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The Honorable Preston Rutledge
Assistant Secretary
Employee Benefits Security Administration
U.S. Department of Labor
200 Constitution Avenue NW
Washington, DC 20210

Dear Assistant Secretary Rutledge:

A fundamental component of our strong capital markets is the existence of responsible corporate governance laws and regulations that encourage companies to stay public and promote long-term shareholder value. Accordingly, we appreciate this opportunity to comment on the Department of Labor's ("DOL" or the "Department") "Review of existing Department of Labor guidance on the fiduciary responsibilities for proxy voting to determine whether any such guidance should be rescinded, replaced, or modified to ensure consistency with current law and policies that promote long-term growth and maximize return on ERISA plan assets" pursuant to Section 5 of Executive Order 13868 (the "Executive Order").

The Department has long held that exercising the voting rights associated with ERISA plan investments is a fiduciary obligation that must be executed solely in the interest of plan participants and beneficiaries. While the Department's basic understanding of this fiduciary obligation has remained constant for more than 30 years, the nature of the investments made by ERISA plans and the mechanisms for exercising the voting rights of these investments have changed quite substantially, as have the roles played by investment managers and proxy voting services. The growth of mutual funds and other collective investments in plans, the growth of assets held by defined contribution plans, and the duopoly of proxy advisory service providers all represent significant developments that affect how fiduciaries should evaluate and carry out this fiduciary obligation.

Importantly, the regulation of proxy voting and related shareholder rights issues by the Securities and Exchange Commission ("SEC" or "Commission") has evolved in response to these developments. The SEC has recognized and responded to the evolving nature of investments and the growing role of proxy voting services, including significant conflicts of interest inherent in the business models of proxy firms and reports that they also often use inaccurate information when making voting recommendations.

Specifically, the SEC staff issued new guidance in 2014 (known as Staff Legal Bulletin (SLB) No. 20[1], recently rescinded two "no-action" letters issued in 2004 to proxy voting service providers, and in August 2019 issued two new forms of SEC Commission-level guidance pertaining to proxy advisory firms and investment advisers that utilize those firms.[2] Furthermore, the SEC has indicated that they are looking to propose additional rulemaking on the issue in the coming months. The goal of these SEC steps is to ensure that proxy advisory firms do not wield outsized influence over the vote and that their recommendations are not given undue weight given the shortcomings in how they operate and their potential conflicts.

While the Department has issued a number of guidance documents addressing the fiduciary issues related to voting rights in ERISA plan investments, its guidance largely addressed the assignment and delegation of the responsibility to do so, and the consideration of costs and benefits in exercising these rights. The foundation of the current regulatory framework for proxy voting consistent with ERISA is the *Avon* Letter, which was drafted before proxy firms took root and when proxy voting mechanics and corporate governance were very different from what they have evolved to today. The *Avon* Letter's charge that ERISA plan fiduciaries should always vote plan shares does not require consideration of the materiality of the underlying issue to the value of plan assets or whether the cost of properly analyzing the issue is worth the expense for the plan.

The drafters of this guidance letter, written in the 1980s, could not have envisioned many of these significant market and regulatory changes related to shareholder rights and voting, or provided a broader context identifying and understanding the relevant factors that should be part of a fiduciary analysis. For

[1] SLB 20 is available at https://www.sec.gov/interps/legal/cfslb20.htm.

[2] Commission Interpretation and Guidance Regarding the Applicability of the Proxy Rules to Proxy Voting Advice is available at https://www.sec.gov/rules/interp/2019/34-86721.pdf; Commission Guidance Regarding Proxy Voting Responsibilities of Investment Advisers is available at https://www.sec.gov/rules/interp/2019/ia-5325.pdf

example, while the use of proxy advisory services may reduce the costs related to voting shares held by plans, only two firms—Institutional Shareholder Services and Glass Lewis—constitute roughly 97% of the proxy advisory firm market. Moreover, given the conflicts and concerns about competency that have been documented with the business models of these proxy firms,[3] is it still prudent for ERISA fiduciaries to rely on them? What factors should fiduciaries consider to ensure they understand how these firms make voting decisions? What information should fiduciaries seek to evaluate potential conflicts of interest?

In light of these developments, we respectfully request that the Department issue new sub-regulatory guidance on the obligation of ERISA fiduciaries to vote proxies. This action will protect the interests of participants and beneficiaries.

