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A Most Ingenious Paradox: Competition vs. Coordination in Mutual Fund Policy

Ann M. Lipton†

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Introduction

Mutual fund regulation is plagued by conflicting impulses. On the one hand, funds are critical investment vehicles that millions of Americans depend on for retirement. These Americans have varying levels of sophistication and resources, and mutual fund regulation is designed to ensure that they are sold products that are appropriate for their needs and risk tolerance levels, at a reasonable fee.

Mutual funds are also, increasingly, a devastatingly powerful economic force. As trillions of dollars flows into these vehicles, the asset managers who control them exercise tremendous influence over where capital flows, how corporations will govern themselves, and what priorities corporate managers will pursue. Regulation is therefore needed not only to ensure that this power is used to benefit investors in the funds, but also to address the very real legitimacy problem that arises when private actors are able to exercise such overweening authority over resource allocation throughout the economy.

Unfortunately, the regulations needed to address these two very different types of problems are often at cross-purposes. Regulations that benefit retirement savers in the short-term may, in the long-term, increase asset managers' power in uncomfortable ways. Asset managers' long-term stewardship over portfolio investments may neglect the immediate interests of individual fund beneficiaries.

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This Essay will discuss some of the tensions inherent in mutual fund regulatory policy and discuss potential paths forward.

I. Competition

The mutual fund has become the most popular vehicle for American investment.[1] These shell entities permit retail investors to reap the benefits of a diversified portfolio under professional management, for a fee that is deducted periodically from fund assets. As regulatory changes encouraged employers to favor 401(k) plans over traditional pension plans,[2] retirement assets gradually shifted into mutual funds, and now U.S. investment companies hold assets worth $26 trillion.[3] Though institutions—like pension funds—may also invest in mutual funds, and some retail investors purchase shares outside the context of retirement planning, mutual funds are also overwhelmingly used as retirement vehicles for individual savers.[4]

For those who choose to invest in mutual funds, a wide variety of options are available. Many mutual funds track an index—namely, a sample of companies selected according to some specific criteria, such as to mirror the market more generally, or to mirror the performance of large cap companies—and the fund (and thus fund investors) pay a licensing fee to the index creator.[5] Alternatively, for higher fees, investors can choose a mutual fund subject to "active" management, namely, a bespoke selection of investments chosen by the fund portfolio manager.[6] These categories—index, or passive, investing, versus active investing—are not necessarily all that far apart; though many index funds track a broad, widely followed index created by an independent entity,[7] many indexes are created by affiliates of the mutual fund companies themselves according to specific criteria, and are followed by only a small number (or even a single) fund.[8]

1. William A. Birdthistle, Empire of the Fund: The Way We Save Now 6 (2016).
2. *See* Martin Gelter, *The Pension System and the Rise of Shareholder Primacy*, 43 Seton Hall L. Rev. 909, 930–31 (2013).
3. Inv. Co. Inst., Investment Company Fact Book, at xii (60th ed. 2020).
4. Birdthistle, *supra* note 1, at 6, 8–9.
5. *See* Adriana Z. Robertson, *Passive in Name Only: Delegated Management and "Index" Investing*, 36 Yale J. on Regul. 795, 847 (2019).
6. *See id.* at 802.
7. *See* Johannes Petry, Jan Fichtner & Eelke Heemskerk, *Steering Capital: The Growing Private Authority of Index Providers in the Age of Passive Asset Management*, 28 Rev. Int'l Pol. Econ. 152, 153 (2019).
8. Robertson, *supra* note 5, at 850.

Unfortunately, many retail investors purchase shares of funds that underperform relative to other available options, whether due to their investment selection, fees, or a combination of both. Multiple funds track the exact same index, differing, in practical effect, only in the fees charged.[9] Active funds, or bespoke indexes, may not be any better. Frequently, they charge high fees that erode into investment returns, and cannot consistently outperform the cheaper passive funds that follow a broad segment of the market.[10] Retail investors may find themselves investing in funds that take on too much risk relative to their needs, and as a result see the value of their investment collapse just when they need it for retirement.[11] Funds may bill themselves as following particularly strategies—such as "sustainability" or "ESG" or value or growth—but the fine print demonstrates that the proposed strategy does not match the funds' investments or its voting and engagement behavior.[12]

In a functioning market, competition would eliminate these high-fee, underperforming funds. And to some extent, that has happened; fees have dropped overall,[13] and investors have dramatically reallocated their dollars from active to passive funds in the past several years (which probably explains the proliferation of purported "index" funds that appear to reallocate what would otherwise be management fees into index licensing fees).[14] Yet problems in the market persist, in large part because many retail investors are either unsophisticated about their options, or cannot afford the search costs associated with identifying more suitable choices.[15]

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9. *See* Jacob Hale Russell, *The Separation of Intelligence and Control: Retirement Savings and the Limits of Soft Paternalism*, 6 Wm. & Mary Bus. L. Rev. 35, 62 (2015); Benjamin P. Edwards, *Conflicts & Capital Allocation*, 78 Ohio St. L.J. 181, 199 (2017); Birdthistle, *supra* note 1, at 78.

10. Birdthistle, *supra* note 1, at 26–27.

11. *Id.* at 168–70.

12. *See* Dana Brakman Reiser & Anne Tucker, *Buyer Beware: Variation and Opacity in ESG and ESG Index Funds*, 41 Cardozo L. Rev. 1921, 1926 (2020); Huaizhi Chen, Lauren Cohen & Umit Gurun, *Don't Take Their Word for It: The Misclassification of Bond Mutual Funds* 1–4 (Nat'l Bureau of Econ. Rsch., Working Paper No. 26423, 2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3474557 [https://perma.cc/4LKU-ST2M].

13. Inv. Co. Inst., *supra* note 3, at 118.

14. Robertson, *supra* note 5, at 843.

15. John Morley & Quinn Curtis, *Taking Exit Rights Seriously: Why Governance and Fee Litigation Don't Work in Mutual Funds*, 120 Yale L.J. 84, 114 (2010).

