Corporate Governance

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Via Electronic Submission to: rule-comments@sec.gov

Mr. Brent J. Fields, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

July 9, 2019

Dear Secretary Fields:

Please see attached rulemaking petition to amend Title 17, §270.30b1-4 Report of proxy voting record.

Thanks for your consideration. Please feel free to call me at (916) 869-2402cor email me at jm@corpgov.net if you would like to discuss any of these ideas in more detail.

Respectfully submitted,

J. McRitchie

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cc: The Honorable Jay Clayton, Chairman
The Honorable Robert J. Jackson Jr., Commissioner
The Honorable Hester M. Peirce, Commissioner
The Honorable Elad L. Roisman, Commissioner
The Honorable Alison H. Lee, Commissioner

Attachment

Rulemaking Petition for Real-Time Disclosure of Proxy Votes

Petition for rulemaking by the SEC in accordance with the provisions of SEC Rule section 192(a).[1]

Amendment Sought in Underline and Strikeout Format

Title 17, §270.30b1-4 Report of proxy voting record.

Every registered management investment company, other than a small business investment company registered on Form N-5 (§§239.24 and 274.5 of this chapter), shall file a~~n~~ ~~annual~~ report on Form N-PX (§274.129 of this chapter)<u>,</u> not later than <u>24 hours after voting each shareholder proxy,</u> ~~August 31 of each year,~~ containing the registrant's proxy voting record <u>in an SEC mandated machine-readable structured format</u>. ~~for the most recent twelve-month period ended June 30.~~

The Nature of My Interest

I am an individual investor[2] in the tradition of Lewis Gilbert[3] who finds it difficult to determine if mutual funds are voting corporate proxies in my best interest based on required annual N-PX filings in HTML format.[4] It is also too time consuming to read through each company proxy and analyze each issue before I cast my own proxy votes. Both tasks would be eased if I could readily access mutual fund votes in close to real-time, as they are cast, using sortable databases on the internet. Such disclosures would further the original intent of the SEC in requiring proxy votes be disclosed, address a number of concerns about indexed funds and would foster competition among mutual funds.

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[1] Rule 192. Rulemaking: Issuance, Amendment and Repeal of Rules of General Application.
(a) *By Petition*. Any person desiring the issuance, amendment or repeal of a rule of general application may file a petition therefor with the Secretary. Such petition shall include a statement setting forth the text or the substance of any proposed rule or amendment desired or specifying the rule the repeal of which is desired, and stating the nature of his or her interest and his or her reasons for seeking the issuance, amendment or repeal of the rule. The Secretary shall acknowledge, in writing, receipt of the petition and refer it to the appropriate division or office for consideration and recommendation. Such recommendations shall be transmitted with the petition to the Commission for such action as the Commission deems appropriate. The Secretary shall notify the petitioner of the action taken by the Commission. https://www.ecfr.gov/cgi-bin/text-idx?SID=7a8c70ad7e458365f6e6071d58539b85&mc=true&node=se17.4.270_130b1_64&rgn=div8

[2] James McRitchie, "Deal Professor Equates Filing Proxy Proposals with Terrorism," August 22, 2014, *Corporate Governance*. https://www.corpgov.net/2014/08/deal-professor-equates-filing-proxy-proposals-with-terrorism/.

[3] James McRitchie, "Lewis Gilbert's Dividends and Democracy Still Timely," May 4, 2010, *Corporate Governance*. https://www.corpgov.net/2010/05/lewis-gilbert-still-timely/.

[4] "Form N-PX," *U.S. Securities and Exchange Commission*. https://www.sec.gov/files/formn-px.pdf.

Currently, up to 91.6% of retail investors fail to vote, depending on delivery mode.[5] Real-time[6] disclosure of proxy votes would get more attention from the press, which is focused on breaking news, not what happened last year. Retail shareholders, and even small institutional investors with inadequate resources to analyze proxies, could benefit from more timely disclosure of proxy votes by funds currently required to file annually on Form N-PX.

Why SEC Should Require Real-Time Proxy Voting Disclosure in Database Format

Chairman Clayton has spoken widely of the need to empower Mr. and Ms. 401(k). One of his guiding principles is that "Our analysis starts and ends with the long-term interests of the Main Street investor." Additionally, "Effective rulemaking does not end with rule adoption" "The Commission should review its rules retrospectively. We should listen to investors and others about where rules are, or are not, functioning as intended."[7]

One accountability measure that fell far short of expectations is SEC Rule 30b1-4. That rule required funds to file annual reports of their proxy votes beginning in 2004 using the N-PX form.[8] The final rule stated, "increased transparency will enable fund shareholders to monitor their funds' involvement in the governance activities of portfolio companies, which may have a dramatic impact on shareholder value." The disclosures would facilitate the ability of Main Street investors to evaluate funds based on their voting records. According to the rule:

> Proxy voting decisions by funds can play an important role in maximizing the value of the funds' investments, thereby having an enormous impact on the financial livelihood of millions of Americans. Further, shedding light on mutual fund proxy voting could illuminate potential conflicts of interest and discourage voting that is inconsistent with fund shareholders' best interests. Finally, requiring greater transparency of proxy voting by funds may encourage funds to become more engaged in corporate governance of issuers held in their portfolios, which may benefit all investors and not just fund shareholders…
>
> Because of the disclosure requirements we are adopting, shareholders will be able to evaluate how closely fund managers follow their stated proxy voting policies, and to react adversely to fund managers who vote inconsistently with these policies.[9]

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[5] See Positions Voted % by Distribution Type, page 4 at "Analysis of Distribution and Voting Trends Fiscal Year Ending June 30, 2017," *Broadridge*. https://www.broadridge.com/_assets/pdf/broadridge-10-year-distribution-and-voting-analysis.pdf.

[6] For the purpose of this proposal, I define real-time disclosure as disclosure within 24 hours of voting.

[7] Jay Clayton, "Remarks at the Economic Club of New York, *U.S. Securities and Exchange Commission*, July 12, 2017. https://www.sec.gov/news/speech/remarks-economic-club-new-york.

[8] "Form N-PX" *U.S. Securities and Exchange Commission.* https://www.sec.gov/files/formn-px.pdf.

[9] "Final Rule: Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management Investment Companies," *U.S. Securities and Exchange Commission*, Modified September 23, 2003. https://www.sec.gov/rules/final/33-8188.htm.

A review by the Commission would find N-PX filings are not fit for purpose. Filings do *not* "enable fund shareholders to monitor their funds' involvement in the governance activities of portfolio companies." Filings do *not* shed light on mutual fund voting to "illuminate potential conflicts of interest and discourage voting that is inconsistent with fund shareholders' best interests." They do *not* enable shareholders to "evaluate how closely fund managers follow their state proxy voting policies, and to react adversely to fund managers who vote inconsistently with these policies."

Proxy voting data are displayed in user-unfriendly HTML format. I know of no retail investors using such information on their own. To make sense of the filings, Main Street investors need to hire a researcher or subscribe to a data provider, such as Proxy Insight.[10] The average 401(k) account balance is less than $40,000 for those under age 40,[11] about the time many employees typically get serious about investing for retirement. Hiring a researcher or subscribing to a database to conduct their own research would not be cost effective for most individuals.