Background:

The Department issued guidance expressing its views on voting rights and shareholder activities relating to ERISA plan investments beginning with a 1988 information letter to Helmuth Fandl, Chairman of the Retirement Board of Avon Products Inc. (the "Avon Letter"). These views were further developed in a series of Interpretive Bulletins 1994-2, 2008-2, and 2016-1 ("IB 94-2," "IB 08-2" and "IB 16-1"), that successively replaced one another. Consistent through all was the basic fiduciary framework: that the fiduciary act of managing investments includes the voting of securities and other exercise of the rights related to the shares owned; that this obligation lies with the plan trustee, except to the extent this duty is delegated to a fiduciary investment manager under the terms of the plan or the trustee is subject to the direction of the named fiduciary; where this obligation is delegated, it remains solely with the investment manager who is responsible for prudently exercising these rights; and that an investment policy statement may govern these actions. Most significantly, all of this guidance clearly stated that ERISA does not permit fiduciaries to subordinate the economic interests of participants and beneficiaries to unrelated objectives in voting proxies or exercising other shareholder rights.

The primary differences in these guidance documents was the role of cost/benefit analysis by the responsible fiduciary—while IB 08-2 indicated that such an analysis was a requirement for all shareholder activities, IB 16-1 suggested that the use of proxy services resulted in little costs to plans, and that therefore an analysis was

[3] The Mercatus Center at George Mason University, *How to Fix Our Broken Proxy Advisory System*, (April 16, 2013); last available at https://www.mercatus.org/publication/how-fix-our-broken-proxy-advisory-system.

not required in many cases. IB 16-1's view, however, does not account for the more recent regulatory focus on the extent to which a proxy advisory firm's recommendation is conflicted or based on inaccurate information. DOL may want to issue guidance that a fiduciary should consider these concerns when hiring a proxy advisory firm.

The SEC has also been an active regulator of proxy voting. All investment advisers owe a duty of care and loyalty when undertaking services on behalf of their clients, including proxy voting. In 2003, the SEC adopted Rule 206(4)-6 under the Investment Advisers Act of 1940, the so-called "Proxy Voting Rule," which requires a registered investment adviser (an "RIA") that exercises voting authority over client proxies to adopt policies and procedures reasonably designed to ensure that the RIA votes proxies in the best interests of clients, to disclose to clients information about those policies and procedures, and to disclose to clients how to obtain information on how the RIA has voted the clients' proxies. In the Rule 206(4)-6 Adopting Release (the "Adopting Release"), the SEC indicated that an RIA could demonstrate that its vote of its clients' proxies was not a product of a conflict of interest if the RIA voted the proxies in accordance with a predetermined policy based on the recommendation of an "independent" third party.

In an effort to clarify the parameters of the Proxy Voting Rule, the SEC staff subsequently issued two no-action letters to Egan-Jones Proxy Service and ISS regarding how to determine whether a proxy advisory firm is, in fact, an independent third party for purposes of the Adopting Release test. In the Egan-Jones letter, the staff stated that "the mere fact that the proxy voting firm provides advice on corporate governance issues and receives compensation from the issuer for these services generally would not affect the firm's independence from an investment adviser." In the ISS letter, the staff indicated that:

> a case-by-case evaluation of a proxy voting firm's potential conflicts of interest is not the exclusive means by which an investment adviser may fulfill its fiduciary duty of care to its clients in connection with voting client proxies according to the firm's recommendation… Whether an investment adviser breaches or fulfills its fiduciary duty of care when employing a proxy voting firm depends upon all of the relevant facts and circumstances. Consistent with its fiduciary duty, an investment adviser should take reasonable steps to ensure that, among other things, the firm can make recommendations for voting proxies in an impartial manner and in the best interests of the adviser's clients. Those steps may include a case by case evaluation of the proxy voting firm's conflict procedures

and the effectiveness of their implementation, and/or other means reasonably designed to ensure the integrity of the proxy voting process.

Together, the two no-action letters were criticized by many for having encouraged the growth in influence of proxy advisory firms' roles in the corporate governance of U.S. public companies. The letters also allowed conflicts of interest within the industry to proliferate and allowed investment managers to rely on the *general* policies and procedures of proxy firms regarding the management of conflicts, as opposed to identifying and managing conflicts of interest that may be specific to a particular issuer.

