Fiduciary Duties Regarding Proxy Voting and Shareholder Rights by Todd Royal

Re: RIN 1210-AB91

Introduction

Now is the time for the U.S. Department of Labor (DOL) to uphold this new rule to designate proxy voting within retirement accounts understand the highest goal plan participants seek are fiduciary standards affirming investment returns, growth, and stability over progressive social values.

My name is Todd Royal, M.P.P., and I am an energy analyst for the past six years. I have published two books: *Energy Made Easy* and *Just Green Electricity* and written over 200 articles published globally on energy, foreign policy, and national security. Additionally, my master's thesis – *Hydraulic Fracturing and the Revitalization of the American Economy* – is published in the U.S. Library of Congress. My scholarly research for Duke University has focused on global furniture value chains, African aid programs from the George W. Bush Administration, and battery energy storage systems (BESS) supply chain coordination.

The American Society of Civil Engineers (ASCE) appointed me to their California Energy and Electricity Infrastructure Report Committee to be the chief policy advisor and write the report on electrical grid valuations stability and cost of grid replacement for California.

My scholarly writings and books focus on the intersection of finance and public policy, which combines energy and environmental issues. I have followed personally and professionally since it affects all aspects of energy the problems of proxy advisory firms advancing shareholder proposals focused on environmental and social causes.

The DOL's, Employee Benefits Security Administration (EBSA) is wisely counteracting previous regulations to address:

> "The application of the prudence and exclusive purpose duties under the Employee Retirement Income Security Act (ERISA) with respect to proxy voting and exercise of other shareholder rights."

This recommended rule will amend the DOL's longstanding and judicious directive that protects American retirement account under its "Investment duties" regulation (20 CFR 2550.404a-1). EBSA under DOL guidance has a sacrosanct obligation to American worker's retirement funds being safe, accessible, and achieving reasonable growth by the end of their working lives. Besides this sacred trust toward investment managers fiduciary responsibility, COVID-19 has shown this trust now extends to the health and wellness of employees and their families to and from the workplace. Transparency and openness are now life and death regulatory matters for retirement plan security.

The same is true for proxy voting using the popular investment strategy tied to environmental sustainability, social justice countenance, and corporate governance (ESG). The notion of doing good while doing well financially without ever knowing if the desired social impact was achieved. All are arrayed in progressive policy agendas without consideration for fiduciary responsibilities or retirement account stability. The DOL proposed a rule that would provide much needed restrictions on this type of investing, which is justified through ERISA principles around fiduciary duty. Hopefully, the DOL adopts this rule without delay.

What the proposed rule in this docket will accomplish if adopted underscores the regulatory need to govern shareholder voting processes, and begin to rein in the undue influence proxy advisory firms carry who skew many major corporate governance decisions based on ESG. No one disputes environmental protections, social concerns that protect worker retirement plans, and transparency in corporate governance are virtuous and needed, but the use of proxy advisors recklessly strips away ERISA retirement plan protection unbeknownst to the plan participants.

Individual investors have the ability to privately secure funds and investment decisions toward any ESG fund(s) that affirms their values by doing whatever they please with their own money. Employer-driven retirement accounts, however, do not allow for this type of personal value driven investing. ERISA plans were never meant nor were proxy advisory firms given alternative power to promote social goals and public opinion that is here today and gone tomorrow. Proxy firms leading the ESG charge are Glass Lewis & Company, LLC (Glass Lewis) and Institutional Shareholder Services (ISS), which control "97 percent of the proxy advisory market." These two firms have a direct conflict of interest regarding ERISA stability, and a history that "biases their recommendations in favor of ESG shareholder proposals regardless of the resolution's merits." While 2003 rulemaking sought to curb this influence,

> "The ultimate result of regulatory intervention has been a direct increase in the extent to which for-profit third-party proxy advisors, which have no economic risk in the underlying investments, drive decision making at investment advisors and corporations." according to Daniel M. Gallagher, former Commission of the Securities and Exchange Commission (SEC) from 2011-2015 before the United States Senate Committee on Banking, Housing, and Urban Affairs, December 6, 2018.

Relevance of the Issue

The 2003 rule (SEC Rel. No. IA-2106), and companion rule (SEC Rel. No. IC-25922) only considered specific and narrow advisor conflicts of interests when voting for plan participant/client matters own interests or voting shares "in a company who pension the advisor also manages." The goal was to limit the investment advisor's ability to adopt preferred social policies instead of focusing on the proxies best economic interests. Problems grew when investment advisors misinterpreted the DOL's 1988 "Avon Letter," which outlined "the fiduciary act of managing plan assets which are shares of corporate stock would include the voting of proxies appurtenant to those shares of stock."

