



October 5, 2020

Acting Assistant Secretary Jeanne Wilson  
Office of Regulations and Interpretations  
Employee Benefits Security Administration  
U.S. Department of Labor  
200 Constitution Ave., NW  
Washington, D.C. 20210

Re: RIN1210-AB91, Proposed Rule “Fiduciary  
Duties Regarding Proxy Voting and Shareholder  
Rights” (“Proposed Regulation”)

Dear Secretary Wilson:

The Securities Industry Financial Markets Association (“SIFMA”)<sup>1</sup> appreciates the opportunity to comment on the Department of Labor’s (“Department”) proposed amendments to the “Investment Duties” regulation under Title I of the Employee Retirement Income Security Act of 1974, as amended (“ERISA”). We understand the intended purpose of the Department’s Proposed Regulation is to clarify that ERISA plan fiduciaries must not vote proxies in circumstances where plan assets would be expended on shareholder engagement activities that do not have an economic impact on the plan.<sup>2</sup>

While we appreciate the Department’s concern that fiduciaries act prudently when exercising shareholder rights with respect to a plan’s equity investment, we believe this Proposed Regulation will result in harm to plans and plan participants, ultimately reducing the value of their retirement investments. As a result, we believe the Proposed Regulation should be withdrawn.

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<sup>1</sup> SIFMA is the leading trade association for broker-dealers, investment banks and asset managers operating in the U.S. and global capital markets. On behalf of our industry’s nearly 1 million employees, we advocate for legislation, regulation and business policy, affecting retail and institutional investors, equity and fixed income markets and related products and services. We serve as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency. We also provide a forum for industry policy and professional development. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit <http://www.sifma.org>.

<sup>2</sup> 85 Fed. Reg. 55219, 55221 (Sept. 4, 2020).

## I. Costs of the Proposed Regulation Outweigh Its Benefits

ERISA requires that a fiduciary act prudently and in the interests of a plan and the plan's participants and beneficiaries. The courts and the Department have long interpreted ERISA's duty of prudence to require that a fiduciary adopt and follow a prudent process for reaching decisions about the management and administration of the plan, and have not measured compliance with prudence in absolutes.<sup>3</sup> This approach recognizes the inherent challenges in determining the future outcome of investment decisions, which are by their nature dependent on multiple variables and assumptions a fiduciary cannot control or predict with certainty.<sup>4</sup>

The Proposed Regulation appears to move away from historic interpretations requiring a prudent process, seeming instead to require fiduciaries to make an absolute determination as to whether the specific economic benefits of voting proxies for a particular proposal outweigh the costs. As with any investment decisions, there are many factors involved in determining whether there is an economic benefit to engaging in the proxy process, many of which will be uncertain and potentially indirect at the time of the vote. On the flip side, we do not see any practical benefit in limiting plan fiduciaries' ability to follow a prudent process in determining whether, when and how to vote proxies. For many plan fiduciaries, the prudent process involves maintaining guiding principles (which change over time) designed to promote the plan's and its participants' economic interest, then voting proxies that are consistent with the guiding principles.

The Proposed Regulation will disrupt fiduciaries' current practice of engaging in a principles-based prudent process that takes into account numerous factors for determining what might have a long-term economic effect on plan investments. We do not believe that the Department has demonstrated that these current practices result in any harm to plans, let alone the type of harm that would justify the Proposed Regulation or the disruption that it will cause. Further, we are concerned this Proposed Regulation creates legal uncertainties and risks that will have the effect of discouraging ERISA plan fiduciaries from engaging in the proxy process and adding their voice to general corporate governance and oversight, which will limit ERISA fiduciaries' abilities to impact the economic result of their investments. We believe the cost of this disenfranchisement of ERISA plans will significantly outweigh any perceived benefit of the

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<sup>3</sup> This position was adopted by DOL in its regulation as to what it means to act prudently. *See* 29 C.F.R. § 2550.404a-1(b)(1). The courts' treatment of the duty to act prudently has been summarized as follows:

[T]he prudent person standard has been determined by the courts to be an objective standard, requiring the fiduciary to (1) employ proper methods to investigate, evaluate and structure the investment; (2) act in a manner as would others who have a capacity and familiarity with such matters; and (3) exercise independent judgment when making investment decisions.