ISS in particular has been criticized for the conflicts inherent in its business model. At the same time ISS is providing analysis and vote recommendations to institutional investors, it offers consulting services to the same corporate issuers about which it renders proxy voting advice. ISS also does not publicly disclose whether a shareholder proposal it is providing a vote recommendation on has been submitted by one its own clients. In the case of Glass-Lewis, the firm is owned by an activist Canadian pension plan that takes positions regarding director elections and other proxy matters in which Glass-Lewis is also providing vote recommendations. These conflicts raise the question as to whether ISS and Glass-Lewis can truly be considered "independent" third parties.

Moreover, significant questions have been raised regarding the level of staffing and expertise at ISS and Glass-Lewis and whether the firms have the capability to provide sound and well-researched voting recommendations. As of June 2017, the ISS team covered 40,000 shareholder meetings with approximately 270 research analysts and 190 data analysts.[4] Glass Lewis purports to analyze fewer issues but has fewer analysts to do so (approximately 200 in 2014), ensuring that its analysts are equally overwhelmed with their responsibilities in the short period of time that constitutes the proxy voting season. Glass Lewis recently reported it covers 20,000 meetings each year with approximately the same number of analysts it had in 2014.[5] The combination of limited staff covering such a large volume of shareholder meetings and votes during a compressed timeframe has led to discernible issues with how vote recommendations are developed by proxy advisory firms and the ability of issuers to respond prior to a vote.

[4] https://www.issgovernance.com/file/duediligence/Due-Diligence-Package-November-2017.pdf
[5] http://www.glasslewis.com/company-overview/

With this background in mind, the SEC staff issued SLB 20, mentioned above. SLB 20 focuses on the responsibility investment advisers' have when voting client proxies and retaining proxy advisory firms to ensure that they have acted in accordance with their obligations as fiduciaries.

Although in most cases clients delegate to their investment adviser all their proxy voting authority, the Proxy Voting Rule grants flexibility in determining the scope of the investment adviser's voting authority. SLB 20 includes a nonexclusive list of examples of alternative arrangements clients and investment advisers can establish, including ones in which they determine:

- the time and costs associated with certain types of proposals or issuers may not be in the client's best interest;

- to vote as recommended by management or in favor of all proposals made by a particular shareholder proponent absent contrary instructions;

- to abstain from voting any proxies; or

- to focus resources on only particular types of proposals.

In short, under certain circumstances, an investment adviser can determine not to vote. Investment advisers that retain proxy firms to assist with their proxy voting responsibilities must perform sufficient due diligence to "ascertain that the proxy advisory firm has the capacity and competency to adequately analyze proxy issues." In making that determination, investment advisers may consider the adequacy of the proxy advisory firm's staffing and personnel and the robustness of its policies concerning identifying and addressing conflicts of interest and ensuring the accuracy of the information used to make its proxy voting recommendations.[6]

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[6] In some instances, SLB 20 is more specific. For example, it provides: "Consequently, the staff has stated that investment advisers should establish and implement measures reasonably designed to identify and address the proxy advisory firm's conflicts that can arise on an ongoing basis, such as by requiring the proxy advisory firm to update the investment adviser of business changes the investment adviser considers relevant (i.e., with respect to the proxy advisory firm's capacity and competency to provide proxy voting advice) or conflict policies and procedures." SLB 20 also states: "[A]n investment adviser may determine that a proxy advisory firm's recommendation was based on a material factual error that causes the adviser to question the process by which the proxy advisory firm develops its recommendations. In such a case, the staff believes that the investment adviser should take reasonable steps to investigate the error, taking into account, among other things, the nature of the error and the related recommendation, and seek to determine whether the proxy advisory firm is taking reasonable steps to seek to reduce similar errors in the future."

In September 2018, the SEC staff withdrew the Egan Jones and ISS no-action letters. Following this action, the SEC in August 2019 issued two new forms of Commission-level guidance, which included guidance that further clarified the fiduciary duty of investment advisers when engaging in proxy voting activities. Additionally, the SEC has indicated that they will be taking further action to regulate proxy advisory firms and improve the overall quality of proxy advice received by fiduciaries.