Currently collected data is underutilized because it is not freely available in a user-friendly format. Year old data is also seen as out-of-date in an age when most news arrives instantaneously on social media. Compare the sortable voluntary disclosure of Trillium Asset Management,[12] which even includes the rationale for each vote, with mandated disclosure of the Vanguard Index Trust Total Stock Market Index Fund, which requires a laborious effort to decipher.[13]

Real-time proxy voting disclosure by funds would allow easy comparison of voting records when writing the news, making investment decisions, or voting proxies. The SEC could accomplish the original goals of Rule 30b1-4, including the empowerment of Main Street and Mr. and Ms. 401(k) investors, by revising its N-PX reporting rules to require filings in real-time and in a user-friendly format.

Some shareholders are concerned about the unintended consequences of real-time disclosure. For example, in 2002 Deutsche Bank voted 17 million HP shares held by its clients against the acquisition by Compaq of HP but switched after CEO, Carly Fiorina, reminded the Bank their decision was "of great importance to our ongoing relationship." That tipped the vote, so the value-destroying merger occurred.

While I see a competition around long-term ethical values, others warn that management interests have huge lobbying budgets. The voices of Mr. and Ms. 401(k) could be drowned in the din. Real-time disclosure could facilitate proxy contestants to spend more time and money lobbying the vote.

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[10] https://www.proxyinsight.com

[11] This is according to Fidelity, as cited by Becca Stanek, "The Average 401(k) Balance by Age," *Smartassets*, August 20, 2018. https://smartasset.com/retirement/average-401k-balance-by-age.

[12] See under "search proxy votes," *Trillium Asset Management*. http://www.trilliuminvest.com/approach-to-sri/proxy-voting/.

[13] *U.S. Securities and Exchange Commission.* https://www.sec.gov/Archives/edgar/data/36405/000093247118006890/indexfunds0085.htm.

However, it would also make more information widely available in such contests and would help investigators and reporters determine illegal practices more immediately. In the HP case, the federal government fined Deutsche Bank $750,000 for failing to disclose its conflict of interest.[14] Real-time reporting would focus more eyes sooner. Attempts to circumvent requirements would likely decrease.

I have personally contacted funds several times on pre-disclosed votes that appeared inimical to the fund's advertised values, prompting them to change their votes. Funds typically vote through standing voting instructions based on their proxy voting policies on specific topics. However, a small change in wording can go unnoticed and sometimes results in funds voting against the intent of their policies. Additionally, new proxy topics may not be covered by a fund's voting policy. Vote disclosure well in advance of meetings *is* likely to stimulate more discussion on the issues, creating positive dialogue. Funds that do not want such attention could reduce the chances of being lobbied by simply voting on or near the last day.

Real-time disclosure of proxy votes would go a long way in solving problems raised by Leo Strine, Lucian Bebchuk, Caleb Griffin, and others regarding potential conflicts of interest and/or under/over investment in ESG advocacy. Real-time disclosure is fully compatible with "A Commonsense Agenda," as outlined by the Main Street Investor's coalition, which includes the following: "Providing retail investors with more visibility into how the funds they own vote on their behalf."[15]

All funds claim to vote their proxies conscientiously in the "best interest" of their clients. *Pensions & Investments (P&I),* "Winning over proxy voters,"[16] editorialized that pensions have a fiduciary duty to announce their proxy votes in advance of annual meetings if doing so is likely to influence the vote. The same logic applies to all big funds. If funds really believe their votes enhance value, why hesitate to disclose those votes to influence others?

Rapid disclosure and reporting of proxy votes would foster real dialogue on the issues faced by corporations and investors. With real-time disclosure, funds would begin to compete not only on the basis of cost and returns but also based on how their votes align with the values of Main Street investors and Mr. and Ms. 401(k). Additionally, real-time disclosure would spark renewed interest in services previously provided by

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[14] "Government Fines Deutsche Bank $750,000 For Actions In HP-Compaq Merger Vote," *InformationWeek*, August 19, 2003. https://www.informationweek.com/government-fines-deutsche-bank--$750000-for-actions-in-hp-compaq-merger-vote/d/d-id/1020424.

[15] "A Common Sense Agenda," *Main Street Investors Coalition*, Viewed March 3, 2019. https://mainstreetinvestors.org/.

[16] Barry Burr*,* "Winning Over Proxy Voters," *Pensions & Investors*, May 12, 2014. https://www.pionline.com/article/20140512/PRINT/305129997/winning-over-proxy-voters.

MoxyVote[17] to facilitate the use of standing voting instructions by retail shareholders. For a discussion of current impediments, see *Standing Voting Instructions: Reviewed*.[18]

Background

Corporations have facilitated the most dynamic economic growth in history. Like many Americans, I do not want my investments to encourage short-termism or adverse externalities, like dark money in politics or climate change that puts at risk earth's salubrious environment. I want to vote my proxies conscientiously, but I do not want to spend a lot of time doing so.

Real-time disclosure of corporate proxy votes would lead to competition among funds, based not only on historic costs and returns to investors, but also on how proxies are voted. Real-time disclosure would help me invest in funds aligned with my own values. I could also compare how funds vote their proxies at individual companies and use that information to guide my own votes.

How could real-time disclosure help? Let us examine its application to two common areas of concern.

Example Issue #1: Dark Money

Former Delaware Supreme Court Chief Justice Leo E. Strine Jr. excoriated the Big 4 mutual fund families (BlackRock, Vanguard, State Street, and Fidelity) for voting against shareholder proposals seeking supermajority shareholder approval of political contributions. Since a combination of BlackRock, Vanguard, and State Street constitute the largest shareholder at 40% of U.S. public companies and nearly 90% at S&P500 firms, their votes matter. (Strine 2018, 12)

Three-fourths of survey respondents, including 66% of Republicans and 85% of Democrats, back a constitutional amendment "outlawing Citizens United," the Supreme Court decision that held restricting independent expenditures for communications by corporations unconstitutional. (Strine 2018, 26) Strine notes, "in *Citizens United v. FEC*, Justice Kennedy, writing for the majority, implicitly assumed that access to information about corporate political spending would be accessible and allow stockholders to correct abuses 'through the procedures of corporate democracy.'" (Strine 2018, 37) Kennedy expressed enthusiasm that technology makes disclosure "rapid and informative." (*Citizens United*, 55)

If political spending is not disclosed, the "procedures of corporate democracy" cited by Kennedy cannot work. Fidelity and Vanguard did not support any shareholder

[17]https://video.search.yahoo.com/search/video?fr=aaplw&p=MoxyVote#id=1&vid=bb59bab6c7aafa8068d7af5d043b794b&action=click

[18] James McRitchie, "Standing Voting Instructions: Reviewed," *Corporate Governance*, November 8, 2017. https://www.corpgov.net/2017/11/standing-voting-instructions-reviewed/.

proposals in 2018 requesting such disclosures. BlackRock supported 4.1% of the time and State Street supported 39.1%.[19]

Strine writes that workers are “forced capitalists” who cannot hold the funds that invest their money accountable.