Requiring a vote on every share when votes are called at shareholder meetings gave clout to institutional investors. Small portions of a firm's securities allowed regulatory intervention to be exploited for today's ESG-devotees. Unregulated third parties such as Glass Lewis and ISS now have free rein to make whatever ESG decision they want without consequence to the "significant errors" both firms routinely give in their proxy-advice practice. ESG investments regularly produce lower returns. Would a plan participant in the U.S. knowingly sacrifice real-dollar performance if non-pecuniary ESG resolutions were disclosed?

Let ERISA fiduciaries utilize the services employed by Glass Lewis and ISS, or other proxy advisory firms if so desired; but make sure accurate and easy-to-understand proxy voting guidelines are in place, and all conflicts of interest disclosed. Otherwise, the proxy system favoring ESG will continue and the DOL's ERISA protections and retirement system in place could be interpreted having no merit, and inherently broken.

Recovering from a pandemic means this is no time to have feel-good investment concepts and poor performance in place that is the ESG-standard. Legal expert Bernard S. Sharfman rightly believes, "Now is the Time to Designate Proxy Advisors as Fiduciaries under ERISA." Bring Glass Lewis and ISS into the harsh glare of ERISA-backed standards and practices. The fact they are not held to the same standards as fiduciaries, while having such a large impact on a fund through the recommendations and vote of a fund's proxies, makes absolutely no sense and strikes at the heart of fiduciary duty. Ethical business practices are important to Americans, but the lackluster results of ESG investment accounts and the proxy votes supporting these decisions demand this new rule from EBSA be enacted over faddish investing discounting retiree protection.

Proxy Votes Supporting Lower Investment Performance

Groundbreaking research by Harvard University's Joseph Kalt found: "ESG activism does not increase shareholder value." Resources are being diverted from retiree growth and good corporate governance, which is why the DOL needs to boost this new anticipated rule to its highest priority. An ERISA plan's fiduciary should have at the forefront whether a vote has a positive or negative economic impact. Underperformance based on "ESG investment strategies, sacrifice returns, increase risks, and promote goals unrelated to financial performance."

Proxy voting by third-party standard bearers using non-pecuniary guidelines are producing 43.9 percent less returns to retirement accounts than a standard S&P 500 index fund according to Wayne Winegarden of the Pacific Research Institute. ESG metrics that aren't based on the bottom line of growing retirement accounts utilizing healthy returns as the priority realize 10-percent less growth. The Spectrem Group's survey of 5,195 retail investors discovered 401(k) participants "demonstrated they prefer maximizing returns over political/social objectives." Americans are still virtuous if they want secure retirements without adhering to ESG investment strategies. Bloomberg analyzed ESG funds who use proxy voting comparing them to standard index funds. One stood out for comparison: iShares MSCI USA ESG Select Social Index Fund (SUSA), this well-known fund trailed the S&P Index by 37 points over 10 years. The SUSA fund has a puzzling track record of why they never invest in Netflix, Ross Stores, or Amazon.com, which grew over 1000% the past ten years. BlackRock, the largest investment manager in the world is not immune to ESG's charms and higher management fees.

When BlackRock steered investors and retirees towards their S&P 500 Growth ETF as an example, this fund beat their Clean Energy ETF by more than 10 percentage points annually.

Pension fund managers embracing their personal values over retirement enhancement is a losing proposition, and why this rule is needed. Merit based evaluations are tricky for ESG activists and their proxy campaigners when carbon intensity is considered.

Princeton University's Burton G. Malkiel has pointed out important fallacies about defining ESG in a recent *Wall Street Journal* opinion column. He noted that Xcel Energy generates significant electricity from coal but is committed to 100% carbon-free energy by 2050. Does that make them ESG worthy, and have the backing of Glass Lewis and ISS? Kinder Morgan is a pipeline company mainly transporting natural gas, which has overtaken coal in the U.S. for base load electrical generation – allowing U.S. emissions to fall "2.8% in 2019." Natural gas is environmentally safer if transported by pipelines than by truck and rail. Should Kinder Morgan receive ESG recommendations?

Energy companies are not the only ones to feel ESG's wrath and proxy advisory firm's resolutions demanding change. Why only use environmental carbon footprints for determination of ESG-blessing and positive proxy votes from Glass Lewis and ISS? Alphabet (Google's parent) and Facebook have serious issues with individual and domestic U.S. privacy while credit card companies tout their commitment to climate issues while imposing "exorbitant interest rates." Returns are sacrificed at the altar of whether the E, the S, or the G is the most important part of ESG.

Each deals with variables of ESG, never considering ERISA's protection obligations. Proxy advisory services need this rule to clip their authority and bring fiduciary responsibility back to the forefront of proxy voting rules and obligations. The underperformance of ESG investment strategies are a lose-lose for retirement accounts, but "robo-voting" is where the true destruction to ERISA occurs.

