July 26, 18

To: The Chairman, Commissioners, and Staff of the SEC

From: Nell Minow, Vice Chair, ValueEdge Advisors

Many thanks for the opportunity to comment on your thoughtful draft five-year strategic plan. The SEC plays a critical role in the stability and credibility of our financial markets. It is the robust transparency and accountability of our corporate structure that has made the opportunities for investors, entrepreneurs, and employees the best in the world, and we are confident that the SEC is committed to upholding those standards.

We strongly endorse your statements of mission, vision, and values, which set exactly the right parameters for the plan, and we support the focus on investors, innovation, and performance. We would hope to see integrity listed explicitly in that top tier as well, because one of the SEC's most important functions is the promulgation and enforcement of rules that protect the integrity of the markets. If investors have even the smallest reason to doubt whether they can rely on investment advisors, financial institutions, and issuers, all of the goals of the SEC's mission, vision, and values will be critically damaged. And we are not convinced that the rest of the plan supports the mission, goals, and values as well as it should.

In particular, we are confused and concerned about the first priority listed in the draft: "Focus on the long-term interests of our Main Street investors." This is of particular alarm because it tracks the language of the instantly discredited, industry-funded front group, the "Main Street Investors Coalition," which purports to be on the side of small investors but in reality is not a membership organization, provides no services to individual investors, and circulates biased, shabby research to support its goal of suppressing the votes of institutional investors. This comment incorporates by reference the essay published in the Harvard Law School Forum on Corporate Governance and Financial Regulation with more information and is appended to this note.

It is not at all clear from your draft exactly who you are referring to as "Main Street Investors," and so we suggest a more descriptive term and definition. As the SEC knows better than anyone else and acknowledges in the draft, individual investors very seldom buy, sell, or vote individual stocks. We completely support investor education efforts by the Commission for those who want to have more control over their investments, but recognize that most people reasonably recognize that they do not have the time, the resources, or the expertise to compete with the sophisticated, multi-billion dollar professionals. For most individuals, investments are managed by financial advisors in 401(k)s, IRAs, mutual funds, and pension funds.

If, indeed, the SEC wants to make protection of the "Main Street" or individual/beneficial holder investor a priority, the focus should be on strengthening the fiduciary obligation of the financial advisors and making the fees, voting records, and potential conflicts of interest transparent to individuals in a clear, accessible manner, which an opportunity for the beneficial holders to either switch or replace the directors, and cast an advisory vote on their compensation as well. We incorporate by reference an interview with Professor William Birdthistle about the conflicts and obfuscations of fund managers, also appended to this comment.

We do not believe any additional regulation is needed for proxy advisors, who publish reports with analysis and recommendations that no one is required to buy or follow. There is no evidence that they have disproportionate influence, especially since even a 100 percent vote according to their recommendation is almost never binding on the issuer. Furthermore, we caution that any effort to restrict or direct the content of published material may be an unconstitutional infringement of First Amendment rights, especially under the standards of the recent Supreme Court decision in the NIFLA case.

We also recommend that the SEC itself undertake more comprehensive research into the data about individual investors, especially more information about gaining the trust of the under-saving millennial generation, who grew up watching the 2008 financial meltdown with little personal responsibility from those involved. The SEC should do a thorough evaluation of the options for addressing the collective choice and rational ignorance problems that have interfered with prudent planning for retirement so it can better assist pension plan beneficiaries and other individuals faced with daunting investment decisions.

Perhaps in cooperation with the Department of Labor, the SEC should also study the impact on the capital markets of the switch from defined benefit to defined contribution pension plans, which has not been fully recognized. We recommend that the SEC examine the proxy voting procedures of financial advisors, to make clear that it is as much a fiduciary obligation as the buy and sell decisions. If pro-management votes are cast more often for portfolio companies that are also clients (as has been shown in past independent studies), this raises conflict of interest questions that the SEC should resolve on behalf of investors.

The SEC should also conduct a comprehensive review of the SRO system of delegated rulemaking. The Exchanges and the world have changed very fundamentally since the SRO system was instituted, and the justification for delegating rulemaking authority to what are now for-profit entities should be thoroughly re-evaluated for its impact on investors.

