



December 14, 2021

Vanessa A. Countryman
Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

Via Electronic Filing

Re: Enhanced Reporting of Proxy Votes by Registered Management Investment Companies; Reporting of Executive Compensation Votes by Institutional Investment Managers (File Number S7-11-21)

Dear Ms. Countryman:

Betterment LLC (“Betterment”) appreciates the opportunity to respond to the Securities and Exchange Commission (“Commission”) proposed regulation, *Enhanced Reporting of Proxy Votes by Registered Management Investment Companies; Reporting of Executive Compensation Votes by Institutional Investment Managers*, File Number S7-11-21 (the “Proposed Rule”).

We agree with the Commission that modernizing the Form N-PX disclosure regime is critical—in particular to ensure an appropriate level of transparency and accountability, as a handful of enormous institutional investors step into an increasingly powerful role, by exercising the proxy voting powers delegated to them by the investing public, including our clients, who invest in their index funds.

The Proposed Rule seeks to address issues the significance of which are hard to overstate. A tectonic shift in the investment industry is underway, putting index fund proxy voting practices in the spotlight. At the same time, the greatest generational wealth transfer in history is about to begin in earnest, with \$7 trillion set to transfer in the next 5 years, a large percentage of which is likely to be invested with the leading firms in the category.¹ Meanwhile, according to Morgan Stanley’s recent research, 99% of millennials, soon to be in receipt of this wealth, express interest in “sustainable investing.”²

¹ <https://www.wsj.com/articles/older-americans-35-trillion-wealth-giving-away-heirs-philanthropy-11625234216>

²

<https://www.businesswire.com/news/home/20211027005375/en/Morgan-Stanley-Sustainable-Signals-U.S.-Individual-Investors-Maintain-Strong-Interest-in-Sustainable-Investing-Despite-COVID-19-Pandemic>



Earlier this year, activist fund Engine No. 1’s dramatic proxy battle victory, tilting Exxon Mobil’s board towards an energy transition, raised awareness for what “sustainable investing” might come to mean in practice for millions of investors. We foresee an increasing amount of asset allocation favoring low-fee index funds that directly advocate for sustainable corporate practices on the basis that they create shareholder value.

We were heartened by then-acting Chair Allison Herren Lee’s speech, who framed the need for Form N-PX reform based on the confluence of two trends—the rise of passive index funds, and the explosive demand for ESG-informed investing products. “Millennials, in particular,” she noted “are increasingly attuned to the specific ways in which funds and companies utilize their money, and their influence will only grow.”³

Having operated for years at the intersection of these two secular shifts, advising primarily millennial investors, we could not agree more with the diagnosis. However, Commissioner Lee’s speech had opened the door to “timelier disclosure”, while the Proposed Rule retains the annual requirement.

We believe that investors will ultimately be better served if large index fund managers are required to disclose how they voted in real-time—that is, as soon as the information is available in their systems. Recognizing that this recommendation would carry meaningful implementation and operating costs, we offer two additional recommendations which we believe would more than mitigate any incremental burden.

Our three recommendations for the Proposed Rule:

1. Entirely remove the requirement to categorize votes by enumerated subject matter
2. Adjust the reporting cadence from annual to real-time
3. Exempt all but the largest passive index funds, holding material positions, from the real-time reporting obligation

By removing the unnecessarily burdensome, prescriptive categorization requirements, while doubling down on the component that matters most systemically, the Proposed Rule can emerge as a paragon of effective regulation—not unreasonably onerous, better tailored to inform investor choice, conducive to market-driven innovation, and well-equipped to endure decades of the change such innovation will deliver.

The enumerated categorization requirement is burdensome and prescriptive

³ <https://www.sec.gov/news/speech/lee-every-vote-counts>

In our view, the obligation for reporting entities to categorize each vote, choosing from a list enumerated in the Proposed Rule, should be removed entirely. It goes beyond the principle, and into prescription, and thus is certain to be outdated prematurely.

The enumerated categories bring to mind another rule the Commission is thankfully in the process of revising⁴, 17a-4, which seeks to ensure the integrity of a broker-dealer's books and records. In its current form, this rule specifies that the only acceptable way to comply when keeping records electronically, is via "write once read many" ("WORM") media—setting out specifications that precisely describe optical disc storage.