Retail investors' lack of sophistication has been extensively documented.[16] Investors have trouble understanding fee disclosures, and basic financial concepts such as the value of diversification.[17] They frequently chase past performance as representative of future returns.[18] Those who invest exclusively through a 401(k) plan are even less sophisticated than investors as a whole, and less capable of making prudent financial judgments.[19] Mutual fund sponsors are aware of these problems and can exploit them by targeting the most expensive funds to the least sophisticated investors.[20] The result is that the market's invisible hand is not sufficient to weed out the more predatory funds and asset managers.[21]

There are a number of potential solutions to this problem. For starters, funds and fund sponsors could be more tightly regulated. Greater restrictions could be placed on fees, rather than the relatively light-touch approach that exists now.[22] Funds that follow broad indices could come with disclosure requirements comparing their fees to similar

16. *See* Jill E. Fisch, Tess Wilkinson-Ryan & Kristin Firth, *The Knowledge Gap in Workplace Retirement Investing and the Role of Professional Advisors*, 66 Duke L.J. 633, 634 (2016); Lisa M. Fairfax, *The Securities Law Implications of Financial Illiteracy*, 104 Va. L. Rev. 1065, 1089 (2018); Edwards, *supra* note 9, at 193–95.

17. Fairfax, *supra* note 16, at 1083; Jill E. Fisch & Tess Wilkinson-Ryan, *Why Do Retail Investors Make Costly Mistakes? An Experiment on Mutual Fund Choice*, 162 U. Pa. L. Rev. 605, 643–44 (2014).

18. Quinn Curtis, *The Fiduciary Rule Controversy and the Future of Investment Advice*, 9 Harv. Bus. L. Rev. 53, 61 (2019); Itzhak Ben-David, Francesco Franzoni, Byungwook Kim & Rabih Moussawi, *Competition for Attention in the ETF Space* 8 (Nat'l Bureau of Econ. Rsch., Working Paper No. 28369, 2021), https://www.nber.org/papers/w28369 [https://perma.cc/7ARP-JJY2].

19. Jill E. Fisch, Annamaria Lusardi & Andrea Hasler, *Defined Contribution Plans and the Challenge of Financial Illiteracy*, 105 Cornell L. Rev. 741, 742 (2020).

20. Birdthistle, *supra* note 1, at 77; *see also* Curtis, *supra* note 18, at 61–62; Donald C. Langevoort, *Private Litigation to Enforce Fiduciary Duties in Mutual Funds: Derivative Suits, Disinterested Directors and the Ideology of Investor Sovereignty*, 83 Wash. U. L.Q. 1017, 1033 (2005); Morley & Curtis, *supra* note 15, at 130.

21. Allen Ferrell & John Morley, *New Special Study of the Securities Markets: Institutional Intermediaries* 8 (Yale L. & Econ., Rsch. Paper No. 580, 2017) https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3005542 [https://perma.cc/LA9B-ZJA7].

22. *See* Morley & Curtis, *supra* note 15, at 136–40 (discussing the flaws with the current liability regime for excessive fees and suggesting that price regulation would be more effective); Birdthistle, *supra* note 1, at 80–88 (discussing problems with permitted mutual fund fees).

funds.[23] Fiduciary obligations could be placed on index providers who create bespoke indexes or modify their indexes after consultation with the funds they serve.[24] Regulators could restrict retail investors' ability to invest in more esoteric funds, with licensing or sophistication requirements,[25] not unlike current standards that limit certain investments only to wealthy and sophisticated buyers.[26]

Alternatively, there could be more robust regulation of sales channels. Currently, funds may be sold through brokers, registered investment advisers, or dual-registered entities, and varying degrees of fiduciary responsibility are placed on each.[27] Brokers and dual-registered entities in particular may operate under conflicts that discourage them from offering the cheapest and most appropriate products to their customers.[28] These conflicts could be regulated more tightly, and reforms could be made to the commission structures to discourage sales of subpar funds.[29]

Many funds are offered as options in a menu of choices provided by an employer as part of a 401(k) plan, and though certain fiduciary obligations attach to employers when constructing these menus, these are quite minimal.[30] Some progress has been made inducing lower fee

23. Jill E. Fisch, *Rethinking the Regulation of Securities Intermediaries*, 158 U. Pa. L. Rev. 1961, 2030–31 (2010).

24. *See* Paul G. Mahoney & Adriana Z. Robertson, *Advisers by Another Name* 44 (Va. L. & Econ., Rsch. Paper No. 2021-01, 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3767087 [https://perma.cc/8LDB-TKDS].

25. *See* Birdthistle, *supra* note 1, at 207–08; Ian Ayres & Quinn Curtis, *Beyond Diversification: The Pervasive Problem of Excessive Fees and "Dominated Funds" in 401(k) Plans*, 124 Yale L.J. 1476, 1525–26 (2015). The SEC briefly floated the idea of requiring brokers and investment advisers to assess their clients' level of sophistication before selling them certain types of funds, but dropped the proposal upon industry pushback. *See* Justin Baer & Paul Kiernan, *Leveraged-ETF Seller Urges Investors to Fight Proposed Regulation*, Wall St. J. (Jan. 30, 2020, 8:28 AM), https://www.wsj.com/articles/leveraged-etf-seller-urges-investors-to-fight-proposed-regulation-11580390914 [https://perma.cc/P3NK-WTQT].

26. Usha Rodrigues, *Securities Law's Dirty Little Secret*, 81 Fordham L. Rev. 3389, 3395 (2013).

27. *See* Nicole M. Boyson, *The Worst of Both Worlds? Dual-Registered Investment Advisers* 1 (Ne. U. D'Amore-McKim Sch. Of Bus., Rsch. Paper No. 3360537, 2019), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3360537 [https://perma.cc/U4VS-D5HF]; Curtis, *supra* note 18, at 59.

28. Boyson, *supra* note 27, at 3; *see* Curtis, *supra* note 18, at 56.

29. Curtis, *supra* note 18, at 87.

30. Fisch, et al., *supra* note 19, at 754–57.

options in 401(k) plans,[31] but there still may be far too many choices for investors to reasonably parse.[32]

There are likely many reasons we have *not* adopted these measures—including, but not limited to, legal roadblocks[33] and the lobbying power of the financial industry,[34]—but at least one issue concerns the inescapable reality that for most retail investors, there should not be many investment options at all. Most retail investors would do best with a passive fund that rebalances to limit risk as their retirement date nears.[35] In fact, when the Obama administration proposed stronger fiduciary obligations for brokers, one of the main objections was that the rules would, as a practical matter, require brokers to sell the same limited set of products to all clients.[36]

That said, however optimal a cheap, simple, passive strategy may be for retail investors, the curtailment of investors' choices would result in an extraordinary concentration within the asset management industry. There is no need to have multiple competing complexes if most investors are following a limited set of broad market indexes; indeed, William Birdthistle proposed that a single asset manager,

31. Curtis, *supra* note 18, at 91.

32. Fisch, et al., *supra* note 19, at 755–57.

33. *See* Chamber of Com. v. U.S. Dep't of Lab., 885 F.3d 360, 388 (5th Cir. 2018).