> Worker Investors do not control the underlying investments, they do not vote at the underlying portfolio companies. That voting is left to the Big 4. Plus, the reality is that there is no comparable stockholder litigation, proxy fights, or other activism in the mutual fund space. An accountability framework of that kind just does not exist. (Strine 2018, 20-21)

Strine wants to bar political spending without the vote of a supermajority of shareholders. However, a rulemaking petition organized by Robert J. Jackson, Jr., with other academics (Committee on Disclosure of Corporate Political Spending, 2011), to simply require disclosure of political contributions, a much lower threshold, received more favorable comments than any other petition in SEC history but has not been taken up for consideration.

Only about half of American households own stock. Most do so indirectly through mutual funds or retirement accounts. For the market to work efficiently, investors need to know how their funds are voting. Right now, they don’t, unless they are reading articles posted at the Harvard Law blog, Morningstar, and other sites frequented by a comparative few.

Real-time proxy vote disclosure would place voting records with other market considerations, such as historic earnings and expenses. If that happens, we may find the half of Americans with investments are less inclined to want companies to disclose political expenditures than the half of Americans with no investments. Alternatively, Mr. and Ms. 401(k) may be outraged, as Strine seems to believe, to learn their funds oppose disclosure of corporate support for political campaigns.

At least if Main Street investors had the information, we could say the market is working. Without the information, investors, especially retail investors, are in the dark. The market cannot play its critically important role if information is not freely available.

Example Issue #2: Motivating Stewardship

Lucian Bebchuk has given more thought to issues surrounding index funds than most researchers. He and co-author Scott Hirst focus on BlackRock, State Street Global Advisors (SSGA), and Vanguard. (Bebchuk & Hirst 2018) The Big Three Index Funds

[19] Dan Carroll and Bruce Freed, “Mutual Fund Voting on Corporate Political Disclosure,” January 9, 2019, *Harvard Law School Forum on Corporate Governance and Financial Regulation*. https://corpgov.law.harvard.edu/2019/01/09/mutual-fund-voting-on-corporate-political-disclosure/

collectively vote about 20% of the shares at all S&P 500 companies. Bebchuk and Hirst estimate the Big Three alone will control 34.3% of S&P 500 votes in 20138 and 40.8% in 2038.[20]

The authors provide a plethora of evidence that index fund managers have strong incentives to under-invest in stewardship and defer excessively to corporate managers. They advance several prescriptive measures to address those incentive problems, such as requiring each index fund to invest a specified minimum of assets under management to stewardship and prohibiting investment managers from administering 401(k) plans for employers or requiring them to disclose such business relationships.

Most of their recommendations would need to be implemented through prescriptive regulations. They would be opposed by the funds they seek to influence, as well as by corporate interests. In contrast, minor amendments to existing rules to require real-time proxy vote disclosure would unleash demand by fund investors for market competition to address these issues. The simpler solution is more competitive capitalism, not regulations dependent on government enforcement.

Index Fund Investors Can Switch

A common myth reinforces a sense that index funds cannot be enlisted to address short-termism and externalities, like dark money and climate change. The following is the central point of a recent study:

> Our key insight is that although index funds are locked into their investments, their investors are not. Like all mutual fund shareholders, investors in index funds can exit at any time by selling their shares and receiving the net asset value of their ownership interest. This exit option causes mutual funds – active and passive – to compete for investors both on price and performance. While the conventional view focuses on the competition between passive funds tracking the same index, our analysis suggests that passive funds also compete against active funds. Passive fund sponsors therefore have an incentive to take measures to neutralize the comparative advantage enjoyed by active funds, that is, their ability to use their investment discretion to generate alpha. Because they cannot compete by exiting underperforming companies, passive investors must compete by using "voice" to prevent asset outflow. (Fisch, Hamdani, & Solomon 2018, Abstract)

Fiduciary obligations are complicated. "Mutual funds' fiduciary duties require them to vote in a manner that benefits their investors, not each company that they hold in their portfolio." (Fisch, Hamdani, & Solomon 2018, 34) For example, holding both target and bidder might lead to a different vote than holding only one.

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[20] Scott Hirst and Lucian Bebchuk, "The Spector of the Giant Three," 99 *Boston University Law Review* 721, 739 (2019) http://www.bu.edu/bulawreview/files/2019/06/BEBCHUK-HIRST-1.pdf.
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> Delaware law provides shareholders with the right to vote their shares as they see fit and does not impose any obligation on shareholders to vote unselfishly or to further the economic interests of the corporation. (Fisch, Hamdani, & Solomon 2018, p. 42)

Since fiduciary standards are weak, better enforcement is unlikely to force better stewardship with regard to many issues important to investors, including economic issues.

Given that funds operate within such a weak legal framework, it is important that individuals, Mr. and Ms. 401(k), have at least some ability to influence how large indexed funds vote their proxies. Public opinion, as I will discuss, is likely to have more impact on proxy voting than fiduciary duty.

Fisch argues that index fund investors can switch, and some can. However, many employer sponsored 401(k) and other plans provide few choices. Main Street investors are often, as Strine argues, "forced capitalists." For example, less than 8% of company-sponsored retirement plans offer an ESG fund option, even though 74% of plan participants want one. This disparity may stem from a belief ESG funds perform more poorly. However, Lipper data finds performance and costs are equal to non-ESG funds.[21]

As big data allows for more rigorous research of financially material ESG risks, many more funds will incorporate such analysis into capital allocation decisions. Long gone are the days of Graham and Dodd when intangible assets represented a small portion of corporate value. "Intangibles have grown from filling 20% of corporate balance sheets to 80%, due in large part to the expanding nature, and rising importance, of intangibles as represented by intellectual capital vs. bricks-and-mortar, research and development vs. capital spending, services vs. manufacturing, and the list goes on."[22]

As Commissioner Pierce notes, ESG-influenced investments and voting recommendations are often based on insufficient evidence.[23] Real-time disclosure of proxy votes in sortable databases on the internet would facilitate a mountain of research.

Too many 401(k) plan administrators take little or no initiative to investigate potential conflicts or breaches of fiduciary duty. They do little or nothing to ensure shares are

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[21] Jeff Benjamin, "ESG Options Scarce in 401(k)s," March 18, 2019, *InvestmentNews*, https://www.investmentnews.com/article/20190316/FREE/190319951/esg-options-scarce-in-401-k-plans.
[22] Christopher P. Skroupa, "How Intangible Assets Are Affecting Company Value in the Stock Market," November 1, 2017, *Forbes*, https://www.forbes.com/sites/christopherskroupa/2017/11/01/how-intangible-assets-are-affecting-company-value-in-the-stock-market/#29b45ad62b8e.
[23] Commissioner Hester M. Peirce, "Scarlet Letters: Remarks before the American Enterprise Institute," June 18, 2019, https://www.sec.gov/news/speech/speech-peirce-061819.

voted in the best interest of program participants.[24] Very few attempt to determine what participants believe to be in their own interests with respect to proxy voting policies.