Outlawing Robo-Voting

The American Council for Capital Formation (ACCF) identified how third-party proxy advisors have an undue influence on shareholder voting decisions. Asset managers are automatically voting off proxy advisory firm ESG mission statements using a practice known as robo-voting. Troubling research from the ACCF study found: "175 entities representing more than $5 trillion in assets under management (a conservative estimate), follow ISS' and (Glass Lewis') recommendations over 95% of the time." Proxy contractual advice to ERISA fund managers and investment advisors have no fiduciary duty to retirees, shareholders, nor do ISS or Glass Lewis even have an interest or stake in companies they are forcing into these losing ESG investments.

Then whose interests are being served? The non-fiduciary advisor, the proxy firm, the retiree's ERISA-backed account, the regulated fiduciary advisor in place, who? Ultimately, it is a small cadre of ESG ideologues linked arm-in-arm with Glass Lewis and ISS unless this regulation is passed with the everyday retail investor as the big loser. Corporate shareholder meetings and board room decisions without this proposed rule are left dealing with biased ESG investors using domineering, agenda-driven proxy advisory firms to their benefit.

High-quality investment recommendations are discarded away based on thousands of votes based on votes that should have considered a firm's data and corporate processes for the betterment of retirement accounts. What ERISA accounts are left with are poor recommendations from the likes of Glass Lewis and ISS whose quality is shoddy, full of mistakes, and bereft of facts. A cookie-cutter approach to corporate governance adhering to ESG-standards are quickly becoming the norm unless action is taken.

At minimum the DOL can strengthen the proposed rule by including a restriction to robo-voting. The DOL should expand upon the SEC's supplemental guidance for investment advisors on proxy voting utilizing robo-voting, because "the Department believes that activities of proxy advisory firms have similar relevance for fiduciaries under ERISA." Incorporating the SEC guidance into this new rule is to counter ERISA fiduciaries taking advantage of proxy firms' automatic vote submission services without disclosure regulations in place, but the DOL should go further than merely re-purposing the SEC's guidance.

Ohio State University Law Professor Paul Rose's research unearthed:

> "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 (Glass Lewis and ISS) without adequate disclosure of that reliance."

Other leading experts against robo-voting and the power of proxy advisors argued:

> "Resulting recommendations will tend to be based on the simple, low cost approaches that ignore the complex contextual aspects that are almost certainly instrumental in selecting the corporate governance structure for individual firms."

Outlawing the destructive practice of robo-voting should be the goal of the DOL and SEC working in conjunction to protect retirees and reform investment managers relying on Glass Lewis and ISS for advice and counsel. Limiting robo-voting influence on contentious corporate issues, or whether to adopt ESG practices onto financial statements would do away with rebuttals from anyone who does not have a vested interest in pension beneficiaries' best practices.

The rise of proxy advisors and the outsized influence they wield through robo-voting have real consequences for investors and retirees alike whose deepest concern is maximizing the value of their retirement accounts. ESG is not one of retail investors' priorities. Blindly robo-voting for ESG-backed strategies disenfranchises retirees and outsources fiduciary responsibility to proxy firms without a vested interested in ERISA, or the DOL's mission to grow American workers health, welfare, safety, and financial health.

Conclusion

This proposed rule requiring "ERISA-governed fiduciaries cast proxy votes only when they would have an economic impact on the retirement plan," is overdue. Besides ensuring ERISA plan fiduciaries "keep their eyes properly focused on the interests of ERISA plan participants," according to a senior Labor Department official, this is a non-partisan issue that makes good economic common sense. Proxy advisory firms in their quest to push ESG are failing to increase shareholder value, disrupting the principles entrusted to asset managers by fund participants.

Clearly, if maximized returns was at the forefront of proxy advisor priorities, Glass Lewis and ISS would be advocating for energy firms whose green credentials are impressive. Environmental advocacy is the linchpin of ESG investments. Strangely, they ignore the new era of American energy dominance that saves countless lives across the world by remaking the geopolitical map towards peace and prosperity. American energy firms are leading the fight against the horrific, COVID-19 pandemic with petroleum-based products such as masks, hospital gowns, and other items.

Proxy advisory firms shouting ESG from the mountaintop should work with pipeline companies since they provide the safest means to transport products necessary to combat COVID. The U.S. is at the forefront meeting the "E" requirement in ESG by cutting air pollution and emissions while increasing production rates to fight the coronavirus across the entire economy. Currently, the U.S. is the only country to meet Paris Climate Agreement goals by relying on natural gas and carbon-free electricity from nuclear energy for power generation. ESG proponents should begin investing in legacy energy firms who are making the products to eliminate COVID-19 while lowering emissions.

Being environmentally-friendly while hijacking corporate governance is no way to govern ERISA plans. Retirement account growth and social responsibility can go hand-in-hand, but mistake-prone firms such as Glass Lewis and ISS using robo-voting muddy the waters of true progressive change. I urge the DOL to finalize this rule this year for the betterment of all Americans.