We concur with the draft's emphasis on long-term returns and encourage the Commission to consider better ways to realize that goal. The global efforts to update a 19$^{th}$-century based system of accounting principles more appropriate for the era of mechanical equipment as a company's primary asset rather than intellectual property provide an excellent opportunity for coordination. We believe a primary driver of short-termism is the structure of incentive compensation, and we urge the Commission to review that as a factor.

We would like to see more emphasis on enforcement, as noted above. In particular, we would like to see directors debarred from serving on public company boards as a part of the settlement of major cases.

We support the draft's initiatives on cyber and other risks, and encourage the SEC to adopt a permanent Y2K-style disclosure requirement about the assessment of cyber-risk, with detailed information about the procedures for oversight by the board. We would also include climate risk as a separate disclosure.

As the so-called Main Street Investors Coalition shows, issuers are using shareholder money to fight shareholder interests. This is yet another reason that we need more transparency on political and lobbying expenditures, especially dark money. The diversion of shareholder money raises serious conflict of interest/agency cost issues and presents as serious a risk as cyber and climate. In Citizens United, the Court said that corporate political spending is protected because it represents the concerns of the shareholders. That can only be true if shareholders see and can respond to it.

We thank you for this opportunity to comment, and would be glad to meet with staff or present testimony at any hearings you plan to hold to consider these issues.

Sincerely,

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# The Main Street Investors Coalition is an Industry-Funded Effort to Cut Off Shareholder Oversight

*Posted by Nell Minow, ValueEdge Advisors, on Thursday, June 14, 2018*

Here's a tip from a long-time Washington DC lawyer: the more folksy or patriotic the name of the group, the more likely that it is funded by people who are promoting exactly the opposite of what it is trying to pretend to be. And thus we have the Main Street Investors Coalition, which bills itself as "bring[ing] together groups and individuals who have an interest in

amplifying the voice of America's retail investor community."
In reality, it is a corporate-funded group with no real ties to retail investors, and its advocacy is as fake as its name. MSIC uses inflammatory language, unsupported assertions, and out-and-out falsehoods to try to discredit the institutional investors who file and support non-binding shareholder proposals. While these proposals are filed at a very small fraction of publicly traded companies and even a 100 percent vote does not require the company to comply, somehow, this very foundational aspect of free market checks and balances is so overwhelming a prospect to corporate executives that they are unable to provide a substantive response and instead establish what in Washington is referred to as an "astroturf" (fake grassroots) organization, setting up a false dichotomy between the interests of large and small shareholders.

MSIC says:
*[A]s the size and influence of these massive institutional holders has grown, so too has their power, influence and share of voice—drowning out the voices and interests of Main Street investors who, despite controlling the single largest pool of equity capital in the world, have almost no ability today to influence the decisions these funds make on their behalf, with their money.*

Of course this completely overlooks the fact that institutional investors are fiduciaries representing everyday working people like teachers, firefighters, and employees of publicly traded companies. What the folksy-sounding, corporate-front Main Street Investors want to do is divide and conquer. They know they can no longer rely on the support of investors smart and focused enough to tell when corporate management has gone off the track and big enough to make their views meaningful. So, they pretend to be concerned about some mythic, stock-picking investors who will read through the proxy statements and decide to vote for management's recommendation. If MSIC really cared about the power of individual shareholders, and if in fact they controlled the single largest pool of equity capital in the world, it would help them to vote their proxies more effectively. It would help them provide oversight to the institutions who manage their money, perhaps circulating reports on the annual disclosures of how the funds vote. After all, index funds have the same fees and returns, but there are differences in how they vote their proxies. Then the investors could decide whether, for example, Vanguard's votes on CEO pay were more appealing than Fidelity's.

MSIC's faux populism about the "real" investor being mom and pop and their little basket of stocks ignores the reality that most working people invest through intermediaries like mutual funds because they perform better. The whole idea of institutional investors is based on the reality that they do better than individuals who do not have the time, resources, or expertise. And it makes sense that the same people who make the buy, hold, and sell decisions should make the decisions about how to vote on proxies as well.