34. Ben McLannahan & Alistair Gray, *Lobbyists Prepare New Fight to Reverse US Fiduciary Rule*, Fin. Times (May 23, 2017), https://www.ft.com/content/3dd4ad40-3ff5-11e7-9d56-25f963e998b2 [https://perma.cc/L5LQ-PJ3Y].

35. Curtis, *supra* note 18, at 96.

36. *See, e.g.*, Andrew Ackerman & Karen Damato, *Obama Backs New Rules for Brokers on Retirement Accounts*, Wall St. J. (Feb. 23, 2015, 6:39 PM), https://www.wsj.com/articles/obama-to-back-new-rules-for-brokers-on-retirement-accounts-1424689201 [https://perma.cc/R9ST-LXKK] ("Wall Street groups warn the rules could crimp investors' choices by limiting the range of retirement products brokers can pitch . . . ."); Anthony Scaramucci, *Your 401(k) Doesn't Need a Federal Babysitter*, Wall St. J. (Nov. 2, 2016), https://www.wsj.com/articles/your-401-k-doesnt-need-a-federal-babysitter-1478042244 [https://perma.cc/M3HB-TGJ8] (warning the rules will "[p]ush investors excessively into passive index funds"); Michael Wursthorn, *Watch Out, Retirement Savers, Your Choices Are Poised to Shrink*, Wall St. J. (Aug. 18, 2016, 6:45 PM), https://www.wsj.com/articles/watch-out-retirement-savers-your-choices-are-poised-to-shrink-1471560128 [https://perma.cc/2VNB-NBD6] ("Some clients will see their investment options diminished or face the prospect of higher fees."); *Reactions to the Labor Department's Fiduciary Rule*, Wall St. J. (Apr. 6, 2016, 6:12 PM), https://www.wsj.com/articles/reactions-to-the-labor-departments-fiduciary-rule-1459954904 [https://perma.cc/5NEV-ZBPB] ("It will encourage more money to flow into passives, ETFs and low-cost funds, which is not good for traditional asset management profitability.").

BlackRock, handle all of America's retirement plans.[37] That presents a problem not only for the industry itself, but also for all of corporate America: through its mutual funds, a single financial institution would control a sizeable equity stake in every U.S. publicly traded company. The power and influence represented by holdings of that size would present a significant economic and *political* problem: It would allow a single, private actor to set the agenda for a massive swath of the economy.

To be sure, that concentration is already occurring. In the past decade, "[t]he share of assets managed by the five largest firms rose from 35 percent at year-end 2005 to 53 percent at year-end 2019, and the share managed by the 10 largest firms increased from 46 percent to 64 percent."[38] The three largest index fund managers, BlackRock, Vanguard, and State Street, together constitute the largest investor in 88% of the S&P 500,[39] with holdings averaging at around 22% per company, up from 13.5% in 2008.[40] Nearly a third of the companies in the S&P 500 have four or fewer shareholders holding roughly 20% of their stock.[41] The growth and consolidation of the industry has resulted in "a concentration of corporate ownership, not seen since the days of J.P. Morgan and J.D. Rockefeller."[42]

Numerous commenters have sounded the alarm over the *political* power exercised by this kind of concentration of equity ownership among a very small number of financial institutions.[43] That concern is part of a long American tradition of distrusting—and regulating to

37. Birdthistle, *supra* note 1, at 213–14.

38. Inv. Co. Inst., *supra* note 3, at 46.

39. Jan Fichtner, Eelke M. Heemskerk & Javier Garcia-Bernardo, *Hidden Power of the Big Three? Passive Index Funds, Re-concentration of Corporate Ownership, and New Financial Risk*, 19 Bus. & Pol. 298, 313 (2017).

40. David McLaughlin & Annie Massa, *The Hidden Dangers of the Great Index Fund Takeover*, Bloomberg Businessweek (Jan. 9, 2020, 12:40 PM), https://www.bloomberg.com/news/features/2020-01-09/the-hidden-dangers-of-the-great-index-fund-takeover [https://perma.cc/9VCW-LMZF].

41. John C. Coates, *The Future of Corporate Governance Part I: The Problem of Twelve* 13 (Harvard Pub. L., Working Paper No. 19-07, 2018), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3247337 [https://perma.cc/9NZG-T8Y6].

42. Fichtner et al., *supra* note 39, at 315.

43. Coates, *supra* note 41, at 2; Fichtner et al., *supra* note 39, at 319; *cf.* Lucian Bebchuk & Scott Hirst, *Index Funds and the Future of Corporate Governance: Theory, Evidence, and Policy*, 119 Colum. L. Rev. 2029, 2128–29 (2019) (recognizing the "policy concerns" raised by the "growing concentration of equity in the hands of three large players").

prevent—concentrated financial power.[44] Additionally, some voices have objected to the popularity of index investing in general, concerned that it contributes to market inefficiencies.[45] Further attempts to limit mutual fund options would only exacerbate these problems.

In other words, we have a paradox in that the regulatory strategies that would most benefit America's retirees would not be optimal for markets—or the economy—as a whole. And so competition is maintained in the industry, which ultimately impedes efforts to improve outcomes for individual savers.

II. Coordination

If one part of the regulatory apparatus encourages competition, other parts encourage cooperation—specifically, cooperation among funds within a single complex.

Corporate theory has long grappled with the problem of how to address agency costs associated with the separation of ownership and control.[46] In any company where the equity owners hire professional managers, there is a risk that the managers will either shirk their responsibilities or generally act to advance their own interests rather than the owners'.[47] Yet if the circle of ownership is small, and each owner has a large stake, they presumably will be able to oversee the managers' performance and discipline them for straying from the owners' interests. In a public company, however, that oversight is lessened. Dispersed shareholders may not individually have large enough stakes to justify the expense of close oversight; as a result, there

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44. Mark J. Roe, Strong Managers, Weak Owners: The Political Roots of American Corporate Finance, at xiv–xv (1994); Coates, *supra* note 41, at 2–3; *see* Marcel Kahan & Edward B. Rock, *Index Funds and Corporate Governance: Let Shareholders Be Shareholders*, 100 B.U. L. Rev. 1771, 1798 (2020) (recognizing that "BlackRock faces political risk" from the "historical suspicion of concentrated economic power in the United States").