Most employers do not even know they have fiduciary duties.[25] Therefore, many do not make proxy voting policies or records available to participants. Like index funds themselves, the only tool "forced capitalists" might have is "voice." However, Main Street investors need information about how their funds vote before they can voice concerns over possible incongruities with public statements, be incentivized to switch to funds that are more aligned with their own values, or ask for more options if funds reflecting their values are unavailable to them.

Main Street Investors Should Have a Say

The National Association of Manufacturers and others formed and sponsor the Main Street Investors Coalition (MSIC), which seeks to give more say to average investors. MSIC questions the recent surge in environmental and social investing. They surveyed 1,000 investors with assets in exchange traded funds (ETFs) and found that 78% of "people invest in passive funds because they want low-fees and consistent returns – not to advance social and/or political causes." Only 22% agreed, "it's about time that passive funds used their size and influence to promote worthy social and/or political causes."[26]

MSIC "is demanding that fund managers focus on maximizing performance and ensuring that retail investors who own passive funds have a say in how their shares are voted."[27] MSIC members believe that if Main Street investors "have their say," passive funds will concentrate on maximizing financial performance. Other research finds increasing numbers of investors want a good return *and* to address environmental and social concerns. For example, "investors marketwide value sustainability. Being categorized as low sustainability resulted in net outflows of more than $12 billion while being categorized as high sustainability led to net inflows of more than $24 billion."[28]

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[24] For example, see James McRitchie, "Savings Plus: Transparent Proxy Voting Needed," August 19, 2014, *Corporate Governance*. https://www.corpgov.net/2014/08/savings-plus-transparent-proxy-voting-needed/.

[25] One survey asked 1,000 defined contribution executives if they were fiduciaries: 49% said no; 6% did not know. Based on their duties, all were fiduciaries. Even 48% of executives from plans with $500 million or more in assets thought they were not fiduciaries. "No excuse for fiduciary ignorance," *Pensions & Investments*, February 19, 2018. https://www.pionline.com/article/20180219/PRINT/180219902/no-excuse-for-fiduciary-ignorance.

[26] "Investors Choose Exchange Traded Funds for Low Fees, not to Promote Social Causes." May 8, 2018, *Main Street Investors Coalition*. https://mainstreetinvestors.org/investors-choose-exchange-traded-funds-for-low-fees-not-to-promote-social-causes/.

[27] "Empty Voting by Mutual Fund Advisors Threatens Shareholder Value." July 2, 2018, *Main Street Investors Coalition*. https://mainstreetinvestors.org/empty-voting-by-mutual-fund-advisors-threatens-shareholder-value/.

[28] Samuel M. Hartzmark and Abigail B. Sussman, "Do Investors Value Sustainability? A Natural Experiment Examining Ranking and Fund Flows," October 12, 2018, *SSRN*. https://ssrn.com/abstract=3016092. See also, "*Report on US Sustainable, Responsible and*

Disintermediating Voting at the Index Fund Giants

Caleb N. Griffin argues the "best interests" standard for proxy voting is "little more than a fiduciary fig leaf when it comes to promoting accountability." (Griffin, p. 3) Griffin critiques many proposed solutions and provides insight as to how investors could influence the Big Three index funds, viewing the central concern as "the disconnect between how index funds vote their shares and the actual preferences and interests of their individual investors." (Griffin, p. 30)

Griffin's analysis arrives at three alternatives or a combination thereof: 1) Allow investors to select representatives who vote their beliefs; 2) survey investors every one to five years on their beliefs, which could then be incorporated into voting policies; and 3) survey investors on key proxy issues to be used in voting fund shares.

John Wilcox of Morrow Sodali, a global consultancy in corporate governance, has similar ideas for more say. In a letter[29] to the SEC regarding the Roundtable on the Proxy Process, he writes,

> The concept of "pass-through voting" on matters relating to issuers has long been dismissed as impractical. It is not legally mandated because voting decisions for the silent majority are delegated to the fiduciaries who make investment decisions on their behalf. However, this hands-off approach is beginning to be questioned. In recent years stewardship codes have amplified the fiduciary standards that asset managers must meet in their oversight of portfolio companies, their governance policies and their proxy voting decisions. Even though there is currently no mandate for gathering feedback from the silent majority, the growing responsibilities of institutional investors and the availability of new technology are beginning to open the door to pass-through communications…
>
> A case can be made that investors who delegate stock picking and proxy voting decisions to third-party professionals, while having no standing to vote at shareholder meetings, should have some means to voluntarily inform their fiduciaries about their views on issues affecting their investments. Indeed, both academics and regulators have recently raised questions about: (i) concentration and common ownership of stocks by index funds; and (ii) the exercise of voting power by ETFs without reference to the views of ultimate owners in managed accounts. These concerns combined with the growing popularity of collective investment vehicles will sooner or later give rise to private sector mechanisms for informal pass-through referendums on ETF's and indexers' voting policies.

Impact Investing Trends," October 31, 2018, The Forum for Sustainable and Responsible Investment. https://www.ussif.org/blog_home.asp?Display=118.

[29] John Wilcox, *U.S. Securities and Exchange Commission,* December 28, 2018. https://www.sec.gov/comments/4-725/4725-4840503-177168.pdf.

> Pressure for such feedback mechanisms will surely increase as environmental and social concerns, shareholder activism and risk oversight feature more prominently in public discussions about corporate purpose and boardroom accountability.

Griffin and Wilcox provide a vision of what "a say" could look like. Griffin entertains pass-through voting to a representative of each participant's choosing. Alternatively, both look to advisory votes to shape both future fund votes and marketing. All their options would raise costs and would have to overcome resistance from both funds and investors. Will participants choose different representatives to vote for each type of issue based on expertise or values alignment? Will values and policy surveys "educate" investors on probable impacts and/or ask leading questions? Will participants be told how current funds vote and why? Real-time proxy vote disclosure would at least make a substantial body of core information available to facilitate such surveys and referenda.

The crux of the problem described by Griffin is:

> (I)ndex fund investors cannot even indirectly express their preferences by selecting a particular fund or a particular index fund provider that is more likely to vote in line with their interest and values, since the shares controlled by different individual funds are nearly always voted in the exact same manner and since the different index fund providers share very similar voting philosophies and priorities. (Griffin, p. 1)

Meeting Investor Proxy Voting Expectations

MSIC, Griffin and Wilcox all envision greater input from investors into how funds vote their proxies. That is certainly an admirable goal and I hope funds will facilitate such participation. In the meantime, an interim step would be to facilitate the ability of investors to confirm proxies are voted as they might expect based on fund names and/or advertising.

