, 2020) 4. *See also* letters from Kenneth A. Bertsch, Executive Director, and Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors (Feb. 4, 2020) 6 ("[T]he evidence suggests the rate of factual errors in proxy advice is extremely low, and the mechanisms that proxy advisors have in place to correct any such errors are prompt and effective"); CFA Institute Letter at 6 ("Based on several estimates, the mistakes are a tiny fraction of annual proxy issues voted. Moreover, the quality of proxy advice has never been higher"); CoPERA Letter at 7 ("Concerns about errors in proxy reports are not shared by PERA. In the 30 years that we have contracted with proxy advisors, we have not known of any material issues with, or errors in, the proxy reports and analysis"). CoPERA also flatly rejected the claim that asset managers mindlessly follow proxy advisers' vote recommendations. *Id.*at 3 ("PERA does not 'robo-vote' in harmony with any advisor's recommendations. . . . Throughout the voting process, we exercise the right to vote in the best interests of our plan beneficiaries, regardless of how other investors vote or the recommendations made by proxy advisors.")

delegated voting authority and any proxy adviser who renders proxy voting advisory services to the plan.

The Department does not address the practicality of these requirements, including whether fiduciaries will be able to add another time-consuming step to an already time-constrained proxy season. Nor does the Department suggest how fiduciaries are to quantify the impact of a plan's vote in any particular instance when they cannot know for certain what synergistic effect that vote could have when combined with the votes of other, like-minded shareholders.

While the Department does not even try to suggest that the new analytical requirement it proposes is workable, it does concede that it could be cost-prohibitive:

> The Department recognizes that because the decision regarding whether a proxy vote will or will not affect the economic value of a plan's investments is critical in triggering a fiduciary's obligations under ERISA to vote or abstain from voting, fiduciaries may need to conduct an analytical process which could in some cases be resource-intensive . . . and that . . . may often burden fiduciaries out of proportion to any potential benefit to the plan.[70]

In fact, the Department goes so far as to suggest that spending plan resources even to decide whether to vote "may be unwarranted and, given the particular facts and circumstances, could constitute a fiduciary breach."[71]

Distilled to its essence, the proposed changes to Rule 404a-1 confirm a fiduciary duty to manage a plan's proxy voting rights; forbid the fiduciary to exercise those rights without first conducting an analysis of the likely economic impact of the vote; and then threaten the fiduciary with an ERISA violation for spending plan resources on the required analysis. In short, the proposed rule marches ERISA fiduciaries into razor wire. Setting fiduciaries up to fail in this way is arbitrary and capricious and definitely not in the best interest of the plan's participants and beneficiaries.

The proposed rule is arbitrary and capricious for the additional reason that it singles out asset management decisions regarding shareholder rights for special treatment without a rational basis to do so. The manager of equity securities to which proxy voting rights pertain is not required to undertake an expensive cost-benefit analysis each time it decides to buy, sell or hold those securities. Nor is the manager obliged to document the rationale for, or articulate the anticipated economic benefit of, every transaction it enters into on the plan's behalf. There is simply no justification for treating management decisions regarding shareholder corporate governance rights any differently.

This proposal also raises serious First Amendment concerns. Proxy voting implicates the First Amendment because it is a mechanism through which shareholders *express* and *communicate* their priorities and urge the company to take (or refrain from taking) certain actions. Yet the Department's proposed rules would place severe conditions and burdens on that protected expression by forcing ERISA fiduciaries to undertake an onerous cost-benefit analysis as a precondition to engaging in such speech. Worse still, those restrictions are content-based and viewpoint-based because (as explained below) the only way to avoid them is to vote with—*i.e.*, *express support for*—the ballot measures supported by management.

[70] Proxy Voting Proposal, 85 Fed. Reg. at 55225 (citation omitted).

[71] *Id*. 55232.

Recognizing that the vote-by-vote cost-benefit analysis requirement is untenable, the Department offers fiduciaries a safe-harbor relief valve if they adopt proxy voting policies that largely abdicate their duty to manage shareholder rights. This aspect of the proposal takes a bad idea and makes it worse.