45. *E.g.*, Alicia McElhaney, *Is Passive Investing Making Markets Dumb?*, Inst'l Inv. (Sept. 18, 2018), https://www.institutionalinvestor.com/article/b1b0glsqj5j134/Is-Passive-Investing-Making-Markets-Dumb [https://perma.cc/LZ9E-JBU4]; Vladyslav Sushko & Grant Turner, *The Implications of Passive Investing for Securities Markets*, BIS Q. Rev., Mar. 2018, at 113, 119, https://www.bis.org/publ/qtrpdf/r_qt1803j.pdf [https://perma.cc/6XB8-2PDW]; Luke Kawa, *Bernstein: Passive Investing Is Worse for Society than Marxism*, Bloomberg (Aug. 23, 2016, 2:23 PM), https://www.bloomberg.com/news/articles/2016-08-23/bernstein-passive-investing-is-worse-for-society-than-marxism [https://perma.cc/XQS4-2LLD].

46. Dorothy S. Lund, *The Case Against Passive Shareholder Voting*, 43 J. Corp. L. 493, 498–99 (2018).

47. *See* Coates, *supra* note 41, at 17 .

is a greater risk of managerial faithlessness.[48] Corporate law and securities regulation have been amended and retheorized repeatedly over the past several decades to find new solutions to this problem, including placing greater disclosure obligations on public companies (to lower the costs of shareholder monitoring),[49] and loosening restrictions on shareholder cooperation (to overcome some of the collective action costs).[50]

The rise of institutional shareholders has been a source of hope to both regulators and theorists alike as a potential solution to shareholders' collective action problem. Institutions, the theory goes, have large enough stakes to make it worthwhile to monitor their portfolio companies; meanwhile, professionalized management ensures they have the skills to do so.[51]

The difficulty is that institutional shareholders are not a monolith. Many are asset managers that sponsor hundreds of funds, each of which holds a different, diversified portfolio.[52] The asset manager earns fees in the form of a percentage of assets under management; thus, as asset size increases, so does the size of the fee.[53] Though this would nominally suggest that the asset managers have an interest in exercising oversight over portfolio companies so as to increase their value (and thus the value of the fund, and fees to the manager), in fact, when viewed on a fund-by-fund basis, each fund's holdings may not be large enough to justify the kind of oversight that many theorists seem to want.

As a result, the expectation has been for *cooperation* over competition, at least when it comes to stewardship over investments.[54]

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48. Bernard S. Black, *Agents Watching Agents: The Promise of Institutional Investor Voice*, 39 UCLA L. Rev. 811, 821 (1992).

49. Jeffrey N. Gordon, *The Rise of Independent Directors in the United States, 1950–2005: Of Shareholder Value and Stock Market Prices*, 59 Stan. L. Rev. 1465, 1548 (2007).

50. John C. Coffee, Jr. & Darius Palia, *The Wolf at the Door: The Impact of Hedge Fund Activism on Corporate Governance*, 41 J. Corp. L. 545, 559–60 (2016).

51. Div. of Corp. Fin., Sec. & Exch. Comm'n, Staff Report on Corporate Accountability: A Re-Examination of Rules Relating to Shareholder Communications, Shareholder Participation in the Corporate Electoral Process and Corporate Governance Generally 383 (1980); Black, *supra* note 48, at 831; Ronald J. Gilson & Jeffrey N. Gordon, *The Agency Costs of Agency Capitalism: Activist Investors and the Reevaluation of Governance Rights*, 113 Colum. L. Rev. 863, 867 (2013).

52. Bebchuk & Hirst, *supra* note 43, at 2050.

53. Kahan & Rock, *supra* note 44, at 1782.

54. Numerous academics have extolled the promise of institutional shareholder monitoring, often assuming that incentives arise from holdings across the entire family, rather than on a fund-by-fund basis. *See, e.g.*, Kahan & Rock,

Even though each mutual fund is a separate entity with a distinct portfolio, most advisors centralize voting behavior.[55] The largest asset managers—which not only manage mutual funds, but also hedge funds and other kinds of accounts—may also include these entities within their voting policy.[56] Though some fund families may give individual portfolio managers greater or lesser freedom to go their own way, others may be quite strict about requiring adherence to the family line.[57]

Advocates see benefits to encouraging families to pool their votes as though all of their holdings were part of a single portfolio. When the entire portfolio is collectivized in this way, the apparent incentives to exercise oversight over each company—whose shares may be held in multiple funds—is far greater.[58] Moreover, across fund families, asset managers' fortunes are tied to the economy as a whole, thus they may have an interest in promoting corporate governance changes that benefit society overall.[59] For example, large, diversified investors may

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supra note 44, at 1785; Bebchuk & Hirst, *supra* note 43, at 2046, 2050, 2080; *See generally* Asaf Eckstein, *The Virtue of Common Ownership in an Era of Corporate Compliance*, 105 IOWA L. REV. 507 (2020)(arguing that large asset managers are well-incentivized and positioned to ensure their portfolio firms comply with the law).

55. Bebchuk & Hirst, *supra* note 43, at 2064.

56. John D. Morley, *Too Big to Be Activist*, 92 S. CAL. L. REV. 1407, 1421–22 (2019); Ann M. Lipton, *Family Loyalty: Mutual Fund Voting and Fiduciary Obligation*, 19 TRANSACTIONS: TENN. J. BUS. L. 175, 187–89 (2017); Fichtner et al., *supra* note 39, at 316–17.

57. Sean J. Griffith & Dorothy S. Lund, *Conflicted Mutual Fund Voting in Corporate Law*, 99 B.U. L. REV. 1151, 1171 (2019); Morley, *supra* note 56, at 1421–22; Asaf Eckstein, The Push Toward Corporate Guidelines 18–19 (Oct. 5, 2020) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3705140 [https://perma.cc/SL3H-VZVM].

Vanguard and Fidelity have separately delegated voting authority for the passive and active funds, apparently to avoid aggregation under Section 13(d) of the Exchange Act. *See* Thomas Franck, *Vanguard to Surrender Some of Its Corporate Voting Power to External Fund Managers*, CNBC (Apr. 25, 2019, 2:26 PM), https://www.cnbc.com/2019/04/25/vanguard-to-give-up-some-of-its-voting-power-to-external-fund-managers.html [https://perma.cc/8WKN-SS3Z]; Stephen Choi, Jill Fisch & Marcel Kahan, *Who Calls the Shots? How Mutual Funds Vote on Director Elections*, 3 HARV. BUS. L. REV. 35, 49 (2013); *see also* Morley, *supra* note 56, at 1423–30.

58. Kahan & Rock, *supra* note 44, at 1785–88.

59. John C. Coffee, *The Future of Disclosure: ESG, Common Ownership, and Systematic Risk* 43 (Eur. Corp. Governance Inst., Working Paper No. 541/2020, 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3678197 [https://perma.cc/6XXR-345P]; Jim Hawley & Jon Lukomnik, *The Long and Short of It: Are We Asking the Right Questions? Modern Portfolio Theory and Time Horizons*, 41 SEATTLE U. L. REV. 449, 450 (2018).

want to reduce carbon emissions because climate change damages their entire portfolio.[60] In the wake of the Black Lives Matter movement, large mutual fund families publicly announced they would monitor their portfolio investments' commitment to diversity.[61] These may have been public relations moves, but they also may have reflected an understanding that racial discrimination harms the economy,[62] and thus harms diversified investors.