*Lanka v. O'Higgins*, 810 F. Supp. 379, 387 (N.D.N.Y. 1992). The standards against which a fiduciary's behavior is measured are those of the investment industry. *Id.* at 387. *See also* James D. Hutchinson, *The Federal Prudent Man Rule under ERISA*, 22 Vill. L. Rev. 15, 43 (1976) ("Much of the emphasis under ERISA is on the procedures which should be followed in properly managing assets or selecting and monitoring investment managers. This emphasis is based upon the fact that sound management of employee benefit plan assets and proper fiduciary conduct under ERISA's prudent man rule are tied to a standard which focuses upon the care, skill, prudent and diligence under the circumstances then prevailing that a prudent man acting in like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims.").

<sup>4</sup> As noted by one court, "ERISA does not make a fiduciary an insurer of a plan's assets or of the success of its investments," given that virtually every investment entails some degree of risk – "even the most carefully evaluated investments can fail while unpromising investments may succeed." *GIW Indus., Inc. v. Trevor, Stewart, Burton & Jacobsen, Inc.*, 10 Employee Ben. Cas. 2290, 2300 (S.D. Ga. 1989), *aff'd*, 895 F.2d 729 (11th Cir. 1990).

Proposed Regulation, which we do not believe has been established with this Proposed Regulation.

### Increased Costs of New Layer of Review

The Proposed Regulation would entail the creation of an all new burdensome and expensive layer of review merely for fiduciaries to determine whether they must or must not vote a proxy. We sympathize with the Department's stated goal of preventing plan fiduciaries from causing plans to incur unnecessary expenses related to exercising proxies that are unlikely to economically benefit the plan. However, rather than reducing expenses, the Proposed Regulation will force plans to incur additional costs associated with thoroughly analyzing and documenting the costs and benefits of each proxy vote to determine whether there is an economic benefit to voting—this analysis itself will be more expensive than the current costs related to proxies.

The Department seems to believe plans will have lower costs because they will not use (or will infrequently use) proxy advisory services if the Proposed Regulation is finalized. However, we believe it is likely that plan fiduciaries will need to engage a service provider at additional expense just to determine whether or not a vote may have an economic impact on the plan. Moreover, we note that plans that delegate proxy voting authority to professional investment managers generally do not incur direct or incremental costs or expenses related to the voting of proxies. This is because most professional investment managers typically include this service as part of their asset-based advisory fee to the plan. Even where a manager engages a proxy advisory firm to help it vote, this is generally done pursuant to a contract with, and for a fee paid by, the manager, and is generally treated as an overhead expense of the manager. Although this fee may be based on the volume of proxies voted, there generally would not be separate fees for individual proxies that are passed on to plans. In fact, if the Proposed Regulation is finalized, we believe there would likely be increased costs to plans if the managers are required to determine and document an economic basis for each proxy they vote for plans.<sup>5</sup>

It would be administratively difficult, if not impossible, for an investment manager to make a voting decision on a client-by-client basis. Investment managers thoughtfully take into account the research and voting recommendations provided by the proxy advisory firms, and make fiduciary decisions as to how to vote. Those voting decisions are then generally applied across all of the investment manager's clients accounts. This Proposed Regulation would likely require the establishment of additional reviews and documentation/recordkeeping procedures. Those would not be duties that could be easily assigned to a proxy advisory firm without additional costs and thus would be likely to increase costs to plans for voting analyses.

### Costs of ERISA Plan Disenfranchisement

By creating uncertainty as to how to measure the potential benefits of proxy voting, the Proposed Regulation will diminish a plan fiduciary's role in initiating changes that could improve corporate governance and other factors the fiduciary reasonably believes will impact the long-

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<sup>5</sup> The Department should consider adding a safe harbor to the regulation itself to permit plan fiduciaries to vote a proxy where there is no incremental cost to the plan in voting proxies.

term value of the plan's equity holdings.<sup>6</sup> As long-term investors, plan fiduciaries consider potential economic benefits of indirect factors like good corporate governance. Fiduciaries tasked with creating long-term value for plans seek to discover factors that are indicative of companies' long-term success as a means of enhancing investment returns for the plan over the time.