For example, SEC Chairman Clayton has suggested that voting decisions should be particularized – that is, based on a proper analysis of particular topics at particular companies. Chairman Clayton remarked in his December 11, 2018 Senate Banking Committee testimony: "We also need clarity regarding the analytical and decision-making processes advisers employ, including the extent to which those analytics are company or industry specific. On this last point, it is clear to me that some matters put to a shareholder vote can only be analyzed effectively on a company-specific basis, as opposed to applying a more general market or industry-wide policy."[7] Chairman Clayton further explained that among the issues that the SEC is looking to address are: "(1) the framework for addressing conflicts of interests at proxy advisory firms, and (2) ensuring that investors have effective access to issuer responses to information in certain reports from proxy advisory firms."

<u>Proposed Action by DOL Consistent with E.O. 13868</u>

ERISA plans hold at least $8 trillion in plan assets, making them a significant fraction of the investors in public securities markets. There has been a significant increase in shareholder activity among public companies since the majority of the DOL guidance was adopted, increasing the importance of the issue. The SEC cited an Ernst and Young analysis showing 72% of S&P 500 companies reporting engagement with shareholders in 2017, compared to just 6% in 2010. While IB 16-1 suggested the proxy voting services were a cost reducer, it did not address their potential conflicts of interest, the manner in which they form recommendations, or their undue influence in the market other than through a glancing reference in a footnote.

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[7] Jay Clayton, Chairman, U.S. Securities & Exchange Commission, Testimony on "Oversight of the U.S. Securities & Exchange Commission" Before the U.S. Senate Committee on Banking, Housing, & Urban Affairs (Dec. 11, 2018), *available at* https://www.sec.gov/news/testimony/testimony-oversight-us-securities-and-exchange-commission-0.

As noted above, ISS and Glass Lewis comprise roughly 97% of the proxy advice market, but their influence over ERISA plan assets may be even greater than these numbers indicate. By some estimates these two firms "control" up to 38% of all shareholder votes because some of their clients automatically follow their vote recommendations.[8] Such an automatic" adoption without review is not consistent with ERISA requirements. This is especially true given that proxy advisory firms generally follow a "one-size-fits-all" approach to their voting recommendations.

The SEC has taken action to update its oversight of certain aspects of the proxy voting process in light of these concerns. It also is considering further revisions in light of these and other factors. For all of these reasons, the Department should revisit these issues and update its regulatory guidance governing these fiduciary obligations.

Sub-regulatory Guidance

In view of the SEC's recent actions recognizing the changes in the proxy voting terrain since the 1980s and to further the policies of Section 5 of Executive Order 13868, DOL should immediately issue sub-regulatory guidance to harmonize its oversight of proxy voting with SLB 20 and the guidance issued by the SEC on August 21, 2019. This sub-regulatory guidance should clarify that if a responsible fiduciary reasonably determines that the cost of voting (including the cost of research, trading, or other restrictions, etc.) is likely to exceed the expected economic benefits of voting, the fiduciary has an obligation to refrain from voting based on the concept of materiality utilized in Section 5(a) of the Executive Order. This may, for example, occur in situations where the issue relates to a social or political matter that plan fiduciaries deem unlikely to alter the underlying value of the asset. This guidance should also make clear that an ERISA fiduciary may not, consistent with the obligations of independence and prudence, adhere to a practice of "automatic" adoption without review of a proxy advisors recommendations.

If issued in a timely fashion, this sub-regulatory guidance would provide coherence and clarity for ERISA fiduciaries—especially those subject to the SEC's SLB 20—and enhance protections for the beneficiaries of ERISA plans during the current proxy voting season.

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[8] ISS 24.7% Glass Lewis 12.9% Source: Ertimur, Yicca, Ferri, Fabrizio, and Oesch. Shareholder Votes and Proxy Advisors: Estimates from Say on Pay (February 25, 2013).

The above-proposed action by DOL, developed in consultation with the SEC, would modernize and harmonize the standards related to the exercise of shareholder rights in ERISA and securities law. This would better protect the interests of ERISA plan participants and beneficiaries.

Thank you for your consideration of this request and we stand ready to discuss these issues with you further.

Sincerely,

Tom Quaadman

Cc: The Honorable Patrick Pizzella, Acting Secretary of Labor