The downside to this kind of coordination is that because funds have different mixes of investments, they may not always have the same interests. Though a simplistic view of corporate governance posits that each firm must simply maximize its individual wealth—and each investor will vote to advance that goal—in fact, a portfolio holder may find that wealth maximization at an individual company does not equal wealth maximization at the fund level. For example, portfolios that include both stock and debt in a single company may vote the stock in a way that maximizes the value of the debt, while pure stockholders would choose a different strategy.[63] A fund might rationally vote to encourage an oil company to reduce carbon emissions—even at the expense of the oil company's profits—if the specter of climate change was damaging other investments in the portfolio.[64] But that means that a *nondiversified* energy fund might prefer that the oil company

60. Madison Condon, *Externalities and the Common Owner*, 95 Wash. L. Rev. 1, 4–6 (2020).

61. Billy Nauman, *US Investors Demand Data in Fight Against Racial Discrimination*, Fin. Times (July 27, 2020), https://www.ft.com/content/1dffac98-fd4e-4288-8683-8f84e236d335 [https://perma.cc/UYV4-FPJJ]; Billy Nauman, *State Street to Insist Companies Disclose Diversity Data*, Fin. Times (Jan. 10, 2021), https://www.ft.com/content/2e512c76-4733-4821-8425-136ab9b98426 [https://perma.cc/T3PJ-WPUR].

62. *See* Adedayo Akala, *Cost Of Racism: U.S. Economy Lost $16 Trillion Because of Discrimination, Bank Says*, NPR (Sept. 23, 2020, 2:42 PM), https://www.npr.org/sections/live-updates-protests-for-racial-justice/2020/09/23/916022472/cost-of-racism-u-s-economy-lost-16-trillion-because-of-discrimination-bank-says [https://perma.cc/Y3YS-LRT8]; Steve Matthews & Catarina Saraiva, *Fed Finds Race, Gender Disparities Cut U.S. GDP by $2.6 Trillion*, Bloomberg (Feb. 2, 2021, 11:32 AM), https://www.bloomberg.com/news/articles/2021-02-02/fed-finds-race-gender-disparities-cut-u-s-gdp-by-2-6-trillion [https://perma.cc/R85R-YCMY].

63. Lipton, *supra* note 56, at 190; *see also* Tao Chen, Li Zhang & Qifei Zhu, Dual Ownership and Risk-taking Incentives in Managerial Compensation 1 (July 26, 2019) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3427030 [https://perma.cc/LBG4-3TM3]; Aneel Keswani, Anh Tran & Paolo Volpin, *Institutional Debt Holder Governance* 28–29 (Eur. Corp. Governance Inst., Working Paper No. 613/2019, 2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3282394 [https://perma.cc/XM8V-DRRT].

64. Condon, *supra* note 60, at 5–6.

maximize its profits, and treating all of the funds as though they were part of one portfolio elides these differences.[65] The more that fund families sponsor niche funds, the more these differences are exacerbated. For example, sustainability funds sponsored by large index providers like BlackRock and Vanguard, apparently vote against environmental and social proposals when it is in the interests of the fund family to do so.[66]

In other words, vote coordination may allow institutional share–holders to fulfill their promise as corporate stewards, but just as breaking funds up into competitive families sacrifices the interests of retail investors in favor of a broader economic plan, allowing funds to coordinate their votes to benefit the economy sacrifices the interests of investors who may only hold shares in a single fund.[67]

To be sure, it may be perfectly reasonable for individual portfolio managers, acting in the interests of a particular fund, to direct the fund to vote its shares with the family. Votes are only valuable en masse; it may be rational for a fund to "sacrifice" its interests on certain votes in order to receive the benefits of speaking with a single voice on other

65. Lipton, *supra* note 56, at 190; Griffith & Lund, *supra* note 57, at 1182–86; Sean J. Griffith, *Opt-In Stewardship: Toward an Optimal Delegation of Mutual Fund Voting Authority*, 98 Tex. L. Rev. 983, 1013–14 (2020); Lucian A. Bebchuk, Alma Cohen & Scott Hirst, *The Agency Problems of Institutional Investors*, 31 J. Econ. Persps. 89, 99 (2017) ("[T]he fact that a given actively managed fund is overweight in a particular corporation might be offset by the fact that other actively managed funds within the same fund family might be underweight. The investment manager of the fund family will have an incentive to bring about an increase in value only if its actively managed funds are on the whole overweight in this corporation . . . ."); Morley, *supra* note 56, at 1439–41.

66. *See* Roni Michaely, Guillem Ordonez-Calafi, & Silvina Rubio, *ES Votes that Matter*, (Eur. Corp. Governance Inst., Finance Working Paper, Paper No. 774/2021, 2021) https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3884917 [https://perma.cc/7XVT-P89B].

67. Vanguard's structure could—but in practical effect does not—break the mold. As described above, Vanguard, like all asset managers, collects fees based on the size of its funds; its incentives to oversee portfolio companies therefore arise, in large part, from the fact that if its funds increase in value, Vanguard's fees increase as well. Unusually, however, the Vanguard asset manager is owned by its funds; thus, theoretically, each fund benefits when Vanguard itself benefits, giving each fund an (indirect) stake in the performance of the other funds in the family. John Morley, *The Separation of Funds and Managers: A Theory of Investment Fund Structure and Regulation*, 123 Yale L.J. 1228, 1276 (2014). But Vanguard uses a set of contractual devices to eliminate each fund's claim on the residual earnings of the management company. *Id.* at 1276–77. Thus, though on the surface each of Vanguard's funds might seem to have an interest in the success of the others, Vanguard has chosen to eliminate that shared interest.

matters.[68] The difficulty is that there is little reason to believe fund managers are in fact conducting that level of analysis; voting policy within a family is dictated from the top down.

Oddly, although this practice arguably violates funds' fiduciary duties under federal and state law,[69] it has not (yet) been the focus of regulatory attention.[70] Eventually, however, regulators will have to determine what funds' obligations are with respect to vote pooling. Their policy choices will reflect their view of the proper balance between using mutual fund complexes as a tool to oversee the economy, versus their immediate obligations to retail clients.