Funds with specifically advertised goals within the largest fund families frequently do not vote in harmony with those goals. Investors in Vanguard's FTSE Social Index Fund might expect it to be voting like a traditional SRI fund on ESG issues. Instead, fund families tend to vote all proxies the same. For example, "in 2015, Vanguard's many different investment funds voted in concert in all but 6 votes out of 100,000." (Griffin, p. 10)

Research by Morningstar highlights these discrepancies. One survey found "State Street's SHE voting record is the least aligned with its investment objective" of the three funds reviewed. “SHE is voting against the very initiatives that can help address gender inequality in corporate America.”[30]

Another Morningstar survey found ESG funds from BlackRock, Vanguard, Fidelity Investments, and TIAA-CREF, among others, cast a number of votes that appear to conflict with an ESG focus, especially for funds specifically aimed at the environment. By way of contrast, among nine fund companies with a long-term ESG focus, not a single vote was cast against climate-change resolutions that garnered more than 40% of the shareholder vote.[31] Despite those seemingly conflicted proxy votes by large indexed funds on their ESG funds, ESG resolutions are seeing record support.[32]

Wide circulation of such discrepancies, as a result of more frequent and sortable reporting of proxy votes, may lead fund families to establish different voting policies for focused funds. Competition within and between fund families will yield more attention on monitoring ESG and possibly other factors.

Moxy Vote

Knowing how funds have voted on any given issue at specific companies is key in helping retail investors vote. Funds must analyze proxies at thousands of companies each year. Typically, funds develop proxy voting policies, hire proxy advisory services to mesh their voting policies with the proxy items and engage staff in analyzing possible exceptions prior to voting, often using various expensive subscription databases and tools. Most individual investors do not bother voting, at least in part, because they do not have such tools.

From late 2009 to mid-2013, the website Moxy Vote gathered proxy votes from a growing number of institutional investors that announce votes in advance. Retail investors could link their brokerage accounts. Then they could develop automated proxy voting policies by brand alignment with their own values, choosing to copy the votes of trusted institutional investors. For example, users could set preferences to vote with Domini. If Domini did not vote (because they did not own the stock), vote with Calvert. If Calvert did not vote, vote with Florida SBA, etc. Investors also had the option of overriding their automated preferences.

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[30] Madison Sargis, *Gender-Diversity Funds: How Strong Are Their Intentions?* April 1, 2019, https://www.morningstar.com/blog/2019/04/01/gender-intentional.html?cid=CON_RES0074 referencing research by Madison Sargis and Jackie Cook.
[31] James McRitchie, Morningstar Direct Uncovers ESG Hypocrites, *Corporate Governance*, March 20, 2019, https://www.corpgov.net/2019/03/morningstar-direct-uncovers-esg-hypocrites/ referencing Jackie Cook, When ESG Funds Don't Walk the Walk on Climate Change Votes, Medium, March 21, 2019, https://medium.com/the-esg-advisor/when-esg-funds-dont-walk-the-walk-on-climate-change-votes-46e28630caf.
[32] Jackie Cook, 2019 On Track to See Record Support for U.S. Environmental, Social Proxy Votes, June 12, 2019, *Morningstar Direct*. https://direct.morningstar.com/research/doc/933160/2019-On-Track-to-See-Record-Support-for-U-S-Environmental-Social-Proxy-Votes.

Unfortunately, the number of funds disclosing votes in advance was extremely limited, Moxy Vote was hindered by antiquated SEC rules,[33] and they had to pay processing fees for each vote cast at higher cost per share than large institutional investors. However, Moxy Vote captured the imagination of tens of thousands of users and demonstrated a system that let shareholders vote their values without spending countless hours analyzing individual proxies. Moxy Vote provided a real-life example of what can work to get retail shareholders to vote their proxies.

Proxy Insight[34] compiles voting information from pre-disclosing funds, as well as from all funds filing annual N-PX forms. Its customers are large investment managers, activist investors, advisory firms, compensation consultants, investment banks and academic institutions. Typical Main Street investors are unwilling to pay for access.

At the end of September 2018, Morningstar acquired Fund Votes,[35] which has long analyzed mutual fund and ETF proxy voting data on company resolutions and shareholder proposals. Morningstar wants to shine a light on how funds fulfill their stewardship role as significant owners of public companies. How funds vote their proxies is a big part of that, yet it is hard for investors and non-investors alike to even find this information, much less make any sense of it. Morningstar promises to change that but their information will likely be behind a paywall, inaccessible to Mr. and Ms. 401(k), except when their research gets covered by the press.

Public Opinion Drives Votes

Influence of Public Opinion on Investor Voting and Proxy Advisors (Renee Aggarwal, Isil Erel and Laura T. Starks, July 2015) found that investors have been voting less with the recommendations of management or proxy advisors and are more influenced by public opinion.

The researchers looked at all proxy proposals for Russell 3000 Index companies for the period January 2004 through November 2010. They reviewed voting records, the recommendations of Institutional Shareholder Services (ISS) and media coverage of executive compensation, as well as Gallup surveys of public opinion.

From the abstract:

> Institutional investors vote corporate proxies on behalf of underlying investors and beneficiaries. We show a strong relation between this voting and public opinion on corporate governance (as reflected in media coverage and surveys), with similarly strong results for voting by mutual funds. We also find that proxy advisors' recommendations are associated with public opinion. Our results suggest that institutional investors and proxy advisors pay attention to the

[33] Larry Eiben, *U.S. Securities and Exchange Commission,* October 20, 2010. https://www.sec.gov/comments/s7-14-10/s71410-181.pdf.
[34] *Proxy Insight*. https://www.proxyinsight.com.
[35] Jackie Cook, *FundVotes*. https://www.fundvotes.com.

changing opinions of their beneficiaries and shareholders, as reflected in their voting decisions, and that the proxy voting process serves as a channel for the public to influence corporate behavior.

Recently, a number of websites and phone apps have been created to provide Main Street investors, Mr. and Ms. 401(k) and the general public with “a say” into how corporations should behave with regard to ESG issues. The following are just a few examples:

- As You Sow[36]
- Center for Political Accountability[37]
- Change.org[38]
- Gender Diversity Exchange[39]
- Just Capital[40]
- Main Street Investors Coalition[41]
- Say[42]
- Shareholder Democracy Network[43]
- Stake[44]
- SumOfUs[45]

These new internet sites and phone applications will create an important feedback loop that drives both public opinion and changes in proxy voting at an accelerated pace going forward. Financial intermediaries, such as mutual funds, will pay even more attention to public opinion in the future than they do today. Real-time disclosure would reinforce that virtuous circle.

Giant Funds Could Compete to Shape Corporate Values

Some competition among large funds based on voting policies is already developing. Real-time disclosure of proxy votes would increase that exponentially by stimulating debate and action around the social purposes of public companies.

Ryan Bubb and Emiliano Catan examined votes on close to 200,000 proposals and developed an interesting typology. (Bubb and Catan) Funds in the “Traditional Governance Party,” which include the Big Three (BlackRock, Vanguard and State

[36] https://www.asyousow.org.
[37] https://politicalaccountability.net.
[38] https://www.change.org.
[39] https://www.leaderxxchange.com/gender-diversity-exchange.
[40] https://justcapital.com.
[41] https://mainstreetinvestors.org.
[42] https://www.say.com.
[43] https://www.shareholderdemocracy.com.
[44] https://www.yourstake.org/start/.
[45] https://www.sumofus.org.