For example, when assessing service-based companies that are dependent on highly educated and mobile talent, an investment manager may give weight to the company's compensation structure, bonus pool, and other retention tools. The investment managers also may look to the strength and depth of customer loyalty, the longevity of key service providers, and strong leadership. Many investment managers look at governance factors as potential indicators of a business' success. And many investment managers conclude that those companies that are able to attract the best talent, build loyal customer bases, prosper through strong corporate governance oversight, mitigate risk, and drive profitable growth by investing in sustainable innovations are the companies that are the most sustainable for the long term, driving shareholder value, and better returns. When investment managers conclude that diverse board and management structures produce better decisions and higher future returns, it should not be surprising that such investment managers take board and management composition into account when making investment decisions, and also support proposals designed to increase board diversity for the purpose of unlocking value in their investments.<sup>7</sup> Many investment managers increasingly view such indirect economic factors as significant indicators of a company's sustainable long-term performance. As such, a proxy vote involving such indirect economic factors may in fact have an impact on the long-term performance of a plan's investments, but this impact may be difficult to objectively measure at the time of the proxy voting decision.

Risk management is another consideration. Proxy voting decisions often are made to mitigate the potential for risk, which by its very nature is impossible to quantify unless that risk materializes. One example would be a company that has governance issues that lead to a disagreement between company board members. Sometimes these disagreements relate to allegations of various wrongdoings. Looking only from a "financial" perspective may lead an investment manager not to vote if the current economic ratings are steady; however, applying a risk mitigation analysis could lead to a different decision. In aggregate, if ERISA fiduciaries shy away from voting to mitigate risk in their portfolios, those portfolios may become riskier over time. We believe this, in and of itself or as a result of the unchecked risk, will exacerbate risk

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<sup>6</sup> The Proposed Regulation would also seem to require that the costs and benefits of voting be considered solely with respect to the individual plan's holdings in the particular issuer. As the Department recognizes, an individual plan's holdings may be so small that the plan standing alone may be unable to tip the scales in a particular vote. However, this ignores that many unrelated plans may collectively hold significant enough interests in an issuer, such that their collective votes would in fact influence the outcome. Moreover, the Department's approach does not seem to consider that plans' economic interests and plan fiduciaries' duties are generally aligned and as such, are likely to vote the same way on a particular issue. We therefore request that, should the Department go forward with this rulemaking, the Department not limit consideration of costs and benefits to be based on the particular plan's holdings to avoid silencing ERISA plans in proxy issues.

<sup>7</sup> See, e.g., McKinsey & Company, *Diversity wins: How Inclusion Matters* (May 2020); Catalyst, *Why Diversity and Inclusion Matter: Financial Performance* (Aug. 1, 2018), (collecting studies that demonstrate the financial benefits of workplace gender diversity); Sylvia Ann Hewlett et al., *How Diversity Can Drive Innovation*, Harv. Bus. Rev. (Dec. 2013); Dieter Holger, *The Business Case for More Diversity*, Wall St. J. (Oct. 26, 2019); Katherine W. Philips, *How Diversity Makes Us Smarter*, Sci. Am. (Oct. 1, 2014); Julia Dawson et al., *The CS Gender 3000: The Reward for Change*, Credit Suisse Res. Inst. at 22–25 (Sept. 2016).

and ultimately will destroy share value and harm the very participants and beneficiaries ERISA is intended to protect.

There are other reasons that managers may vote on seemingly “non-economic” proposals, including to obtain information that managers believe could shed light on, or lead to disclosure of economically relevant information. For example, a shareholder proposal requesting disclosure of greenhouse gas emissions may not, on its face, appear to the Department to be a proposal that is directly economic in nature. However, depending on the information contained in the eventual disclosure requested a manager may change its view of the value of the company’s stock as an investment.

Moreover, there may be logistical challenges with determining the economic benefits of some proposals. As an example, when an institution lends shares under a securities lending program, it cannot generally vote those shares at an upcoming shareholder meeting if the shares are on loan on the record date for identifying voting rights. Because the institution may not know what will be on the meeting agenda until after the record date, it would not be able to perform a rigorous “economic analysis” to determine whether the benefits of recalling or restricting shares from lending so that they can be voted outweigh the costs. As such, faced with uncertain benefits and objective costs associated with a recall or restriction, the likely outcome is that these shares would not be voted.