But if the regulatory system encourages the proliferation of funds out of a distrust of concentrated economic power, the problem is simply reproduced when massive fund families are permitted to coordinate their voting behavior. Indeed, the real-world effects of this concentrated power may already be exhibiting themselves; several researchers have argued that when a fund family takes large stakes in firms in the same industry, competition between the firms is lessened, to the detriment of other stakeholders.[71]

One solution, proposed by Lucian Bebchuk and Scott Hirst, would be to limit the holdings of mutual fund families to 5% of a given company's stock, which, they argue, is enough to provide incentives for oversight but not so high an amount as to create undue economic

68. Lipton, *supra* note 56, at 196–97.

69. *See id.* at 192–95.

70. *But see* Elad L. Roisman, Comm'r, Sec. & Exch. Comm'n, Keynote Remarks: ICI Mutual Funds and Investment Management Conference (Mar. 18, 2019), https://www.sec.gov/news/speech/speech-roisman-031819 [https://perma.cc/657M-57WG] (expressing the SEC commissioner's con– cern about centralized voting).

71. Martin C. Schmalz, *Common-Ownership Concentration and Corporate Conduct* 9 (CESifo Working Paper No. 6908, 2018), https://papers.ssrn .com/sol3/papers.cfm?abstract_id=3046829 [https://perma.cc/JC5T-AS 33]; Einer Elhauge, *Horizontal Shareholding*, 129 HARV. L. REV. 1267, 1279 (2016); Miguel Antón, Florian Ederer, Mireia Giné & Martin C. Schmalz, *Common Ownership, Competition, and Top Management Incentives* 1 (Eur. Corp. Governance Inst., Working Paper No. 511/2017, 2021) https:// papers.ssrn.com/sol3/papers.cfm?abstract_id=2802332 [https://perma.cc/ NJR9-Q96Y]; Jose Azar, Martin C. Schmalz & Isabel Tecu, *Anticompetitive Effects of Common Ownership*, 73 J. FIN. 1513 (2018); *see also* Zohar Goshen & Doran Levit, *Common Ownership and the Decline of the American Worker*, (Columbia L. & Econ., Working Paper No. 653, 2021) (arguing that concentration of ownership among a small number of large mutual fund families contributes to wage stagnation) https://papers.ssrn. com/sol3/papers.cfm?abstract_id=3832069 [https://perma.cc/UJ5M-6Q8 K].

concentration.[72] This, again, though, might encourage the fracturing of the mutual fund industry, with the dysfunction that follows. Meanwhile, Eric Posner, Fiona Morton, and E. Glen Weyl contend that mutual funds' outsized power over the economy is tied to their diversification, and therefore fund families should be limited in their ability to own stocks in competing companies.[73] That might encourage improved corporate oversight[74] but not only would further encourage market fracturing among mutual fund complexes,[75] it may also worsen outcomes for the retail shareholders who would bear less diversified risk.

III. Regulatory Misfires

Rather than move in these directions, regulators have sought to disrupt shareholder coordination by targeting all investors generally rather than mutual funds specifically. For example, a recent bete noir of companies chafing under investor oversight has been the proxy advisor system. Proxy advisors, like ISS and Glass-Lewis, analyze the myriad issues that appear on corporate proxy ballots, and issue reports to institutional investors offering commentary and voting recommen–dations.[76] Through this process, proxy advisors make it easier for shareholders to coordinate their votes and express coherent preferences. Though many have accused institutional investors of blindly following proxy advisors' recommendations,[77] the matter is not so simple: ISS and Glass-Lewis tailor their recommendations to the preferences of large institutions,[78] and may serve more of an "agenda-setting" function by

72. Bebchuk & Hirst, *supra* note 43, at 2129; *see also* Goshen & Levit, *supra* note 71 (recommending limits on assets under management).

73. Eric A. Posner, Fiona M. Scott Morton & E. Glen Weyl, *A Proposal to Limit the Anticompetitive Power of Institutional Investors*, 81 Antitrust L.J. 669, 672, 724 (2017).

74. Depending, of course, of one's definition of improved, eliminating common ownership might eliminate incentives to reduce systemic risk, see *supra* notes 72–73 and accompanying text, or industry-wide compliance risk, see Asaf Eckstein, *supra* note 54, at 511–12.

75. Their proposal would make exceptions for some "pure" index funds that remained entirely passive, and for families that limited the size of their holdings, which presumably would encourage a proliferation of families.

76. Andrew F. Tuch, *Proxy Advisor Influence in a Comparative Light*, 99 B.U. L. Rev. 1459, 1464 (2019).

77. *E.g.*, Paul Rose, Robovoting and Proxy Vote Disclosure 1 (Nov. 26, 2019) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3486322 [https://perma.cc/W9SQ-Y8S3].

78. Asaf Eckstein, The Push Toward Corporate Guidelines 58 (Oct. 14, 2020) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3705140 [https://perma.cc/HPB7-GSK5]; Stephen Choi, Jill Fisch & Marcel Kahan, *The Power of Proxy Advisors: Myth or Reality?*,

identifying key matters in what would otherwise be a cacophony of issues that are presented to shareholders every year.[79]

In recognition of proxy advisors' rising influence, the SEC recently proposed rules that would have required, among other things, that proxy advisors distribute drafts of their reports to issuing companies for their comment before sending them to investors.[80] These rules would have made it far more expensive for proxy advisors to operate, and incentivized them toward recommending that shareholders vote with management.[81] The final rules are less draconian; among other things, they only require that issuers be given a copy of the report at the same time that it is distributed to investors, and that the proxy advisor send its clients hyperlinks to any issuer responses.[82] But additional SEC guidance warning institutional investors of their duty to review issuer responses before casting a ballot may disrupt or burden the voting process.[83]

Rule 14a-8 is another mechanism by which shareholders coordinate with each other and express preferences about how corporations should be run.[84] Rule 14a-8 allows shareholders to include proposals on the corporate proxy ballot for other shareholders to vote on. They are typically used to advocate for particular governance arrangements—such as destaggered boards, the separation of the chair and CEO roles, and so forth—or to request that the company engage on social and

59 Emory L.J. 869, 883 (2010); Chong Shu, The Proxy Advisory Industry: Influencing and Being Influenced 3–4, (Dec. 22, 2020) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3614314 [https://perma.cc/3E4Q-WN2Q].

79. Douglas Sarro, *Proxy Advisors as Issue Spotters*, 15 Brook. J. Corp. Fin. & Com. L. (forthcoming 2021) (manuscript at 3), *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3699227 [https://perma.cc/R4VW-L8HG].