Street), support management at the highest rate of the author's typologies. Although these funds strongly support managers, they defend the right of majority shareholders to wrest control at annual meetings by supporting proposals such as those to declassify the board and reduce supermajority vote requirements.

The "Shareholder Interventionist Party," typified by Institutional Shareholder Services, supports shareholder proposals and proxy contests more than the "Shareholder Veto Party," advised by Glass Lewis. The largest funds in the Interventionist Party are Dimensional Fund Advisors, OppenheimerFunds, and John Hancock Group. The largest Veto Party members are Franklin Templeton, Columbia Funds, and Charles Schwab. "The Shareholder Intervention Party supports shareholder proposals at a rate of 84%, compared to only 49% for the Shareholder Veto Party." "In contrast, the Shareholder Veto Party supports management proposals at a rate of only 59%, compared to 72% support for the Shareholder Intervention Party." (Bubb and Catan 24)

A few funds, like Domini and Calvert, score highly on both dimensions of fund preference. "Our framework shows that these socially responsible fund families are *extreme* in their shareholder rights orientation, as expressed through their votes." (Emphasis added, Bubb and Catan 26) It may be a mistake to dismiss such funds as extreme. Even though socially responsible investing (now often termed sustainable impact investing) or SRI funds represent only a small proportion of all investments, large index funds are moving into that market. One out of every four dollars under professional management in the United States, $12.0 trillion was invested according to SRI strategies as of year-end 2017. That represents 38% between 2016 and 2018.[46]

The sample period for Bubb and Catan was 2010 – 2015. Given growing pressures from the press, social media and applications outlined above, a similar study undertaken in the near future could yield significantly different results. In his 2018 letter,[47] BlackRock CEO Larry Fink advised corporations to have "a sense of purpose." "A company's ability to manage environmental, social and governance matters demonstrates the leadership and good governance that is so essential to sustainable growth, which is why we are increasingly integrating these issues into our investment process."

Fink's 2019 letter clarified that "purpose is not the sole pursuit of profits but the animating force for achieving them." Fink also included the following in his 2019 letter,

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[46] "Sustainable investing assets reach $12 trillion as reported by the US SIF Foundation's biennial *Report on US Sustainable, Responsible and Impact Investing Trends,*" The Forum for Sustainable and Responsible Investment, October 31, 2018. https://www.ussif.org/files/US%20SIF%20Trends%20Report%202018%20Release.pdf.

[47] Larry Fink, "Larry Fink's 2018 Letter to CEOs: A Sense of Purpose," *BlackRock*. https://www.blackrock.com/corporate/investor-relations/2018-larry-fink-ceo-letter.

> In a recent survey by Deloitte, millennial workers were asked what the primary purpose of businesses should be – 63 percent more of them said "improving society" than said "generating profit." [48]

While all three of the largest funds have launched ESG funds to appeal to consumer demand, they have not moved as quickly in their proxy voting practices to reflect ESG concerns. That is probably because voting records remain largely invisible to the investing public.

> In the 2017-2018 season, asset managers supported, on average, 42% of climate proposals and 28% of political disclosure proposals. A clear pattern of leaders and laggards, with the largest asset managers showing the least support on key climate and political disclosure votes. For example, BlackRock and Vanguard supported only 23% and 33% of climate proposals, respectively; both voted against 100% of resolutions calling for greater disclosure of corporate political expenditures.[49]

Lack of support for climate and political disclosure proposals conforms with characterization of the Big Three as leaders of the Traditional Governance Party. Of the Big Three, State Street has been the most supportive of both climate change and political disclosure reports. Maybe that has something to do with their creation of the "Fearless Girl"[50] statue, originally facing down the Wall Street Bull statue. Was Fearless Girl merely a publicity stunt to support launch of the Gender Diversity Index (ticker symbol SHE)? Was it aimed at diverting attention from a $5 million settlement[51] for allegedly underpaying women and employees of color or was the statue a genuine commitment to diversity?

Original intent may not matter. Reality has a way of catching up to statements made to bolster public relations. Just as the words "all men are created equal" in the Declaration of Independence arguably became more revolutionary than the war those words sparked, the Big Three may soon be held accountable to their own statements.

"Fearless Girl" may have marked an inflection point for State Street, which voted against 400 directors in 2017 for lack of diversity.[52] According to Rakhi Kumar, global head of asset stewardship and ESG with State Street:

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[48] Larry Fink, "Larry Fink's 2019 Letter to CEOs: Purpose & Profit," *BlackRock*. https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter.

[49] Kimberly Gladman, "Asset Manager Climate Scorecard 2018," *50/50 Climate Project*. https://5050climate.org/wp-content/uploads/2018/09/FINAL-2018-Climate-Scorecard-1.pdf.

[50] "Fearless Girl," *Wikipedia*, Last modified February 28, 2019. https://en.wikipedia.org/wiki/Fearless_Girl.

[51] Sarah Cascone, "A Bunch of Bull? Wall Street Firm Behind 'Fearless Girl' Settles Gender Discrimination Suit," *artnet news*, October 10, 2017. https://news.artnet.com/art-world/fearless-girl-settles-gender-discrimination-suit-1110587.

[52] Emily Chasan, "After Fearless Girl, State Street Puts Men-Only Boards on Notice." *Bloomberg*, July 26, 2017. https://www.bloomberg.com/news/articles/2017-07-26/after-fearless-girl-state-street-puts-men-only-boards-on-notice.

> The investor demand is there. But typically who do CEOs and CFOs hear from? They hear from analysts on quarterly calls, where the time horizons are very different. I'm not on quarterly calls because we're long-term investors and we're looking at long-term risks. We've published papers, we've sent letters, and we've talked about these issues at conferences for years. But we're still trying to pivot management's views to the long-term and that's very challenging.[53]

State Street asserts Fearless Girl has inspired 300 companies to hire female directors as part of its gender diversity asset stewardship programs in the US, UK, Australia, Japan, Canada, and continental Europe. According to State Street, the percentage of companies in the Russell 3000 Index without female directors has dropped from 24 to 16 percent since the end of 2016.[54]

According to Broadridge, institutional investor support for social and environmental proposals increased from 19% in 2014 to 29% in 2018.[55] That is a clear trend. Real-time proxy voting disclosure would be one way for the Big Three to demonstrate their votes reflect their public statements and to ensure inflows continue. According to ISS, "Disclosure on ESG issues is only beginning to gain prominence among U.S. companies; therefore, given the right targeting, there is ample room for these types of proposals to gain additional support."[56]

Groups like the Main Street Investors Coalition may assume giving beneficial owners a say in how their funds vote will decrease focus on ESG issues, since retail shareholders typically vote with management. According to *ProxyPulse*, a joint publication of Broadridge and PwC, retail shareholders supported ESG proposals at a rate 12% lower than institutional shareholders, so the Coalition has real evidence to support their position. To take a more specific example, retail shareholders support initiatives to disclose political spending at a rate 8% lower than institutional investors.[57]

Others point to evidence that investors increasingly want to have a positive impact on the world, as well as earn a good financial return. For example, funds categorized as

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[53] Ben Ashwell, "SSGA's Kumar warns companies on ESG progress," *Corporate Secretary*, August 21, 2018. https://www.corporatesecretary.com/articles/esg/31324/ssgas-kumar-warns-companies-esg-progress.

