MAGUIRE ENERGY INSTITUTE

September 22, 2020

The Honorable Eugene Scalia
U.S. Department of Labor
200 Constitution Ave., N.W.
Washington, DC 20210

Rule Number: RIN 1210-AB91

Dear Secretary Scalia:

Thank you for the opportunity to comment on the proposed Department of Labor rule on proxy voting and ESG investing. The views expressed are mine alone and not necessarily those of the Maguire Energy Institute, the Cox School of Business, or Southern Methodist University.

The Labor Department should be commended for proposing a rule to address proxy voting with respect to the Employee Retirement Income Security Act (ERISA). As I noted in my July letter regarding Environmental, Social, and Governance (ESG) investing, a great number of Americans depend on sound retirement and pension programs, meaning those plans deserve strong regulatory oversight. By clarifying that plans do not have to vote on every proxy matter, particularly if it does not have an economic impact or benefit, the department can help reduce costs for plan participants and allow ERISA fiduciaries to focus resources on proxy votes that do have an economic impact on the plan.

As I explained, when addressing ESG investing in general, there is no place for plans that invest and vote proxies on "unrelated" matters that do nothing for the bottom line. In fact, approaches that stray from the financial wellbeing of plans only serve to jeopardize the long-term results that pensioners and investors expect and deserve. As an economist at Southern Methodist University's Cox School of Business, and associate director of the Maguire Energy Institute, I have been particularly interested in efforts to use ESG principles to divest from energy funds and stocks tied to fossil fuels, despite the historically strong returns of that sector. With that in mind, I am hopeful that this proposed rule will take another important step in ensuring that those responsible for vast sums of American retirement savings, including the proxy advisory firms Institutional

Shareholder Services (ISS) and Glass Lewis, will now be required to make decisions solely in the financial interest of their plans and not in pursuit of alternate policy agendas.

There are at least four good reasons why DOL's proposed rule will benefit investors:

First, advisory firms have consistently abused the proxy system to the detriment of pensioners and investors. Two companies, Institutional Shareholder Services (ISS) and Glass Lewis, enjoy de facto duopoly control of the proxy advisory market nationwide. Not only have these two firms shown they are willing to recommend feel-good ESG resolutions that do not focus on maximizing returns, but evidence also shows their recommendations often include significant errors.[1] At the very least, ERISA fiduciaries using the services of proxy advisory firms deserve to know that these firms are making accurate voting recommendations and are not entangled in conflicts of interest. Greater scrutiny provided by DOL's proposed rule in this area will go a long way toward providing the transparency and peace of mind that pensioners deserve.

Second, pensioners also deserve to know the costs of paying proxy advisory firms. While it is commendable that DOL's proposed rule acknowledges the unknown costs and possible conflicts of interest by proxy advisors, the Department should consider further extending its regulatory reach. For example, the Department could ratchet up the requirement for plans to simply monitor potential conflicts of interest and, instead, prohibit these conflicts outright, as regulators currently do for auditors and credit-rating agencies. Such action would help ensure that pension beneficiaries are not diverting their retirement savings towards proxy advisors who may have conflicting agendas.

Third, the rule's robo-voting section could also be clarified so that ERISA beneficiaries have peace of mind when relying on the firms' pre-population or vote submission services. This could be accomplished by incorporating the provisions of the SEC guidance on this matter into the rule itself, rather than making an oblique reference to this guidance. This clarification could come in the form of clear guardrails for ERISA fiduciaries when it comes to robo-voting or automatic vote submission services. For example, the SEC guidance requires asset managers to evaluate additional information, including rebuttals from the

[1] https://www.sec.gov/comments/s7-22-19/s72219-7409692-219183.pdf

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company involved, after a proxy firm's vote recommendation—meaning proxy firms don't have free rein to robo-vote on behalf of those asset managers without fully considering all sides of an issue. Extending this practice to ERISA plans would provide an extra layer of human accountability.

As a specific alternative, the DOL's proposed rule could greatly restrict or even prohibit robo-voting, particularly for controversial matters. Such a move would be the best way to ensure visibility for pensioners into the proxy votes that affect them. This is especially true when it comes to important contested issues. In these instances, automatic votes should be switched off so that fiduciaries can ensure that voting decisions are made in the best interest of plan participants.

In fact, robust research from Ohio State University Law Professor Paul Rose finds that "institutional investors have become overly reliant on the recommendations of proxy advisors, often outsourcing analysis and voting decisions to the two largest firms in the market without adequate disclosure of that reliance."[2] That includes a finding that 400 investors automatically voted based on ISS's recommendations more than 99.5% of the time.[3] Clearly, robo-voting is problematic because it transfers voting power from institutional investors to firms such as ISS and Glass Lewis.

Fourth, and finally, proxy voting is a major part of an ESG approach that consistently fails pensioners and investors. DOL's proposed rule should not allow proxy votes or shareholder activity to take place if it doesn't focus on maximizing returns or enhancing financial value for beneficiaries. The rule should, in fact, require documentation by investment professionals that proxy votes will have a positive impact on the plan's financial performance.

Compelling research has shown that ESG-related activism may actually be harming shareholders. Harvard University's Joseph Kalt finds, for example, that ESG-related shareholder activism does not enhance shareholder value and in many cases diverts resources from the primary goals of shareholder returns and good governance.[4]

[2] https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3486322
[3] https://www.sec.gov/comments/s7-22-19/s72219-6429308-198569.pdf
[4] https://corpgov.law.harvard.edu/2018/06/17/political-social-and-environmental-shareholder-resolutions-do-they-create-or-destroy-shareholder-value/

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ESG-investing has been found to produce 43.9% lower returns than standard S&P 500 index funds, according to Wayne Winegarden with the Pacific Research Institute. His research also cities data showing that retirement nest eggs could be 10% lower without the types of reforms being proposed by the DOL.[5] Likewise, a Bloomberg analysis of ESG funds compared to standard index funds finds that one of the oldest and largest ESG ETF's on the market, the iShares MSCI USA ESG Select Social Index Fund (SUSA), has trailed the S&P 500 index by 37 points over 10 years.[6]

The Department has a golden opportunity to reform proxy voting and make important clarifications to its proposed rule, specifically on robo-voting. Millions of Americans cannot afford to have their proxy ballots controlled by activists with little or no stake in a company's success. An ERISA pension fund's top priority should be financial return maximization. If designed properly, DOL's proposed rule can accomplish that and give pensioners and investors the peace of mind they deserve.

Sincerely yours,

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[5] https://www.pacificresearch.org/wp-content/uploads/2019/05/ESG_Funds_F_web.pdf
[6] https://www.bloomberg.com/opinion/articles/2020-01-27/esg-etfs-your-socially-conscious-fund-probably-has-some-holes

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