Capitalism, after all, is named for the investors who provide capital, not the executives. And it is founded on the idea of accountability to ensure confidence that the capital they provide will be used honorably. But now that investors are pushing back on issues like excessive CEO pay, ineffective boards, and failure to consider climate risk via advisory shareholder proposals, corporate executives are trying to kill the messenger. Corporate executives love to talk about the free market until it delivers a response they do not like.

MSIC is not a membership organization. Its board does not include representatives of the groups that actually do work with small investors, like, for example, the American Association of Individual Investors, which has excellent educational materials for its members, or Motley Fool and FolioInvesting, which provide services for individual investors. Instead, MSIC has "partners" like the powerful corporate lobbying group the National Association of Manufacturers and the anti-public pension fund American Council for Capital Formation, which says on its website that its purpose is "exposing the politicization of corporate governance."

So we should be skeptical about their assertion that investors do not care about issues like the environment. PWC's annual report on boards found, to the contrary, that investors are much more concerned about incorporating environmental risk into corporate strategy than boards are. This is exactly why we have a system allowing for shareholder proposals: to send a message when there is a disconnect between investor and director priorities.

The Main Street Investors Coalition has been tweeting about a new academic study that purports to show that shareholder resolutions have an adverse impact on share price. And where do we find that study? On the website of the NAM, which paid for it. That subsidy alone should make anyone skeptical about its findings.

There are further flaws as well. One is MSIC's constant use of the term "political" to describe shareholder resolutions to indicate that their purpose is counter to shareholder value. On the contrary. These proposals, filed by fiduciaries who represent large, sophisticated financial institutions acting on behalf of millions of small pension plan participants in most cases, are explicitly grounded in the promotion of long-term shareholder value. SEC rules strictly limit the subject matter of these non-binding shareholder proposals to matters directly relating to legitimate areas for investor feedback. Every one of the proposals is explicitly tied to investor concerns about long-term, sustainable growth.

If corporate management would like to explain on the merits why their positions are incorrect, they have as much room in the proxy statement as they like to rebut it (while shareholders are limited to 500 words). But so far, they have not been persuasive, which is why shareholder resolutions on better disclosure of climate risk, for example, have had support from almost two-thirds of investors. No wonder—78 percent of directors at the largest companies have said that climate change was never or seldom discussed in their board meetings. If corporate executives want to explain why that is appropriate, they will have to do better than they have so far.

Even with strong support for a few advisory resolutions, there is no evidence that financial institutions managing billions of dollars have all of a sudden turned into the Sierra Club. Approximately half of top asset managers opposed more than 50 percent of key climate-related proposals in 2017, and several top managers voted against more than 85 percent of key climate proposals. Eight of the top ten asset managers failed to support key climate votes more than 50 percent of the time. At the very least, this shows that the institutions MSIC is so shrill about are reviewing the proposals carefully and making distinctions between those they do and do not want to support. And that means that the votes are not in any way "political."

The study MSIC is promoting uses highly suspect metrics to purport to prove that these proposals do not help and can hurt shareholder value. The study looks at the reaction of companies' stock prices to both increased disclosure of climate-change-related information and shareholder proposals calling for such disclosure.

In what way is that a relevant measure? There are innumerable factors that go into the pricing of stock on a given day, and no one is suggesting that the adoption of particular policies urged by shareholders will have the immediate positive stock price impact that, say, a generous tender offer would. These are complex, multi-layered issues and, more important, these are essentially permanent shareholders. They are not trying to time or manipulate the market. As corporate governance expert Beth Young points out, "The yardstick should not be whether a company's stock price goes up upon disclosure of climate-related risk/opportunity disclosure; investors might see the disclosure and think that the company has more risk than previously understood, or decide that the risks are being poorly managed, in which case the right direction for the stock price is down." It is not in investors' interests to have the stock price inflated due to inadequate disclosure. If more information results in a more accurate stock price, that will help managers and directors make better decisions going forward.