Drafted 25 years ago, this requirement began to show its age almost immediately, as technology raced ahead. By the 2010's, the challenge of complying with this critically important rule while utilizing modern technology to operate the business was universally bemoaned across industry, by newcomers and massive incumbents alike. The greatest minds of my generation spent years ensuring that sophisticated, highly secure cloud-based software, thoughtfully engineered to achieve the rule's underlying policy objective, could also satisfy a checklist which was designed with a LaserDisc in mind.

No time machine is required to observe the challenges intrinsic to prescriptive rulemaking. Another commenter draws attention to the "inexplicably narrow pool of proposals that the proposed rule focuses on in establishing its reporting categories and subcategories". The commenter suggests that drawing on issues which happened to be prevalent in 2020 allows for "almost no right-of-center proposals". In calling out political bias implicit within the enumerated classifications, the commenter questions whether they need to exist at all.⁵

On the last point at least, we could not agree more. Unlike 17a-4's WORM requirement, principles-based regulation like the 1940 Advisers Act endures not because those rule makers thought of everything, but because they did not try.

Even if one believes these categories are not "wrong" today, they will be soon enough. Plus, they are not necessary. In the age of APIs, where outputs are generated by software talking to other software, the desired output of the Proposed Rule can be best thought of as "disclosure infrastructure"—human-readable, yes, but primarily building blocks for views of the data that humans will actually consume.

⁴ <https://www.sec.gov/rules/proposed/2021/34-93614.pdf>

⁵ <https://www.sec.gov/comments/s7-11-21/s71121-9436504-263649.pdf>



The market will produce many takes on classifying and presenting this information. Analysts have been assembling value-added reports on proxy activity for years, and with machine-readable inputs, that market will deliver innovative offerings to satisfy evolving investor demand we are not in a position to imagine today.

The need for timelier disclosure: Betterment’s perspective

Launched in 2010, Betterment leverages technology to offer its advisory clients globally diversified portfolios constructed using low-fee exchange traded funds (“ETFs”). As of the date of this submission, Betterment manages \$33 billion on behalf of 700,000 clients, with a median age around 35.

We launched our first Socially Responsible Investing (“SRI”) managed portfolio option in 2017, and for several years, saw meaningful but modest adoption from our client base. It wasn’t until 2020, however, that we saw exponential growth, particularly as we iterated our methodology to focus on the climate-aware pillar of ESG, including the addition of a new “Climate Impact” managed portfolio. In the year since that launch, both the number of clients electing an SRI strategy, and SRI assets under management, have tripled.

In July 2021, we augmented all of our SRI portfolios to include VOTE, an active ownership-focused ETF issued by Engine No. 1 on the tail of their Exxon victory, thereby introducing shareholder engagement as a new prong of SRI to our client base.

Several commenters have suggested that there is no evidence that retail investors have any interest in how index funds vote on their behalf, which would obviate the need for timelier disclosure. Based on direct interactions with our clients, as well as emerging industry-wide trends, we respectfully disagree.

Retail investors attach significance to how index funds exercise shareholder rights

Proxy voting may be a technical, complex aspect of corporate governance, but when investors begin to appreciate its significance, particularly in connection with ESG issues, they care—many deeply.

In a report published in May 2021, Morningstar researchers found that “there is appetite among fund investors for understanding how their funds voted on ESG issues and that they may be prepared to act on this information”.⁶ The report suggested to its authors that index fund proxy voting on investors’ behalf was “the sleeping giant of ESG-oriented investing”. Of those

⁶ <https://www.morningstar.com/articles/1037056/re-envisioning-esg-in-401k-retirement-plans>



surveyed, 61% said that ESG issues should be factored into how funds in their 401(k)s vote, while 75% indicated that they would like to have more of a say in how their funds vote.

Under the existing regulatory regime, the only way such investors can do so is by voting with their dollars—selling one index fund, and buying another—or have their financial adviser do so on their behalf.

Our own experience with our clients around this issue further strengthens our belief that while index fund proxy voting is a technical concept with low awareness today, once investors appreciate its function, they see it as important.

After adding Engine No. 1's VOTE to our clients' SRI portfolios, we sent these clients a multiple choice survey, asking them, as shareholders of the VOTE ETF, which of the following corporate engagements they would personally prefer to see Engine No. 1 tackle next:

1. Push the auto industry for a faster transition to electric vehicles.
2. Push big pharma to disclose the lobbying dollars they use to keep drug prices high.
3. Push big retail to improve hiring practices and pay their workers a fair, living wage.
4. Push another oil giant to get serious about climate change, with the same playbook as Exxon.
5. Other

Over a thousand clients responded, and a significant number wrote into the "Other" comment field. Not a single free-form response expressed skepticism that an index fund should be engaging in this manner on their behalf. Frankly, we were surprised by the level of passion and thought that went into many responses to an optional field in an already optional survey.