The Permitted Practices Are Incompatible With the Prudent and Loyal Management of Shareholder Rights

The proposal constructs three possible shelters from ERISA fiduciary liability in connection with proxy voting, and suggests there may be others.[72] The first is for fiduciaries who adopt a policy of always voting in accordance with management's recommendations on any proposal or type of proposal that the fiduciary determines is unlikely to significantly affect the value of the plan's investment.[73] The Department assumes that rote voting with management is unlikely to harm participants and beneficiaries because corporate officers and directors owe fiduciary duties to the company under state law and because nearly all management proposals are approved anyway.[74]

In taking this position, the Department ignores the history of corporate governance in the United States. As explained above, Congress stepped in to protect shareholders in the proxy process after determining that "unfair practices by corporate insiders" contributed to the stock market crash of 1929 and the Great Depression, and it stepped in again after the 2008 recession when it identified abusive practices involving executive compensation and gave shareholders an advisory role in the matter. More significantly, the Department willfully ignores the fact that the "intense focus on shareholder voting by ERISA plans"[75] in the 1980s was driven not just by a rise in takeover activity, but by the corporate malfeasance—including "green mail, poison pills, golden parachutes, and all kinds of creative devices to protect entrenched management"—that went with it.[76] These practices gave plan fiduciaries "an even greater obligation" to "keep themselves informed as to corporate governance issues and other issues which affect the value of plan investments and vote accordingly,"[77] because if "any institution in the country is capable of taking a long-term view and weighing the benefits of permitting management to adopt shark repellants and other methodologies of thwarting takeovers, it is the pension fund fiduciaries."[78]

The Department's assumption that thoughtful proxy voting is not important because shareholders ultimately support nearly all management proposals is also flawed. Although shareholders are

[72] *Id.* at 55231.

[73] Proposed Rule 404a-1(e)(3)(iii)(A). This provision subjects the automatic voting to any conditions requiring additional analysis because the matter in question "is likely to have a significant economic impact on the value of the plan's investment." It is not clear what, if anything, this exception means, or how it would operate in practice, since identifying an exception to the safe harbor presumably would require the very cost-benefit analysis that the safe harbor purports to eliminate.

[74] Proxy Voting Proposal, 85 Fed. Reg. at 55225.

[75] *Id.* at 55220.

[76] Testimony of Ian Lanoff, Former Administrator, Office of Pension and Welfare Benefit Programs, DOL, Hearings before the S. Subcomm. On Oversight of Gov. Mgmt, S. Hrg. 99-310 (June 25-26, 1985) at 17.

[77] *Id.*

[78] *Id.* at 26.

often deferential to management, they can and do vote against management-backed measures when there are serious governance problems that need to be addressed. But it is a *non sequitur* for the Department to suggest that *all* proxy voting should be brushed aside as irrelevant merely because shareholders *often* vote in favor of management. Moreover, companies are more likely to offer shareholder-friendly proposals when they know shareholders are watching and willing to speak up to protect their interests. Closing shareholders' watchful eyes would, in the words of the late Justice Ruth Bader Ginsburg, be like "throwing away your umbrella in a rainstorm because you are not getting wet."[79]

Finally, the Department's support for a default policy of voting with management on non-controversial issues cannot be squared with its opposition to a similar policy of voting in accordance with the recommendations of a proxy advisory firm.[80] Not only do proxy advisers owe their clients fiduciary duties of care and loyalty, but they also are obliged to adopt and disclose policies and procedures reasonably designed to ensure that they act in clients' best interests.[81] In addition, they are required to fully and fairly disclose all conflicts of interest which might incline them—"consciously or unconsciously—to render advice [that is] not disinterested,"[82] and they are subject to rigorous due diligence by the fiduciaries who use their services. Should the Department promulgate a vote-with-management permitted practice, ISS respectfully submits that it must adopt a corresponding safe harbor permitting fiduciaries to align their votes with the recommendations of proxy advisers as well.

The other two permitted practices proposed in amended Rule 404a-1 address not *how* a fiduciary votes plan proxies, but *when*. Proposed paragraph (e)(3)(iii)(B) allows a fiduciary to adopt a policy of voting only those ballot proposals that it deems to have a significant impact on the value of the plan's investment. The Department suggests that these would be proposals relating to mergers and acquisitions, dissolutions, conversions, consolidations, share issuances or buybacks, and contested elections, but not precatory proposals, unless the fiduciary determines that such a proposal "will somehow still have an economic impact on the value of the plan's investment."[83] The Department estimates that adopting a practice of this nature could potentially reduce a plan's voting by more than 94 percent.[84]

That a prudent and loyal fiduciary should spend more time and resources on "big-ticket" proxy proposals than on routine issues is hardly a radical idea. Today, ERISA fiduciaries and the proxy

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[79] *Shelby County v. Holder,* 570 U.S. 529, 590 (2013) (Ginsburg, J. dissenting).