[54] "State Street Global Advisors Reports Fearless Girl's Impact: More than 300 Companies Have Added Female Directors," press release, *BusinessWire*, September 27, 2018. https://www.businesswire.com/news/home/20180927005518/en/State-Street-Global-Advisors-Reports-Fearless-Girl's.

[55] "2018 Proxy Season Review," *Broadridge*. https://www.broadridge.com/report/2018-proxy-season-review.

[56] Kosmas Papadopoulos, "The Long View: US Proxy Voting Trends on E&S Issues from 2000 to 2018," *Harvard Law School Forum on Corporate Governance and Financial Regulation*, January 31, 2019. https://corpgov.law.harvard.edu/2019/01/31/the-long-view-us-proxy-voting-trends-on-es-issues-from-2000-to-2018/.

[57] Proxy Pulse™, "2018 Proxy Season Review," *Broadridge + PWC*, October 2018. https://www.broadridge.com/_assets/pdf/broadridge-2018-proxy-season-review.pdf.

low sustainability led to net outflows of more than $12 billion, whereas those categorized as high sustainability led to net inflows of more than $24 billion. "Investors have a strong belief that better globe ratings positively predict future returns. We also find suggestive evidence of non-pecuniary motives, consistent with altruism or warm glow."[58]

As I have argued elsewhere, an increased number of people no longer view the economy as outside our sphere of influence. It is our values – our own efforts as individuals, as members of organizations (such as corporations), and public opinion that are the main drivers in creating the future. Public opinion is moving in the direction of investing *with* our values and our dreams, instead of *despite* our values and desires.[59] People want their investments to have a positive impact even before they collect personal financial gains.

Large indexed funds are being targeted both by those who want corporations to maximize shareholder returns and those who want corporations to better reflect the full range of human values. What currently appears as two diametrically opposed positions may converge. As universal owners, investors in large indexed funds only profit from earnings that are not canceled out by a greater loss of consumer purchasing power, disproportionate costs imposed on other firms, or on society. In short, fund managers should support honest competition but not profiteering tactics that externalize costs on others.[60]

> Universal owners have a responsibility, derived from the duty of care, to oppose policies that create negative externalities, like pollution, and support policies that produce positive externalities, such as corporate education and training programs. In contrast to single firms who may find it advantageous to throw off the costs of pollution to society, universal owners will suffer the costs of cleanup through deteriorating infrastructures, higher taxes and other costs to their other holdings.
>
> At the same time, universal owners are able to capture nearly the full benefit of positive externalities, like corporate training programs, because even if trained employees subsequently leave the firm where training occurred, they are likely to find new employment with another universally owned firm. Since the size and breadth of universal owner portfolios expose them to economy-wide risks and rewards, their programs must increasingly be concerned with the long-term growth and economic efficiency of national and world economies.

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[58] Samuel M. Hartzmark and Abigail B. Sussman, "Do Investors Value Sustainability? A Natural Experiment Examining Ranking and Fund Flows," October 12, 2018, *SSRN*. https://ssrn.com/abstract=3016092.
[59] James McRitchie, "Who Wants Impact Investing?" *Corporate Governance*, August 23, 2018. https://www.corpgov.net/2018/08/who-wants-impact-investing/.
[60] David Apgar, "Chasing Profits at Others' Expense Can Harm Investors," *Shareholder Democracy Network*, January 24, 2019. https://www.shareholderdemocracy.com/blog/2019/1/23/chasing-profits-at-others-expense-can-harm-investors.

> Universal owners who want to maximize shareholder value will need to develop "public policy" positions to ensure a well-trained labor force, effective infrastructure, legal and regulatory environment, as well as monetary and fiscal policy. They want to ensure the corporate environment encourages efficiency and doesn't externalize costs.[61]

Large index funds hold competing companies over long time horizons. They could act as stewards of the commons and would be more likely to do so if pressured by fund participants. "Social pressure fueled by socially responsible investment funds and non-profit organizations and customer pressure from individual investors are critical in mitigating free-rider problems among asset managers and sustaining engagement practices."[62]

Real-time proxy disclosure would help both profit maximizers and more holistic investors focus their arguments to proxy voting fiduciaries. The market could play an indispensable role in facilitating debate over values but only if proxy vote information is freely available in a structured, easily accessible and sortable form to Main Street investors and Mr. and Ms. 401(k). As Tepper and Hearn observe, "Capitalism without competition is not capitalism."

> Competition matters because it prevents unjust inequality, rather than the transfer of wealth from consumer or supplier to the monopolist. If there is no competition, consumers and workers have less freedom to choose. Competition creates clear price signals in markets, driving supply and demand. If promotes efficiency. Competition creates more choices, more innovation, economic development and growth, and a stronger democracy by dispersing economic power. It promotes individual initiative and freedom. Competition is the essence of capitalism, yet it is dying.[63]

Even if the SEC adopts the requested amendments, a larger problem remains.

Broader Shareholder Base Needed to Reflect American Values

In the United States, the wealthiest 10 percent of households own about 84 percent of corporate stock. Given that tilt, proxy votes cannot truly reflect the full spectrum of American values. For the 1967 revised edition of *The Modern Corporation*, Berle added a new preface asking, "Why have stockholders?"

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[61] See brief review by James McRitchie of James P. Hawley and Andrew T. Williams, "The Rise of Fiduciary Capitalism: How Institutional Investors Can Make America More Democratic," *Amazon.com*, September 8, 2000. https://www.amazon.com/Rise-Fiduciary-Capitalism-Institutional-Democratic/dp/0812235630.

[62] George Serafeim, "Investors as Stewards of the Commons?" August 7, 2017, *SSRN*. https://ssrn.com/abstract=3014952.

[63] Jonathan Tepper with Denise Hearn, *The Myth of Capitalism: Monopolies and the Death of Competition*, Wiley, 2019, pp. xv-xvi.

> What contribution do they make, entitling them to heirship of half the profits of the industrial system, receivable partly in the form of dividends, and partly in the form of increased market values resulting from undistributed corporate gains? Stockholders toil not, neither do they spin, to earn that reward. They are beneficiaries by position only. Justification for their inheritance must be sought outside classic economic reasoning… justification turns on the distribution as well as the existence of wealth. Its force exists only in direct ratio to the number of individuals who hold such wealth. Justification for the stockholder's existence thus depends on increasing distribution within the American population. Ideally the stockholder's position will be impregnable only when every American family has its fragment of that position and of the wealth by which the opportunity to develop individuality becomes fully actualized."[64]

Participation by every American family in the market and in corporate governance is needed to address growing inequality, a shared sense of powerlessness and our economy's slowing growth rate. As long as 84% of corporate stock is owned and controlled by 10% of Americans, corporations will not be trusted; nor should they be. As noted by the president and CEO of the U.S. Chamber of Commerce, "Despite overall economic gains nationwide, "many Americans have lost faith in core institutions—public and private alike. They don't believe that government or business understand the challenges they face, or are willing or able to address them."[65]

A study by Citi Research and the Oxford Martin School, *Inequality and Prosperity in the Industrialized World*, found: A one percentage point increase in the Gini index for income inequality leads to a fall of two percentage points in the share of individuals who believe that 'most people can be trusted.'

