Submitted: December 6, 2019

Ms. Vanessa Countryman
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-0609

File Number S7-22-19

Dear Ms. Countryman:

I applaud the U.S. Securities & Exchange Commission for the methodical and inclusive way it has approached reform of the proxy-voting system. As a former Treasurer of the State of Ohio and Mayor of Cincinnati, I have had direct involvement with that system and am personally aware of its deficiencies. It needs to be fixed, and the SEC is on the right track.

In 2003, the Commission approved a regulation to require investment advisers to public-employee pension funds and other funds under its jurisdiction to adopt transparent policies to avoid conflicts of interest. The concern was justified, but unfortunately, because of subsequent staff interpretations, that regulation's intent became distorted and, in fact, another kind of conflict of interest flourished.

As Commissioner Hester Peirce stated at a hearing earlier this month,

"Much of the mischief in this area has arisen from the misperception—perpetuated in part by the SEC—that the fiduciary duty [of fund advisers] included an obligation to vote each and every proxy. Advisers, particularly small ones, overwhelmed with the number of proxies to be voted each season, reasonably sought third-party assistance in wading through the workload. Indeed, this agency, through staff no-action letters, encouraged them to do just that.

As a result, two large proxy advisory firms, Institutional Shareholder Services (ISS) and Glass Lewis, with minimal oversight, became the dominant forces in determining corporate governance policies for America's large corporations. The recommendations of these firms have not always been in the best interest of the members of America's public pension funds, hard-working public servants who saved for decades to gain a secure retirement.

After 15 years, it was clearly time to rein in the power of proxy advisory firms. In November 2018, the SEC held a Roundtable to discuss possible regulatory changes. The Commission asked for comments, approximately 300 of which were submitted over about a year.

On Aug. 21, the SEC provided guidance on how proxy advisory firms must fulfill their fiduciary responsibilities. This was the first major step in mitigating the unintended consequences of the 2003 action.

Then, on Nov. 5, the Commission voted to "propose amendments to its rules governing proxy solicitations to enhance the quality of the disclosure about material conflicts of interest that proxy voting advice businesses provide their clients. The proposal would also provide an opportunity for a period of review and feedback through which companies and other soliciting parties would be able to identify errors in the proxy voting advice." I write to encourage these recommendations and urge the SEC to implement these reforms in the final rule.

This letter offers comments that I hope will help the Commission in devising a final rule.

In an opinion article for the *Washington Times* in October (a copy of which is enclosed here), I focused on the SEC's interpretation that proxy voting advice provided by proxy advisory firms constitutes a solicitation under federal proxy rules.

As I wrote, "Previous SEC actions had given the investment community the distinct impression that proxy advisers had special protections and that investment funds, including public pension plans, could shift responsibility for making proxy-voting choices onto the advisers without either group assuming the sort of responsibility that traditionally extends to advice-giving and receiving in the securities world."

Very simply, the Commission wants to hold proxy advisers responsible for their advice. I urge the Commission, then, to clarify that this advice must have a singular focus, as Commissioner Peirce stated in response to a question from Congressman Andy Barr (KY-6th) at a hearing of the House Committee on Financial Services on September 24. That focus is maximizing shareholder value, not pursuing a social or ideological agenda.

Chairman Clayton remarked on November 5 that a "common theme" in many comment letters received from shareholders "was the concern that their financial investments – including their retirement funds – were being steered by third parties to promote individual agendas, rather than to further their primary goals of being able to have enough money to lessen the fear of 'running out' in retirement or to leave money to their children or grandchildren."

Among the letters he cited was one from Mr. and Mrs. Vytautas Alksninis of Ashford, CT. They wrote that they had spent their "entire lives working not only for our children but taking care of our parents in their golden years. We have done our very best to save." The letter continued…

"Recently, we received a document from one of our mutual fund companies and I was completely flabbergasted to learn that an advisory firm would be voting our proxies in accordance to some Environmental, Social Governance policy. Call me naïve but I certainly didn't sign up for groups with their own agenda voting my proxy!"

This is the issue. Funds have outsourced decisions on proxy voting – which, in turn, powerfully influence the conduct of listed companies – and those decisions are not always being made with enhancing shareholder returns as the sole goal. As the Chairman said, "These letters are a helpful reminder that the issues the Commission grapples within this area are not a matter of (1) shareholders versus companies or (2) businesses that provide proxy advice versus companies. These are false dichotomies."

I completely agree with the Chairman. As I wrote in my Washington Times article,

"We cannot expect to safeguard the retirements of the 14 million-plus public servants contributing to pension plans if the SEC fails to assign proper accountability to the firms that are responsible for more and more pension-fund decisions."

Chairman Clayton noted that 20 years ago that "the business of providing proxy voting advice was nearly non-existent." Today, just two firms dominate an advice-giving industry, selling recommendations to thousands of investment advisers "managing trillions of dollars in assets."

We can see the results of investments on policies that are not guided exclusively by the goal of increasing shareholder value. A recent study from the Pacific Research Institute, for example, found that, after 10 years, an ESG (for environmental, social, and corporate governance) portfolio would be "43.9% smaller compared to an investment in a broader, S&P 500 index fund."

The returns of the largest public-employee pension fund, CalPERS, a prominent ESG practitioner, have been especially dismal. For the fiscal year ending June 30, returns of the public stock portion of the CalPERS portfolio were just 6.1%, compared with 8.2% for Standard & Poor's 500 Stock Index, according to the *Wall Street Journal*.