[80] *See e.g.,* Proxy Voting Proposal at note 54.

[81] *See* discussion at 10, *supra.* Although only three of the five U.S. proxy advisers are currently registered with the SEC under the Advisers Act, the statute's fiduciary conduct provision and the SEC's rules thereunder apply to all of the firms, because each one meets the definition of "investment adviser." Note 51, *supra.*

[82] *Commission Interpretation Regarding Standard of Conduct for Investment Advisers*, Advisers Act Rel. No. 5248 (June 5, 2019), 84 Fed. Reg. 33669, 33676 (Jul. 12, 2019), *citing Capital Gains Research Bureau, Inc.,* 375 U.S. 180, 191 (1963).

[83] Proxy Voting Proposal, 85 Fed. Reg. at 55226. This example is a not-so-subtle attempt to discourage plans from exercising their right to be heard on executive compensation, despite Congress' clear intent to give them a voice.

[84] *Id.* at 55233 and note127, *citing* data from the Investment Company Institute.

advisers they engage have found a very cost-effective way to do just that, while still allowing the plans to exercise general oversight of management as state law intends them to do.[85] What is radical (and reckless, in ISS's view) is the Department's failure to acknowledge that eliminating plans' general oversight role could lead to worse corporate governance, worse investment performance, and reduced economic benefits for America's workers and retirees.

Proposed paragraph (e)(3)(iii)(C) would permit a plan fiduciary to shield herself against an adverse action by the Department if she adopts a policy to refrain from voting whenever the plan's holding of the issuer relative to the plan's total investment assets is below a stated limit, which the Department suggests could be 5 percent. The Department does not explain how a fiduciary would identify such a threshold when "total investment assets" are spread among a number of separately managed accounts and collective investment vehicles.

ISS strongly disagrees with the Department's assumption that "voting the shares of plan holdings that comprise a small portion of total plan assets rarely advances plans' economic interests,"[86] Depending on the size of the plan, even small relative positions can have a big dollar value. Furthermore, the Department's view ignores the synergistic power of proxy voting. As Professor Ann Lipton explained:

> [T]his is the problem with thinking of voting as a single action within a single context. Votes have power because they are a collective act, both with other shareholders in the context of the particular matter under consideration, and for a signal they send to the market with respect to investor preferences more generally. Shareholders at a few companies, for example, cast ballots for majority voting, and declassifying boards, and proxy access, and it led to widespread and voluntary adoption of these measures across a large swath of the market.[87]

ISS is also troubled by the possible ramifications of the Department's position. If ERISA's fiduciary duties do not protect shareholder rights appurtenant to relatively small portfolio holdings, what assurance do participants and beneficiaries have that these duties apply to the shares themselves? This concern is exacerbated by the Department's acceptance of the possibility that the quantitative threshold safe harbor might induce plan fiduciaries to break up existing portfolio positions in order to be relieved of the regulatory risks of proxy voting.[88] The Department sees this possibility as a benefit providing more optimal diversification, but such an outcome is more honestly characterized as the proxy-voting tail wagging the investment-decision dog.

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[85] *See e.g.* Remarks of Jonathan Bailey, Managing Director and Head of ESG Investing, Neuberger Berman, LLC, Transcript of the Roundtable on the Proxy Process (Nov. 15, 2018) *available at* https://www.sec.gov/files/proxy-round-table-transcript-111518.pdf, ("2018 Roundtable Transcript") 197 ("[I]t is efficient and cost-saving for our clients to be able to use the work flow management capabilities that the proxy advisory firms offer us. . . . Where we think we add value as active investors is . . . spending time deeply diligence-ing and making informed decisions where . . . a company's governance structure is not aligned with best practice and where value is not being created for clients"); remarks of Patti Brammer, Corporate Governance Officer, Ohio Public Employees Retirement System, 2018 Roundtable Transcript at 198.

[86] Proxy Voting Proposal, 85 Fed. Reg. at 55234.

[87] Ann Lipton, I Just Read the Department of Labor's New ERISA Voting Proposals and Boy Are My Fingers Tired (from typing) (Sep. 4, 2020), https://lawprofessors.typepad.com/business_law/2020/09/i-just-read-the-department-of-labors-new-erisa-voting-proposals-and-boy-are-my-fingers-tired-from-ty.html

[88] Proxy Voting Proposal, 85 Fed. Reg. at 55235.