> The literature highlights several potential mechanisms via which inequality could directly erode social trust. First, inequality increases the socioeconomic distance between individuals, reducing the familiarity between them. Second, when greater inequality is perceived as unfair (as exemplified for example in the "we are the 99%" slogan), trust can be easily eroded. Last but not least, as recent events demonstrate, trust in media — an essential component of a functional democracy — can also be undermined. This also undermines common understanding, and subsequent capacity for effective public discourse and debate.[66]

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[64] "The Modern Corporation and Private Property," *Wikipedia,* Last modified June 20, 2018. https://en.wikipedia.org/wiki/The_Modern_Corporation_and_Private_Property.
[65] Thomas J. Donohue, "2018 State of American Business Address," *U.S. Chamber of Commerce*, January 10, 2018. https://www.uschamber.com/speech/2018-state-american-business-address.
[66] Citi & Oxford Martin, "Inequality and Prosperity in the Industrialized World: Addressing a Growing Challenge," *Oxford Martin*, September 2017. https://www.oxfordmartin.ox.ac.uk/downloads/Citi_GPS_Inequality.pdf.

Full Participation Needed to Justify Shareholder Primacy

For capitalism to be compatible with democracy, we not only need investment funds that align with our values,[67] we need participation by most, preferably every American family. Americans have lost faith in our institutions because most do not reap the benefits generated by corporations.

Marjorie Kelly noted at the turn of the century, "investing" in the stock market is speculating, since 99% of the money invested in shares simply represents a bet on future growth. Shareholders are not providing capital to companies. They are buying shares from other shareholders, gambling the price will rise. Only about 1% of shares sold (mostly during the initial public offering) actually finds its way to corporations. A more accurate description of "investors," according to Kelly, would be "extractors."[68] There is little to justify shareholder control over corporations, except historical legal precedent and the fact that shareholder control probably yields better alignment with societal values than managerial control.

The growing phenomenon of founders retaining control with dual-class shares is expected to further increase wealth inequality. (Jackson February 15, 2018) Given the historical rate of returns for capital outpacing growth[69] and recent tax cuts favoring the wealthy, we can expect the pace of income and wealth inequality to accelerate.

While about half of American households own stock, they do so mostly through mutual funds or retirement accounts. Less than 14% of households directly own stock.[70] Of direct shareholders, about two-thirds hold less that $6,000, often through employee stock ownership plans. In 2010, of direct holding families, 29 percent held only one stock; 18 percent held more than ten stocks. Of the families that held shares, the median portfolio was $20,000, while the median retirement account of families with retirement accounts was $44,000.[71]

In the United States, the wealthiest 1% of households own 40% of corporate stock outstanding; the top 5% own 71%; and top 10% own 84%.[72] Capitalism cannot survive if

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[67] James McRitchie, "Internet Will Drive Public Opinion and Proxy Voting to Reflect American Values," *Corporate Governance*, January 31, 2019. https://www.corpgov.net/2019/01/internet-will-drive-public-opinion-and-proxy-voting-to-reflect-american-values/.

[68] James McRitchie, "The Divine Right of Capital: New Corporate Paradigm?" *Corporate Governance*, February 2, 2002. https://www.corpgov.net/2002/02/the-divine-right-of-capital-new-corporate-paradigm/.

[69] John Cassidy, "Piketty's Inequality Story in Six Charts," *The New Yorker*, March 26, 2014. https://www.newyorker.com/news/john-cassidy/pikettys-inequality-story-in-six-charts.

[70] Tepper, p. 197.

[71] Norton Reamer & Jesse Downing, Chapter 1 in *Investment: A History*. NY: Columbia University Press, February 19, 2016, https://books.google.com/books?id=eQFeCwAAQBAJ&printsec=frontcover&dq=inauthor#v=onepage&q&f=false.

[72] Includes direct ownership of stock shares and indirect ownership through mutual funds, trusts, IRAs, Keogh plans, 401(k) plans, and other retirement accounts. All figures are in 2016 dollars. Edward N. Wolf,

it serves 10% of the population or less. The impacts of wealth inequality[73] are too numerous to be adequately covered here. Just focusing on investors, "(t)he benefits of considering income inequality in investment decision making include increased economic growth, improved stability in financial markets, and governmental cohesion."[74] One way to help restore faith in our institutions and further tap the wealth generating capacity of corporations would be to make shareholders of every family in America.

After World War II, the New York Stock Exchange developed a marketing campaign, "Own Your Share of American Business" (OYS), to rebuff communism, restore profitability to retail brokerage firms, and convince Americans to lower capital gains taxes. OYS was never aimed at really transforming America by shifting power from the few to the many. Participation in corporate governance was not one of the objectives. Giving small retail shareholders a "sense" of participating in capitalism was enough.[75]

Imagine, instead, if all Americans had a substantive stake, as well as a meaningful voice in how corporations are governed and corporate resources are deployed. Imagine if investing in shares was promoted as a way to participate in financial returns *and* to vote on what future we want to live in based on each company's "social purpose." Imagine if the SEC took on the role of protecting not just investors as consumers, but in helping investors use their voice in how corporations are governed.

Creating a nation of small shareholders involved in corporate governance could be transformative. How to accomplish that should be a matter of national debate. In order to map the future, it would help to first know how shares are currently being voted on our behalf. Real-time proxy vote disclosure would give us a start. Main Street investors and Mr. and Ms. 401(K) could pick funds based on cost, historical returns *and* proxy voting that aligns with their own values.

"Household Wealth Trends in the United States, 1962-2016: Has Middle Class Wealth Recovered? *"National Bureau of Economic Research,"* November 2017, Page 63. http://www.nber.org/papers/w24085.

[73] "Effects of economic inequality," *Wikipedia*, Last modified January 13, 2019. https://en.wikipedia.org/wiki/Effects_of_economic_inequality.

[74] Steve Lydenberg, Michael Musuraca, William Burckart & Mackenzie Clark, "Why and How Investors Can Respond to Income Inequality," *PRI Principles for Responsible Investment, and TIIP The Investment Integration Project*, October 2018. https://www.unpri.org/download?ac=5599.

[75] James McRitchie, "A Nation of Small Shareholders" review of Janice M. Traflet "A Nation of Small Shareholders: Marketing Wall Street after World War II," *Corporate Governance*, July 17, 2018. https://www.corpgov.net/2018/07/a-nation-of-small-shareholders-review-essay/.

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