One glaring example of how proxy advisory firms have failed their fiduciary responsibility in this area is through the use of customized or specialty reports, an issue that the Commission is scrutinizing in its proposed rule. These reports are based on the philosophies of specific investors. For example, ISS, the largest of the proxy advisers, for example, offers customized "Socially Responsible Policy" and "Sustainability Policy" reports, among others. This practice allows companies to pay a firm such as ISS to validate proxy voting that is based, not exclusively on increasing shareholder value, but on certain social objectives.

The Commission must make it crystal clear that striving to produce maximum risk-adjusted returns – a difficult goal in itself – must be the only objective of fund advisers and the proxy advisers that they hire to help them. The SEC should require full disclosure of the means by which specialty or customized reports are devised.

"Public pension funds are already underfunded and underperforming," I wrote in my article in the *Washington Times*. The Commission has a unique opportunity to take a giant step toward a remedy. Proxy advisory firms must be held accountable. They must not merely provide better disclosure but, as fiduciaries, they must act on behalf of shareholders in a pension funds, not promote or validate the bias of the boards and managers of those funds.

I look forward to reviewing the Commission's updated proposed rule.

Sincerely,

Ken Blackwell

Enclosure:

https://www.washingtontimes.com/news/2019/oct/8/safeguarding-the-pensions-of-public-employees/

The Washington Times

Safeguarding the pensions of public employees

With proxy reforms the SEC takes a first step in improving the health of U.S. pension funds

By Ken Blackwell - - *Tuesday, October 8, 2019*

ANALYSIS/OPINION:

Nearly a year after it held a roundtable on the topic, the Securities and Exchange Commission on Aug. 21 issued "an interpretation that proxy voting advice provided by proxy advisory firms generally constitutes a 'solicitation' under the federal proxy rules."

This is a big deal. Proxy advisers have become the most powerful players in corporate governance. The field is dominated by just two firms, Institutional Shareholder Services (ISS) and Glass Lewis. They provide recommendations to funds on how to vote on proxy questions that come before them as owners (on behalf of their investors) of shares of thousands of different companies. Those proxy questions include electing board members and engaging accounting firms but, more and more, funds are called on to vote on environmental, social and governance issues that are subsumed under the shorthand acronym "ESG."

The advisers have been criticized for making decisions — especially in the ESG arena — using ideological rather than strictly financial criteria. They have also been accused of making factual errors and not correcting them quickly, of using one-sizefits-all approaches to questions rather than considering the needs and strengths of individual companies, and of conflicts of interest.

And they've been criticized for forcing a practice often called "robo voting." Specifically, "robo-voting" takes place when pension fund managers and other fund managers automatically vote in alignment with proxy advisory firm recommendations. This practice undermines the First Amendment rights of public pensioners and retail investors since their voice has been disenfranchised in the shareholder resolution votes by fund managers. This practice is most problematic if the resolutions advance a political agenda instead of prioritizing financial returns. J.W. Verret on the SEC Investor Advisory Committee and George Mason Law School called attention to this issue in a recent Financial Times op-ed when he wrote, "This kind of automatic voting in line with unregulated third parties' guidance is undermining the fiduciary duty that advisers owe to investors."

While the SEC's "interpretation" or "guidance" is not a rule-making or a regulation, it "could have significant impacts on how proxy firms and investment advisers conduct business," wrote Peter Rasmussen on BloombergLaw.com. Nor is the SEC finished with the matter. Great oversight may be coming.

The SEC made it clear that the recommendations of proxy advisers are subject to legal anti-fraud provisions under the SEC's Rule 14a-9. Previous SEC actions had given the investment community the distinct impression that proxy advisers had special protections and that investment funds, including public pension plans, could shift responsibility for making proxy-voting choices onto the advisers without either group assuming the sort of responsibility that traditionally extends to advice giving and receiving in the securities world.

The SEC warned that Rule 14a-9 "prohibits any solicitation from containing any statement which … is false or misleading with respect to any material fact." And the commission stated that proxy advisers would have to disclose information which "extends to opinions, recommendations, or beliefs" in order to avoid a potential violation.

It appears that proxy advisers will have to justify their voting recommendations much more rigorously than they do now. If so, millions of Americans will benefit.

We cannot expect to safeguard the retirements of the 14 million-plus public servants contributing to pension plans if the SEC fails to assign proper accountability to the firms that are responsible for more and more pension-fund decisions. A Manhattan Institute study has shown that a portfolio of ESG investments performs more poorly than the market as a whole, and the recent returns of the largest public-employee pension fund CalPERS, which is a prominent practitioner of ESG investing, have been especially dismal. For the fiscal year ending June 30, returns of the public equity portfolio of CalPERS's portfolio were just 6.1 percent while S&P 500 index funds returned 9.7 percent.

This emphasis on ESG, driven by proxy advisers, poses disastrous consequences for our nation's already-suffering public pensions. Americans deserve better. After sacrificing a portion of every hard-won paycheck in order to secure financial stability for their families' futures, plan members need to receive what was promised to them in retirement.

According to the SEC's own language, its mission is to "protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation." There's nothing fair about a market skewed by trending political causes advanced by vocal minorities.

On Aug. 21, the SEC took a good first step at reviving the principles of fiduciary responsibility. Lack of transparency and accountability both enable the practices that can lead to recommendations that harm the performance both of corporation and pension funds.

Public pension funds are already underfunded and underperforming. The SEC is in a unique position to address a serious problem. Now is the time for leading officials to ensure that investments are based, in the SEC's own words, on "timely, comprehensive, and accurate information," not on blanket recommendations steeped in ideology.

• *Ken Blackwell has served as treasurer and as secretary of State of Ohio, as well as mayor of Cincinnati. He serves on the Advisory Board of the Institute for Pension Fund Integrity.*