The Department opines that the proposed changes to Rule 404a-1 "would not conflict with any relevant federal rules,"[89] but that is not so. They would conflict with the Advisers Act's fiduciary standard and the proxy rule thereunder. The SEC does not share the Department's skepticism about proxy voting's positive effect on shareholder value. On the contrary, the SEC has long recognized that through their proxy voting authority, investment managers are in a position "to significantly affect the future of corporations and, as a result, the future value of corporate securities held by their clients."[90] While the Advisers Act permits an investment adviser and its clients to define the parameters of the of the proxy voting duties the adviser undertakes on the clients' behalf, once it assumes those duties, it cannot abdicate them, but must carry them out in the clients' best interest.

Shortly before the SEC issued the 2019 guidance on the proxy voting responsibilities of investment advisers, ExxonMobil asked the Commission to create a pair of Advisers Act safe harbors that look a lot like what the Department proposes here. The first would have shielded investment advisers from liability where they follow a proxy adviser's recommendation that happens to be aligned with the issuer's recommendation. The second would have shielded advisers from liability when they refrain from voting on a ballot proposal as to which a proxy adviser recommends voting against the issuer's recommended position.[91] The SEC declined to incorporate this radical suggestion into either its 2019 guidance or the 2020 supplement thereto.

ISS believes that safe harbors for fiduciaries who vote in accordance with the recommendations of management or who abstain from voting altogether do not belong in Rule 404a-1 any more than they belong in the proxy rule under the Advisers Act.[92]

The Department Has Failed to Demonstrate That the Benefits of this Proposal Outweigh the Costs

For a proposal that requires ERISA fiduciaries to undertake rigorous cost-benefit analyses before exercising shareholder rights on behalf of America's workers and retirees, its own cost-benefit analysis is remarkably feeble.

The Department claims that the proposed changes to Rule 404a-1 will conserve plan resources that are currently being squandered on proxy advisers and proxy voting,[93] but that claim sits on a very wobbly base. Not only does the Department make unjustified and unproven assumptions regarding the long-term economic benefits of proxy voting and the accuracy, integrity and

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[89] *Id.* at 55239.

[90] *Proxy Voting by Investment Advisers,* Advisers Act Rel. No. IA-2106 (Jan. 31, 2003) at 2, 68 Fed. Reg. 6585, 6586 (Feb. 7, 2003). *See also Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management Investment Companies*, Investment Company Act Rel. No. 25922, 68 Fed. Reg. 6564, 6566 (Feb. 7, 2003) ("Proxy voting decisions by funds can play an important role in maximizing the value of the funds' investments").

[91] ExxonMobil Letter, *supra*, note 54.

[92] The Executive Order directing the Department to revisit its past guidance on proxy voting in order to "promote private investment in the Nation's energy infrastructure" does not alter our view. *See* note 12, *supra.*

[93] Proxy Voting Proposal, 85 Fed. Reg. at 55231 ("The societal resources freed for other uses due to voting fewer proxies . . . would represent benefits of the rule").

transparency of proxy advisory services, but it assumes facts contrary to the evidence.[94] Inhibiting plans' exercise of the shareholder rights states and Congress have granted them is no benefit at all.

Moreover, the Department offers no useful evidence of the costs plans incur today to exercise their corporate governance rights Instead, the Department concedes that available information about payments to service providers "sheds little light on the costs attendant to voting proxies or exercising other shareholder rights."[95] What scant information there is indicates that the costs are infinitesimal.[96] Undeterred, the Department says the "actual total proxy voting costs *could be* substantially higher for some or many plans, and even small costs *may not be* justified"[97] (emphasis supplied).

The Department surmises that the proposed rule "may reduce plans' demand for proxy advice,"[98] but it does not explain why that would be. It is unlikely that a prudent and loyal fiduciary would be able to assess the economic impact of thousands of ballot proposals without the comprehensive research and analysis proxy advisers supply. And even the permitted practices have exceptions, the identification of which may require independent, expert advice.

The Department's suggestion that the "proposed rule would benefit plans by providing improved guidance regarding how ERISA's fiduciary duties apply to proxy voting"[99] borders on comical. Without any credible evidence of fiduciary confusion, the Department has constructed a cost-prohibitive and unworkable procedure that presents enormous risk to any fiduciary who dares to use it. A fiduciary who prudently determines that companies' long-term performance fares better when they listen to their shareholders, and who believes that in a corporate democracy—as in a civil democracy—every vote counts, risks an enforcement action by a hostile regulator simply for doing her job.