80. Amendments to Exemptions from the Proxy Rules for Proxy Voting Advice, 84 Fed. Reg. 66,518 (proposed Dec. 4, 2019) (to be codified at 17 C.F.R. pt. 240).

81. Robert J. Jackson Jr., *Statement on Proposals to Restrict Shareholder Voting*, Sec. & Exch. Comm'n (Nov. 5, 2019), https://www.sec.gov/news/public-statement/statement-jackson-2019-11-05-open-meeting [https://perma.cc/AJ9X-GXJQ] (calling the proposal a "tax" on "anti-management advice").

82. Exemptions from the Proxy Rules for Proxy Voting Advice, 85 Fed. Reg. 55,082, 55,110 & n.346 (Sept. 3, 2020) (to be codified at 17 C.F.R. pt. 240).

83. *See* Supplement to Commission Guidance Regarding Proxy Voting Responsibilities of Investment Advisers, 85 Fed. Reg. 55,155, 55,157 (Sept. 3, 2020).

84. Shareholder Proposals, 17 C.F.R. § 240.14a-8 (2020).

environmental issues, such as being more transparent about political spending or workforce diversity and pay disparities.[85]

Shareholder proposals are influential not just at the targeted corporation, but also at a wide swath of companies, because a favorable vote on a particular proposal sends a signal to other corporations as to what shareholders demand. The votes also allow shareholders to see *what other shareholders* are thinking and learn from it. Merely putting a proposal on the ballot allows ISS and Glass-Lewis to comment on the proposal, which makes it easier for shareholders to form their own judgments. Through shareholder proposals, markets can come to consensus about various corporate reforms.

In a recent rulemaking, the SEC dramatically restricted shareholders' ability to use Rule 14a-8, imposing much higher ownership thresholds before shareholders can offer a proposal, and limiting shareholders' ability to re-propose failed proposals in successive years.[86] These changes may be rolled back by the Biden Administration, but assuming they take effect, they would limit investors' ability to coordinate with each other and exercise control over their portfolio companies.

The ironic side effect of these actions, though, will likely be to *enhance* the power of the largest mutual fund families while minimizing the power of other shareholders. So long as the largest families coordinate their voting behavior across their funds, they do not need to use the proposal process to communicate their desires to management; they simply need to make a phone call.[87] They have sufficient in-house resources to determine their corporate governance preferences without

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85. *E.g.*, Philip Stamatakos & Joel May, *How to Respond to Shareholder Proposals Seeking Board Declassification*, Deal Laws., Jan.–Feb. 2011, at 1 (discussing board de-staggering); Craig McGuire, *What is a Shareholder Proposal?*, S'holder Activist, http://theshareholderactivist.com/shareholder-activism-spotlight/what-is-a-shareholder-proposal/ [https://perma.cc/KBF7-ZLM6] (last visited Mar. 13, 2021) ("Some typical uses of shareholder proposals are to address issues with management compensation, change shareholder voting rights, focus on a policy related to a social or environmental issue, or to advocate for corporate charitable contributions.").

86. Procedural Requirements and Resubmission Thresholds Under Exchange Act Rule 14a-8, 85 Fed. Reg. 70,240 (Nov. 4, 2020) (to be codified at 17 C.F.R. pt. 240).

87. *See* Brandon Rees, Deputy Dir. Corps. & Cap. Mkts., Am. Fed'n of Lab. and Cong. Indus. Orgs., Security and Exchange Commission Round Table on the Proxy Process 150:8–16 (Nov. 15, 2018) ("Large institutional investors—the Blackrocks and State Streets and Vanguards of the world—do not need the shareholder proposal rule process to get the attention of management or the board of directors. There's not a corporate secretary or investor relations department in the country that would not return their call within 24 hours.").

relying as heavily on proxy advisors,[88] and they can coordinate preferences in private conferences with other large investors.[89]

If Rule 14a-8 proposals are rarer, that only means that the very largest asset managers will not be forced to take public positions on matters of corporate governance, while still maintaining their ability to influence corporate managers in private. They are not obligated to disclose voting policies on matters that never come up for a vote. If it becomes harder or more expensive for ISS and Glass-Lewis to operate, the coordination costs will be felt by the smaller shareholders who rely more on their counsel, leaving it to the giants alone to influence corporate policy.

In other words, moves targeted at disrupting shareholder coordination will have the ironic effect of increasing the influence of the largest asset managers, and reducing their transparency and accountability to the public.

IV. A Balancing Act

There may be no obvious way out of this dilemma, in a world where we both encourage, and discourage, the enormous accumulation of capital. Asset managers need to be just disaggregated enough not to represent a political threat, but not so disaggregated that predatory funds proliferate and their ability to exercise oversight over portfolio companies is undermined. Improvement in one direction causes deterioration in another.

At least one possibility is to recognize, and remedy, the fact that America is uniquely reliant on private savings to protect people in retirement. Many countries have a more robust public retirement system to serve as a safety net; American Social Security benefits are stingy by comparison.[90] That puts enormous pressure on private savings to provide basic needs that are uniform across most of the population. If these needs were met via government benefits, there really would be an appropriate market, targeted to wealthier beneficiaries, for tailored and varied private retirement options. This class of savers might also be sophisticated enough to avoid more predatory plans.[91] Redirecting savings from private actors to a government plan might also lessen the power of the investment giants, which would satisfy political concerns, while possibly leaving them still large enough to engage in effective stewardship over portfolio companies. Moreover, if the power of these

88. Bebchuk & Hirst, *supra* note 43, at 2078.

89. Coates, *supra* note 41, at 15.

90. *See generally* Mercer & CFA Inst., Glob. Pension Index 8 (2020) (assigning grades to various systems throughout the world).

91. *Cf.* Fisch et al., *supra* note 19, at 743–44 (noting that involuntary workplace investors, by contrast, are not sophisticated enough to avoid more predatory plans).

giants is lessened by redirecting a portion of what is now private savings into a government pension, there might be less discomfort with stronger regulation that functionally eliminates the more predatory funds and families entirely.

There may also be regulatory mechanisms to balance the competing goals of preserving fund families' oversight capabilities, minimizing their political power, and protecting the distinct interests of investors in each fund.

One option is, in a sense, *architectural*: regulators could *mute*, but not eliminate, the families' influence by introducing friction into the coordination process. For example, the legal rule could be that families are obligated to vote each fund's shares in the best interests of that fund, and that each fund manager must be given the freedom to vote independently of other funds in the family. Then, some degree of documentation could be required to demonstrate that any coordination among funds' votes was reviewed by each fund board to ensure that the interests of each fund were protected. The substantive goal would be to ensure that when votes are pooled, it is done because that is in the best interests of each fund individual, and to permit the possibility of divergent votes, so as to blunt families' voting power. At the same time, however, the paperwork obligations alone could deter funds from pooling votes on minor matters, while still being worth the price for the more significant votes. Thus, in real ways, the influence of mutual fund families could be mitigated while still preserving their ability to act as corporate stewards overall.