And then there is the study's "finding" that these proposals can impose millions of dollars of cost onto the corporations. We reiterate that these proposals are not binding, so there is no obligation to spend any money at all. And we fully expect that corporate executives, as a matter of professional responsibility and fiduciary obligation, would never authorize expenditures unless they were supported by cost-benefit analysis. Yet we do not see benefits from complying included in these calculations. More important, we suspect that self-reported, unsubstantiated reports of costs may be inflated to a considerable degree.
Perhaps the next step should be a shareholder proposal to stop wasting money on fake public interest groups and poorly designed studies.

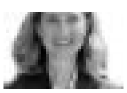
And yet, they are trying to undermine shareholder votes here. What is especially outrageous is their argument that mutual funds are "uninformed," because what they are suggesting here is that individual investors are somehow more informed. On the contrary, individual investors entrust their money to managers who have the expertise, resources, and fiduciary obligation to buy, sell, hold, and vote their shares.
In a post on this blog, MSIC asserts without any substantiation that retail investors don't know and don't approve of the way fund managers vote. They assert contrary to documented data that fund managers outsource their votes to proxy advisors. In reality, the data show that while institutional investors appreciate the analysis they receive from proxy advisors, they vote according to their own proxy voting policies, and the more complex or controversial the issue, the less likely they are to follow the proxy advisors' recommendations. Proxy advisors are like securities analysts. No one has to buy their products. No one has to follow their recommendations. But their clients find them a valuable resource. It is also not true that proxy advisors are unregulated. We often see corporations object to any regulation except that which protects them from competition or other market tests, so we note that proxy advisors are subject to stringent restrictions when they register as investment advisors.

MSIC engages in the slimiest possible rhetorical trick by assuming without evidence and contrary to the record that fund managers are somehow voting against the economic interests of their customers. They assert without any evidence that the people who manage money do not know what their customers want but they do.

We do agree with one point made by MSIC: the best decisions about proxy voting are made by those with the most significant economic interest. MSIC has none; indeed its interests are entirely the other way. So until they fully disclose all of their sources of funding and put some actual retail investors on their board they should leave it to those who have not only economic interest but fiduciary obligation, and are thus in the best position to provide what even they acknowledge is "an important component of efficient corporate governance." The only way to make that vital component effective is to respond to votes against management's recommendations by engaging with shareholders, not creating fake advocacy groups to try to undermine them.

[NOTE: In the interest of providing the transparency I am urging on MSIC, I am co-founder of four companies focused on corporate governance that provided services to institutional investors, including proxy advisory services at ISS, which I left in 1990. I have no ownership interest in any of those companies. I do not currently receive any income from institutional investors or expect to receive any in the future. I also serve on the board of a non-profit called the 5050 Climate Project that advises large shareholders on climate change-related matters, but accepts no payment from them.]

# How to Fix Mutual Funds so They Work for Investors, Not Fund Managers



**By Nell Minow**

If I could assign every politician running for office this year one book to read, it would be Professor William Birdthistle's *Empire of the Fund: The Way We Save Now*, the story of the avalanche of money poured to mutual funds and the staggering inadequacy of the results as the baby boomers approach retirement. He calls it "the richest and riskiest experiment in our financial history."

The consequences of this failed experiment affect every aspect of the US economy, as investor funds are diverted to pay costly hidden fees, capital is inefficiently allocated, and critical elements of accountability between the investor and the money manager and the money manager and the companies in the investment portfolio have all but disappeared.

The book is witty and accessible, citing sources from Jane Austen to Angry Birds and Ronco infomercials. He even has a rap video. But it is a comprehensive and powerful indictment of a system that has been distorted to look like pure capitalism when it is really subsidizing an increasingly ineffective financial services industry.

In an interview, Professor Birdthistle discussed some of his findings and conclusions. (Interview edited for length — for the complete version see here.

