Mr. Jason A. DeWitt
Office of Regulations and Interpretations
Employee Benefits Security Administration
Room N-5655
U.S. Department of Labor
200 Constitution Ave., N.W.
Washington, DC 20210

Re: Proposed Rule on Fiduciary Duties Regarding Proxy Voting and Shareholder Rights
RIN 1210-AB91

October 5, 2020

Dear Mr. DeWitt:

Once again, I congratulate the Department of Labor for clarifying the Department's position on the fiduciary responsibilities of managers and advisors of pension plans under ERISA. In my previous letter on DOL's proposed rule on Financial Factors in Selecting Plan Investments,[1] I cited the Department's concern that "the growing emphasis on ESG investing may be prompting ERISA plan fiduciaries to make investment decisions for purposes distinct from providing benefits to participants and beneficiaries." The same concern, as the Department correctly states in the new proposed rule, "Fiduciary Duties Regarding Proxy Voting and Shareholder Rights,"[2] must apply to proxies.

My background is relevant to these issues. I am the William Simon Professor of Economics and Public Policy, as well as Director of Economics, at Hillsdale College. I formerly served as Deputy State Treasurer for Taxation and Economic Policy for the state of Michigan and as a member of the Michigan Board of Education. I earned my PhD in economics at the University of California at Berkeley.

In this letter, I would like to address two related issues raised in the proposed rule: 1) the value of proxy voting to investors and their retirement portfolios, and 2) cost-benefit analysis of proxy voting, and specifically automatic voting. In summary, I am skeptical of the value of proxy voting except in certain specific cases; the costs nearly always exceed the benefits.

The Value of Proxy Voting

The proposed rule cites analysis by Institutional Shareholder Services (ISS), "the largest proxy advisory firm, which controls approximately 60 percent of the market," observing that "investor

[1] https://www.federalregister.gov/documents/2020/06/30/2020-13705/financial-factors-in-selecting-plan-investments
[2] https://www.federalregister.gov/documents/2020/09/04/2020-19472/fiduciary-duties-regarding-proxy-voting-and-shareholder-rights

voting behavior among owners of U.S. companies has changed significantly – perhaps almost revolutionarily – over the past two decades."[3]

ISS adds, "Investors continue to add to the list of factors they consider in their review and analysis of governance practices, including board independence, board accountability, diversity, myriads of executive compensation factors, shareholder rights, and environmental and social factors."

ISS, of course, has a stake in investor interest in proxies, and ISS's business has been greatly enhanced by confusion over the Avon Letter and other guidance that appeared to require pension plans, mutual funds and other institutional investors to vote proxies on all matters involving all stocks they own. The Department ably resolves that confusion in the proposed rule, making it clear that there is no requirement that plans vote proxies. In fact, plans must *not* vote proxies without demonstrating net economic gain.

The factors the ISS analysis cites may be of general interest to investors, but the question that fiduciaries must ask is this: Will a particular proxy vote enhance shareholder returns after the costs of voting are considered? My judgement is that in most cases, the answer is no.

The proposed rule states that while proxy voting on such questions was believed at one time to be "likely to enhance the value of plan, research regarding whether proxy voting has reliable positive effects on shareholder value and a plan's investment in the corporation has yielded mixed results." The citation for that sentence, number 39, lists five sources. For example, Maria Goranova and Lori Verstegen Ryan, in an article titled, "Shareholder Activism: A Multidisciplinary Review," in the Journal of Management, refers to the "equivocal results" of shareholder activism on corporate performance.[4]

In a recent paper for the American Enterprise Institute, Glenn Hubbard, the former chairman of the Council of Economic Advisers and now a professor of economics and finance at Columbia University, and Sanjai Baghat of the University of Colorado, analyze issues related to corporate social responsibility, or CSR, investing, an acronym that was in vogue before ESG (environmental, social, and governance), but meaning essentially the same thing. The authors conclude, "There is no consistent evidence that CSR ratings are positively related to long-term shareholder value."[5]

What about pension beneficiaries themselves? How important to them are proxy votes that may have social value, but not economic, value? A survey released in April by Spectrem Group, a wealth management research specialist, designed with assistance from J.W. Verret, a member of

[3] https://corpgov.law.harvard.edu/2019/01/31/the-long-view-us-proxy-voting-trends-on-es-issues-from-2000-to-2018/

[4] "Shareholder Activism: A Multidisciplinary Review," 40 Journal of Management 1230, 1251-1253 (July 2014)

[5] https://www.aei.org/wp-content/uploads/2020/09/Should-the-Modern-Corporation-Maximize-Shareholder-Value.pdf

the SEC's Investor Advisory Committee, found that 91% of retail investors "indicated a preference for wealth maximization over political of social objectives."[6]

The finding is not surprising as retail investors have other ways of achieving social objectives.