When fiduciaries are unsure whether there is a clear economic benefit in connection with a particular matter being voted on, we believe the Proposed Regulation, whether by accident or design, will tilt most fiduciaries in favor of not voting, rather than run the risk that a decision to vote could be alleged to be a fiduciary breach. The Proposed Regulation would suggest that any fiduciaries err on the side of not voting given the objective and relatively short-term nature of costs, and the often subjective and potentially long-term nature of benefits. In effect, the Proposed Regulation deprives ERISA plans of the benefits of their fiduciaries’ fulsome, cost-effective, analyses of issues and the prudence of proxy voting based on that fulsome analysis. This bias towards not voting will result in ERISA fiduciaries not engaging in the proxy voting process. ERISA plan investors will be deprived of a say on issues that, although perhaps having only a long-term economic impact, or perhaps having only an uncertain, indirect or not obvious economic impact, ultimately could affect the value of the plan’s investments.

An unintended consequence of the Proposed Regulation is that, if ERISA fiduciaries choose not to vote plan proxies in general, issuers will find it increasingly difficult in achieving quorums; or they may achieve quorums, but without the support needed to prevent shareholder proposals that might not be in issuers’ (and thus plan investors’), best interests.<sup>8</sup> This could have a significant impact on issuers’ corporate governance and be detrimental to issuers’ economic performance. It may also significantly increase the company’s costs associated with its proxy solicitation activities, indirectly and unnecessarily harming all of its investors (including ERISA plan investors).

By regulating in a manner that restricts, or at a minimum, calls into question, fiduciaries’ abilities to vote proxies (even where they believe a vote could positively impact long-term value, but are challenged in objectively determining and documenting this value), the Department is removing

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<sup>8</sup> The Department should consider adding a safe harbor to permit plan fiduciaries to vote a proxy if needed to achieve a quorum for its shareholder meeting.

potential opportunities for ERISA investors to have a say on issues that could affect their investment returns and hold management responsible to the needs and concerns of their investors. The Department should place no restriction or other special rules on fiduciaries' proxy voting decisions beyond those of prudence and loyalty as currently required under ERISA.

## II. The Department Should Align with the SEC's Guidance on Proxy Voting Responsibilities of Fiduciary Investment Advisers<sup>9</sup>

While the Department establishes the rules for fiduciaries with regard to plan investments, the Securities and Exchange Commission ("SEC") is responsible for ensuring that investment advisers satisfy their fiduciary duties to their clients, including ERISA plans. We believe the SEC's guidance allows for an appropriate level of flexibility in considering the costs and benefits of voting proxies that results in a more cost-effective approach to making proxy voting decisions that will be to the benefit of investors, including plan investors. As a result, we believe ERISA plan investors would be better served if the Department better aligns its rules with the SEC's rules with regard to proxies. Should the Department choose to go forward with regulation in this area, we urge it to repropose the regulation consistent with this approach.

Under SEC guidance, an investment adviser and its clients can define the contours of the adviser's proxy voting duties and practices. For example, a client *may* ask its investment adviser to refrain from voting proxies if the adviser determines that the costs of doing so outweigh the benefits. In contrast, the Proposed Regulation sets a binary standard: Fiduciaries *must* vote if they determine that the matter being voted on would have an economic impact on the plan, taking into account the costs involved, and *must not* vote unless they determine that the matter being voted on would have an economic impact on the plan, taking into account the costs involved. The SEC's standard is more flexible and reflects the fact that whether costs or benefits are greater is subjective and will be based on the fiduciary's judgment as to what decision is most likely in the client's best interests. Further, the cost to make this determination under the Proposed Regulation, which in many cases could be inconclusive or could produce multiple answers on which reasonable fiduciaries may differ, likely will be greater than the cost of the cost/benefit analysis built into managers' current prudent and systemic proxy voting analyses. The standard under the SEC guidance recognizes the dynamics inherent in proxy voting decisions, and allows for a more flexible principles-based standard that gives advisers the ability to make reasonable determinations as to what is best for their clients, and recognizes that whether costs or benefits are greater is a facts and circumstances decision that may evolve.<sup>10</sup>