*How has the switch from defined benefit pension plans (with the employer making investment decisions and guaranteeing a particular level of retirement benefits) to defined contribution plans (with individuals making investment decisions and receiving whatever results, gain or loss) impacted investors? Is it fair to expect individuals with busy lives and no expertise to be responsible for making investment decisions and how can we make it easier for them to be more effective investors?*

Over the past few decades, we have launched massive financial experiment: millions of Americans have lost pensions and received defined contribution plans like 401(k)s and 403(b)s, whether they like it or not. The hypothesis is that millions of investing amateurs with jobs, families, but little training can successfully manage their life savings for decades in a system dominated by investment firms, like those that so vigorously oppose the fiduciary rule.

But the evidence so far says we're not doing well with this project: one-third of all Americans have zero savings for retirement, and even those on the cusp of retirement have nest eggs that will provide an average of just about $7000 a year.

So we've seen this massive cultural shift in just a single generation with almost no corresponding change in the way we train people to manage their own life savings or provide them with a structure that encourages their success. Attempts to ease enrollment in 401(k)s plans, to lower fees in those plans, and to stamp out conflicts of interest routinely become pitched battles with years of legislative and judicial conflict.

To assume we're all going to thrive in this brave new world of financial autonomy is willfully obtuse — or financially cynical. Humans are pretty good at learning how to do things with practice, but as Richard Thaler notes, "barring reincarnation," we only get one chance to succeed at saving for our future.

I think we need to embrace as many complementary ways to improve this process as possible. So, yes, we definitely need more auto-enrollment and auto-escalation, so that people begin this project as early as possible. But we also need to copy the lessons of America's most successful companies, such as Wal-Mart and Amazon, by harnessing the bargaining power of millions of individual investors to enjoy economies of scale. If we invested as a massive group, such as through the Thrift Savings Plan, then we could demand the quality of the best investment firms, working for the lowest possible fees, and delivering the most scrupulous performance.

*How can investors find the hidden fees in their mutual fund investments?*

The problem with finding fees in a mutual fund investment is that there are so many of them. The obvious fees — such as those for management, distribution, 12b-1 plans, administration, and so on — are set forth in the fee and expense tables of fund prospectuses. With a little Googling, those tables are relatively easy to find. But they're not very easy to read.

First, the disclosure for many funds is often consolidated into a single prospectus, which means an investor will have to know the specific name and share class of their investment in order to find and interpret the correct table. In my book, I include a single prospectus that covers 17 different funds with at least 4 different share classes each. Second, the tables are less easy to read than one might think — they can include waivers that may apply for unknown periods. The presence of several footnotes on those charts is a pretty good clue that they're not simple.

The less obvious fees — such as those for the fund portfolio's brokerage commissions, for soft dollar arrangements, and other arcane operations — can be buried in Statements of Additional Information, which are impenetrably thick documents often found only online. And there's no easy trick to figure those out.

*Will the new IEX exchange limit the front-running abuses giving special treatment and higher returns to some investors over others that you describe in your book?*

Yes, the IEX looks like a promising trading venue for mutual funds and their trillions of dollars of our savings. Just like we, as individuals, need to harness our bargaining power to demand better investments, mutual funds need to wield their own clout, in a market haunted by hedge funds and high-frequency traders, to improve their own investing. And, of course, if funds can avoid losing value by being front-run in the market, they should be able to pass those savings down to their shareholders: us.

*Are you advocating a pension equivalent of the "public option" many people want for healthcare?*

I'm advocating opening the Thrift Savings Plan to all Americans, so that everyone — even the self-employed, the unemployed, and those employed at small businesses — can benefit from an excellent plan with a concise menu of prudent funds managed by a sophisticated adviser, BlackRock, at astonishingly low fees (less than 3 basis points or 0.03%).

Now, depending on who we'd like to please or offend, we can describe that proposal as either (a) a "public option" that makes a great government plan available more broadly or (b) a way to make individual investing more successful using bargaining power, economies of scale, and other tools of capitalism. Obviously, (a) might appeal more to the stereotypical Democrat, but candidate Clinton focuses on expanding Social Security; and (b) might appeal to the stereotypical Republican (Marco Rubio did once endorse the idea), but I'm not sure what candidate Trump's retirement policy is. Perhaps we can take some comfort, in this bizarre presidential campaign, from an idea that might offend both sides.