The introduction of administrative friction into the decisionmaking process has a long pedigree as a mechanism for inhibiting the exercise of power.[92] Though it may seem like an arbitrary imposition of costs, in practical effect it imposes a tax, in the form of administrative paperwork, on certain types of actions, ensuring that they will only be taken if the benefit exceeds the cost of the tax. Because mutual funds have more information and ability to calculate the benefits of action than do regulators, such a tax could be an appropriate compromise mechanism to disrupt their voice without eliminating it for matters on which all funds have similar interests.

There might be other ways to ensure that the managers of individual funds within a family pursue each fund's best interest when it comes to stewardship, whether that means coordinating with the other funds in the family or breaking with them. For example, as above, mutual fund asset managers charge fees based on the total assets under management.[93] This is not a performance fee; though fees increase when

92. *See* Ann M. Lipton, *Beyond Internal and External: A Taxonomy of Mechanisms for Regulating Corporate Conduct*, 2020 Wisc. L. Rev. 657, 671–77.

93. Bebchuk & Hirst, *supra* note 43, at 2053.

asset managers' stewardship increases the value of the funds, the fees also increase or decrease based on investor inflows and outflows. Nonetheless, it is common practice for mutual fund families to compensate individual portfolio managers—who are in charge of handling particular funds—for performance, at least when the fund is actively, rather than passively, managed.[94] Researchers have found that these performance incentives for the portfolio managers have an effect on fund performance.[95]

Regulators might therefore require that *all* portfolio managers—both index and active—receive some performance compensation based on increases to the value of the portfolio, as well as requiring that each fund manager be given the freedom to coordinate, or not, with the other funds in the family when engaged in voting and stewardship activities. Fund managers might also be given freedom to decide whether the stocks in their funds would be available for lending to short sellers—which might generate fees for the fund—or whether instead they would remain in the portfolio, where they would be available for voting on particular matters.[96] With this kind of framework, families would still be able to leverage their power through the use of common research and resources that serve all of their funds,[97] and in many cases, portfolio managers might choose to cooperate with each other in order to benefit from the increased influence that coordination brings. But managers might also have incentives to defect from the family on particular occasions, which would disrupt the more troubling aspects of mutual fund families' power, while ensuring that funds' differing interests would be respected.

Conclusion

At the end of the day, the problem may be that we have put too much public responsibility on private actors. In addition to expecting mutual funds to fund retirement in a manner that, in other countries,

94. Linlin Ma, Yuehua Tang & Juan-Pedro Gómez, *Portfolio Manager Compensation in the U.S. Mutual Fund Industry*, 74 J. Fin. 587, 588 (2019).

95. Richard Burtis Evans, Melissa Porras Prado & Rafael Zambrana, *Competition and Cooperation in Mutual Fund Families*, 136 J. Fin. Econ. 168, 186 (2020).

96. Edwin Hu, Joshua Mitts & Haley Sylvester, *The Index-Fund Dilemma: An Empirical Study of the Lending-Voting Tradeoff* 2 (N.Y.U. L. & Econ. Rsch. Paper No. 20-52; Colum. L. & Econ. Working Paper No. 647, 2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3673531 [https://perma.cc/MY3R-3MW7]. It may be difficult to give portfolio managers discretion over share lending, however, because fees depend on the number of shares available, which in turn may require centralized decisionmaking at the family level.

97. *See* Lipton, *supra* note 56, at 200–01.

might be a governmental responsibility, we increasingly rely on institutional investors to do the work of policing corporate misbehavior. Certainly, the exhortations for mutual funds to use their investment dollars to combat climate change,[98] structural racism,[99] corporate political spending,[100] gun violence,[101] and sexual orientation discrim–ination,[102] gives the impression that mutual funds are being tasked with governmental responsibilities. They cannot both have that power, and not have it; eventually, a choice will have to be made.

To some extent, the largest mutual funds may eventually make the choice themselves; as this Article goes to press, BlackRock announced that it was exploring a program by which investors in its funds would have the option to choose how their proportionate share of the fund would vote.[103] Depending on how this program is implemented and the number of investors who accept the invitation, BlackRock's influence on corporate governance could be significantly muted, with power redistributed to uncoordinated and indirect—and therefore less impactful—fund investors.

98. Alastair Marsh & Saijel Kishan, *BlackRock, Vanguard Fall Short on Climate Voting, Report Says*, Bloomberg (Sept. 22, 2020, 12:01 AM), https://www.bloomberg.com/news/articles/2020-09-22/blackrock-vanguard-fall-short-on-climate-voting-report-says [https://perma.cc/4VP3-3XMN].

99. Evie Liu, *Shareholders Tried to Combat Racial Inequality Through 48 Resolutions This Year. Here's How Fund Companies Voted.*, Barron's (Nov. 18, 2020, 5:30 AM), https://www.barrons.com/articles/how-fund-companies-voted-on-48-racial-inequality-resolutions-this-year-51605695401 [https://perma.cc/UW77-4Z63].

100. Leo E. Strine, Jr., *Fiduciary Blind Spot: The Failure of Institutional Investors to Prevent the Illegitimate Use of Working Americans' Savings for Corporate Political Spending* (Univ. Pa. L. Sch., Inst. for Law & Econ., Rsch. Paper No. 19-03, 2018), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3304611 [https://perma.cc/52T7-ZDN5].

101. Annie Massa, *Larry Fink Confronted by Anti-Gun Protesters at Yahoo Summit*, Bloomberg (Sept. 20, 2018, 11:08 AM), https://www.bloomberg.com/news/articles/2018-09-20/larry-fink-confronted-by-anti-gun-protesters-at-yahoo-summit [https://perma.cc/D5YS-6QV7].

102. Greg Ryan, *Boston Firm Scolds BlackRock Over Proxy Votes on Gay Policies*, Bos. Bus. J. (Oct. 9, 2016), https://www.bizjournals.com/boston/news/2016/10/19/boston-firm-scolds-blackrock-over-proxy-voteson.html [https://perma.cc/X4GV-55LP].

103. Mark McCombe, Salim Ramji, & Sandy Boss, *Working to Expand Proxy Voting Choice for Our Clients*, BlackRock, https://www.blackrock.com/corporate/about-us/investment-stewardship/proxy-voting-choice [https://perma.cc/7XHP-QND6] (last visited Oct. 7, 2021).