In recognition that reasonable fiduciaries may differ on proxy voting decisions, the SEC requires investment advisers to follow a reasonable voting process governed by policies and procedures with oversight of both advisers by investors, and oversight of proxy advisory firms by advisers. Further, the SEC does not currently prohibit voting a proxy if a manager cannot document that voting will result in some economic benefit to a particular investor. In connection with the cost versus benefit analysis, the SEC's standard is far more likely to increase the value of investors' assets than the Department's approach. As noted above, we believe in fact that the SEC's

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<sup>9</sup> Commission Guidance Regarding Proxy Voting Responsibilities of Investment Advisers, 84 Fed. Reg. 47420 (Sept. 10, 2019); Supplement to Commission Guidance Regarding Proxy Voting Responsibilities of Investment Advisers, 84 Fed. Reg. 55155 (Sept. 3, 2020).

<sup>10</sup> We note that an investment manager's financial interests are directly aligned with making investment decisions (including proxy voting decisions), that increase portfolio values after taking costs into account.

standard is more consistent with the Department's long-standing approach under ERISA, which depends on assuring that fiduciaries establish and follow prudent processes in deciding on a course of action, than is the inflexible Proposed Regulation, which requires fiduciaries to act (or refrain from acting) in certain circumstances.

There are also administrative and fiduciary issues raised by a fiduciary's having two different sets of obligations from different regulators for proxy voting. From a practical standpoint, it will be burdensome for a manager to vote non-ERISA client proxies based on its generally applicable proxy voting process, while not voting ERISA client proxies because the manager is not comfortable it can appropriately document that voting will have an economic impact on the ERISA clients' investment. From the fiduciary's standpoint, there may be a question as to how to justify taking two different approaches in the best interest of its clients, solely based on the Department's requirement to determine and document an economic impact, which may be challenging for the reasons discussed above.

Similarly, a registered investment adviser to a plan asset vehicle is required to comply both with the SEC's proxy voting rules and guidance and the Department's proxy voting rules. Since the Proposed Regulation, in the Department's view, is expected to result in registered investment advisers not voting proxies in most cases, while the SEC's proxy voting rules and guidance are, in the SEC's view, expected to result in registered investment advisers voting in most cases, there is an inherent regulatory conflict for registered investment advisers managing commingled investment vehicles.

Thus, to improve efficiencies and better serve ERISA plans' and plan participants' and beneficiaries' interests, the Department should, if it believes rulemaking in this area is necessary, repropose a rule that better aligns with the SEC's guidance with regard to voting of proxies.

### III. The Permitted Practices Need to Be Clarified

As noted above, the Department should focus its proxy rules on requiring a prudent process, as opposed to strictly delineating when a fiduciary can and cannot vote a proxy. ERISA requires plan fiduciaries to act prudently and in so doing they are responsible for determining opportunities, concerns and factors that they believe are appropriate to consider in deciding when, whether and how to vote proxies.

Should the Department go forward with the Proposed Regulation, the permitted practices, if constructed as safe harbors, would be somewhat helpful to fiduciaries in establishing voting practices that avoid inadvertently violating the Proposed Regulation (although these safe harbors alone would not eliminate the problems the Proposed Regulation otherwise creates). However, as proposed, the permitted practices are challenging to follow and do not sufficiently reduce fiduciaries' risks and burdens in complying with the Proposed Regulation. Further, because the fiduciary retains the obligation to override a permitted practice when costs outweigh the benefit, the permitted practices would not appear to provide sufficient protection to plan fiduciaries, which potentially remain subject to being second-guessed on every vote.