On the flip side, the Department opines that the incremental cost of the proposal per plan will be small because most fiduciaries will, by necessity, default to the safety of the permitted practices.[100] However, the Department makes no attempt to calculate the costs of utilizing the permitted practices, including the cost of identifying and justifying exceptions to the safe harbors and the cost of identifying the quantitative threshold. Nor does the Department estimate the costs plans

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94 *See* discussion at 11-13 *supra.*

95 Proxy Voting Proposal, 85 Fed. Reg. at 55229.

96 *Id*. The costs paid to two service providers averaged only 0.2 basis points. While payments to another service provider averaged 6.3 basis points, many of those payments appeared to be for services other than proxy voting.

97 *Id*. at 55229 ("The magnitude of unreported costs is unknown").

98 *Id*. at 55232.

99 *Id*. at 55231.

100 *Id*. at 55232. The Department concedes that where fiduciaries decline to use the safe harbors, the proposal's cost "may be significantly greater." *Id.*

would incur if their decision not to participate in the proxy process prevents issuers from achieving quora for their shareholder meetings.[101]

A more glaring omission relates to the costs asset managers, trustees and other responsible fiduciaries would incur in altering their existing compliance programs to meet the amended rule's requirements. The Department opines that responsible plan fiduciaries "would spend some time familiarizing themselves with the rule," but it expects that such compliance costs would be "minimal."[102] Nothing could be farther from the truth. Because prudent and loyal fiduciaries currently assume that the shareholder rights they are duty-bound to manage are valuable, they neither undertake vote-by-vote cost benefit analyses nor follow policies that cause them to throw most proxy votes away. Implementing a rebuttable presumption against the exercise of shareholder rights would require a sea change in the responsible fiduciaries' existing policies and procedures.

Among other things—and this list is not exclusive—fiduciaries would have to: substantially revise their compliance policies and procedures relating to proxy voting for ERISA plans; develop a means of tracking each plan's total share ownership and percentage ownership of the issuer across numerous separately managed accounts and collective vehicles; implement a mechanism to document (for the asset manager or proxy voting service) or review (for the trustee or named fiduciary) voting policies and vote-by-vote cost-benefit analyses or exceptions to permitted practices; and harmonize the permitted practices (should they decide to rely on them) with the fiduciary requirements of the Advisers Act and other applicable fiduciary laws. Managers of ERISA-governed collective investment vehicles would have to obtain each investing plan's consent to the manager's proxy voting policy or concoct a method of voting that reflects multiple plans' relative investments in the collective vehicle. Other registered investment advisers would be obliged to run two parallel proxy voting compliance programs: a general one, focused on voting in clients' best interests, and an ERISA one, focused on voting as little as possible. And after incurring all that expense to comply with the new rules, fiduciaries would have to prepare for the possibility that they will be sued by plan participants and beneficiaries for breaching their fiduciary duty by squandering the plan's valuable shareholder rights.[103]

Perhaps the most critical flaw in the Department's cost-benefit analysis is that the Department does not even acknowledge the possibility that virtually eliminating ERISA investors' role in corporate governance will lead to a resurgence in "unfair practices by corporate insiders." If the management abuses of the past resurface, or if new ones take their place, the long-term investment returns available to provide benefits to America's workers and retirees will be greatly diminished.

At the end of the day, all the Department has to offer is an admission as to "the uncertainty regarding the proxy voting activities of ERISA plans, and the attendant costs and benefits of this proposal."[104] ISS respectfully submits that "uncertainty" is not a sufficient basis for rulemaking.

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[101] *Id.* at note 63.

[102] *Id.* at 55232.

[103] ERISA § 502(a), 29 U.S. C. § 1132(a).

[104] Proxy Voting Proposal, 85 Fed. Reg. at 55233.

Conclusion

For all the foregoing reasons, ISS respectfully asks the Department not to play politics with the employment benefits and retirement security of hardworking Americans and to withdraw this proposal in its entirety. Should the Department proceed with this rulemaking, ISS asks that affected parties be given a minimum of eighteen months to comply with the new requirements.

We would be happy to supply the Department with additional information regarding any of the matters discussed herein. Please direct any questions about these comments to the undersigned, to our General Counsel, Steven Friedman, who can be reached at 301.556.0420, or to our outside counsel, Mari-Anne Pisarri, who can be reached at 202.223.4418.

Respectfully submitted,

Gary Retelny
President and CEO

Cc: Joe Canary, Office Director, Office of Regulations and Interpretations
Jeffrey Turner, Deputy Director, Office of Regulations and Interpretations