It's clear to us that a growing portion of our clients would find the voting records of the index funds we recommend to be material, so we have added this as a consideration factor when building SRI portfolios. For the time being, however, our ability to incorporate this factor on equal footing with others is severely limited by unavailability of reliable and timely data.

Our largely automated asset selection process incorporates a number of data points from the universe of available index funds, including expense ratio, tracking error, and liquidity metrics, all of which are available digitally via APIs, in real time. However, the annual disclosure requirement for the funds' voting records means the information may not be readily available for up to 15 months after a vote took place, which foreshadows a host of challenges..

For example, if a particular index fund has appreciated in value in the year after its selection, only to have its lagging voting record subsequently fail to satisfy some established criteria, is a



client best served by switching to a fund that does, at the cost of realizing taxable gains? These problems will soon cease to be hypothetical, but given the current opportunity to futureproof Form N-PX disclosure, they are entirely avoidable.

Voluntary communications evidence demand for timelier disclosure

To appreciate the mounting demand for index fund voting records on a timelier than annual basis, one needs to look no further than the voluntary actions of the industry itself. Only recently, BlackRock, Vanguard and State Street, the so-called “Big Three” index fund managers, have begun to consistently, if selectively, make this information public well before they are obligated to do so. However, absent a regulatory requirement, these investor communications could be driven not by first principles of winner-agnostic transparency, but primarily by each actor’s public relations and marketing considerations.

The Big Three, along with a handful of their peers, are faced with an intractable business problem, navigating surging investor demand for rapid disclosure on a case-by-case basis. The status quo is both inefficient operationally, and insufficient in output.

For the highest profile shareholder actions, the Big Three often announce their votes just days after the contest, publishing standalone “vote bulletins” with context and analysis of the issue. In the case of this spring’s Exxon proxy battle, BlackRock even made the highly unusual decision to announce its intent to support Engine No.1’s slate the day *before* the vote. However, on dozens of lower profile votes, often addressing the same issues, the Big Three remain silent.

Just recently, the Big Three, led by BlackRock, began to voluntarily profile their stewardship activity on a quarterly basis, in addition to the annual regulatory obligation. These meticulously produced reports include detailed spotlights on certain votes during the quarter, but omit basic detail for others. The Big Three are inconsistent on what data they choose to include, making comparisons impossible even for expert observers, much less for software.

There is no first-mover advantage for any one of these giants to voluntarily provide timely, no-frills disclosure on every vote they cast on the investing public’s behalf. As long as their competitors are not compelled to do the same, doing so would vastly expand the surface area of their already daunting public relations challenges.

The lack of timely, machine-readable disclosure of proxy voting records, as demand for this data builds, is a looming market failure caused by a collective action problem, which thoughtful, lightweight regulation would resolve.



Unreasonably impacted reporting entities should be carved out, provided the Proposed Rule’s overarching objective is not compromised

The Proposed Rule, and the activity it seeks to govern, is important, and details matter, but we believe it matters even more not to miss the forest for the trees. Real-time disclosure of proxy voting by the Big Three is critical to addressing what many commenters believe is a looming governance crisis. Any category of reporting entities that present complications to implementing real-time disclosure should generally be carved out, rather than accommodated via dilution of the rule.

Wherever the rule ultimately lands, it will be unduly onerous on the smallest fund managers. Institute an extremely generous *de minimis* exemption. There are many analogues throughout existing securities regulation which define what constitutes a “material” threshold for a position in a public company’s stock, which the Proposed Rule could incorporate.

In a different vein, concerns have been raised that more-frequent-than-annual proxy voting disclosure could be used to back into an active mutual fund’s positions, presenting a competitive disadvantage. Carve them out.

The list of “trees” can go on. The “forest” is that BlackRock, Vanguard, and State Street collectively hold voting rights for ~20% of the stock of nearly every public company, and that share is growing. The vast majority of assets Betterment manages for its clients is invested in index funds issued by one of the Big Three, and we are not unique in this regard.

We thank the Commission for offering the opportunity to comment on the Proposed Rule, and we would welcome any further engagement on this issue.

Sincerely,

/s/ Boris Khentov
Head of Sustainable Investing