Examples of the issues the permitted practices raise include the following:

- The Proposed Regulation generally appears to prohibit a fiduciary from voting on matters that are “insignificant” (in that they do not necessarily have an economic impact on a plan investor), yet the fiduciary is allowed to vote with management on those same “insignificant” matters. While we note that the SEC guidance also permits policies of voting with management, it is unclear how this practice in the Proposed Regulation reconciles with the general prohibition against voting on insignificant matters, particularly given the override noted above.
- The permitted practice of voting only when the ERISA plan holds a meaningful interest in the registrant is difficult to implement in practice due to the nature of diffuse ownership and does not appropriately reflect the potential benefits of voting proxies along with other ERISA plan investors with aligned interests that may collectively hold a meaningful interest (see disenfranchisement discussion above). Under the Proposed Regulation, most often the answer will be to not vote, which means abdicating to large shareholders whose interests may not align with participants and beneficiaries. In fact, given the diversification requirements of ERISA Section 404(a)(1)(C) and the unlikelihood that a single plan would own more than a small percentage of a single issuer, it seems that the Department is encouraging ERISA plans to adopt proxy voting policies that will result in non-voting of almost all proxies.

Should the Department move forward with this Proposed Regulation, then the permitted practices should clearly be denoted as safe harbors. Further, it should make it clear that a permitted practice includes a manager’s following its prudently constructed and applied proxy voting guidelines. We also suggest including a provision to allow for a policy of voting proxies on a proposal or on particular types of proposals where the fiduciary prudently determines that refraining from such proxy voting is unlikely to result in material cost savings to the plan.

The Department should also consider addressing contracts that currently are in place. For existing relationships, the Department should consider grandfathering the proxy voting arrangements in place with managers’ ERISA plan investors. Also, because new reviews of proxy advisory firms or new services to be provided by those firms might be necessary, time would be needed to renegotiate those contracts and get agreement from the proxy advisory firms to make the changes in contracts.

#### IV. The Provision Regarding Pooled Investment Vehicles Should Be Eliminated

Section (e)(4)(ii) of the proposed amendments to the regulation states that ERISA Section 404(a)(1)(D) would require the investment manager of a pooled investment vehicle that holds plan assets (a “plan asset vehicle”) to reconcile the conflicting investment policies of investing plans and engage in proportionate voting of proxies in order to reflect such conflicting policies. It further provides that the investment manager may develop an investment policy statement consistent with Title I of ERISA and this section, and require participating plans to accept the investment manager’s investment policy, including any proxy voting, before they are allowed to invest. In such cases, this provision would require the plan fiduciary to “assess whether the investment manager’s investment policy statement and proxy voting policy are consistent with Title I of ERISA and this section.”



Because it would be impractical for a fund manager to comply with conflicting investment policies, investment in a plan asset vehicle is almost universally conditioned upon acceptance of the investment objectives, guidelines and/or policies that apply to the vehicle. In addition, the governing documents for plan asset vehicles generally provide that the investment manager, which derives its authority to manage the plan assets held in the vehicle pursuant to section 403(a)(2) of ERISA, has full responsibility and discretionary authority for proxy voting, as proportionate voting of proxies also is impractical. Accordingly, we recommend that section (e)(4)(ii) be eliminated, and that section 2550.404a-1(e)(4)(i)(B) be expanded to apply explicitly to proxy voting and other shareholder rights for plan assets held in a plan asset vehicle, except to the extent the documents that govern an underlying plan asset vehicle provide otherwise. Consistent with ERISA and prevailing industry practice, this would reflect that investment managers of plan asset vehicles have “exclusive authority to vote proxies or exercise other shareholder rights appurtenant to such plan assets,” except as otherwise provided in the governing documents, and subject to their obligations as ERISA fiduciaries.

#### V. Effective Date

Lastly, if the Department moves forward with this Proposed Regulation, we believe it is critical that it provide a longer period of time until it becomes effective. Investment managers will need significantly more than 30 days to develop and implement new proxy voting guidelines, as well as communicate with clients. We would suggest a one-year period after the regulation is finalized before it becomes effective.

#### VI. Conclusion

We believe this Proposed Regulation not only does not benefit ERISA plans and their participants, but in fact is likely to cause harm. Accordingly, we urge the Department to withdraw the Proposed Regulation. We believe the Department has neither established the case that the Proposed Regulation provides any meaningful benefit to plan investors (let alone one that would outweigh the significant costs we believe this Proposed Regulation will impose on ERISA plans), nor has it shown why the Proposed Regulation moves so far from the SEC’s proxy voting regulations and guidance.

Please do not hesitate to contact me with any questions.

Sincerely,

*Lisa J. Bleier*

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