Costs vs. Benefits

The benefits of proxy voting – except in clear cases of economic gain, such as mergers and acquisition – are dubious at best. What about the costs?

First, let me congratulate the Department on addressing costs with the kind of thoroughness many government agencies ignore. The word "cost" appears 183 times in the proposed rule.

The costs of proxy voting are substantial. The Department estimates that an ERISA plan will vote 9.3 times annually, on average, per stock, and that a plan owns an average of 8,020 stocks. That makes 74,586 votes a year. Even if a pension fund spent $20 researching each vote, the cost would be $1.5 million. In fact, few plans can conscientiously determine the value of many of the proxies to plan members' retirement security, so they outsource the vote to proxy advisors, to which they pay a fee (the Department, by the way, should require that fee to be disclosed by the plan). The proxy advisors must, by necessity, deploy one-size-fits-all formulaic decision-making. And the proxy advisors themselves have their own biases on ESG-related proxies.

The Department, in its proposal, states that it "is concerned that the costs for fiduciaries to prudently exercise proxy voting rights often will exceed any potential benefits to the plan." All of us should be concerned.

The proposed rule states that, in deciding whether to vote, "fiduciaries may need to conduct an analytical process which could in some cases be resource-intensive (requiring, among other things, organizing proxy materials, diligently analyzing portfolio companies and the matters to be voted on, determining how the votes should be cast, and submitting proxy votes to be counted), and that these activities may often burden fiduciaries out of proportion to any potential benefit to the plan."

The Department wisely offers several solutions. For example, "if the proposal has no or negligible implications for the value of the plan's investment, it would be better for the plan to simply refrain from voting than to incur even small costs making this determination." Costs do not merely involve laying out dollars; they involve opportunity costs (time that the fiduciaries spend on investment decisions, for example) as well. "Even if the proposal has substantial implications for the company, the cost of voting still may be higher than the potential benefit to the plan," says the rule.

The Department, in Paragraph (e)(3)(iii)(C) proposes that a fiduciary can adopt a policy of refraining to vote on all proposals, or particular kinds of proposes, when "the plan's holding of the issuer relative to the plan's total investment assets if below quantitative material impact" on

[6] https://spectrem.com/Content_Press/press-release-new-spectrem-study-reveals-significant-concern-among-retail-investors-over-role-of-proxy-advisors.aspx

investment performance. The Department is soliciting comments on whether "a maximum cap should be defined."

My recommendation is that a decision to vote– with a possible exception of material events such as mergers and acquisitions – should be based on two factors. The rule should state that a plan must not vote if *either* of two conditions prevails:

1. The issuer's assets represents less than 5% of the total assets of the plan, or
2. The plan owns less than 5% of the issuer's outstanding stock or, in the case of debt securities, less than 10% of the issuer's total debt.

The Department also asks for comments on "whether, to what extent, and under what circumstances plans' proxy votes are likely or unlikely to increase the value of their shares or otherwise advance their participants' economic interest."

Circumstances where proxy votes will enhance shareholder value, in my view, are few and far between. They certainly do not include "advisory" votes, such as "say on pay."[7] They also do not include votes requiring companies to make predictions about events far in the future, such as whether energy assets may be affected by prospective legislation. They do not involve such "social" policies as the diversity of board composition, unless it can be shown, through serious research, that such policies enhance shareholder value. They do not involve disclosures that have no material effect on corporate performance, such as political contributions.

There is no space here to recite all the possible areas where proxy votes do not increase the value of plan's assets. I simply want to endorse the Department's position that a vote must, on net after costs, enhance economic value. In addition, the vote must be thoroughly researched. It is certainly not in the best interests of stockholders for any plan to engage in "robo-voting," automatically following proxy advisory recommendations with pre-populated proxies. Robo-voting should be abolished completely by the Department, and especially for controversial ESG-related matters.

The proposed new rules will go a long way toward putting pension plans back on the right path, focusing only on enhancing returns. The beneficiaries will be America's current and future retirees, as well as the U.S. economy as a whole.

Sincerely,

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[7] https://www.sec.gov/files/sayonpay.pdf