

CLIENT ALERT

DOL Issues Proposed Rule on Exercise of Fiduciary Duties Regarding Proxy Voting and Shareholder Rights

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I. Overview

On September 4, 2020, the Department of Labor (“DOL”) proposed amending its investment duties regulation relating to proxy voting and the exercise of certain shareholder rights by fiduciaries (the “Proposed Rule”) for plans subject to the Employee Retirement Income Security Act of 1974, as amended (“ERISA”).¹ The Proposed Rule would alter the fiduciary analysis and recordkeeping requirements for plans, with the result that fiduciaries would be prohibited from voting proxies or exercising other shareholder rights unless the matter has an economic impact on the plan . The Proposed Rule would affect ERISA-covered pension, health, and other welfare plans that hold shares of corporate stock – whether held directly or through entities holding stock as plan assets (e.g., collective investment trusts, master trusts and pooled separate accounts). The Proposed Rule does not cover corporate stock held through mutual funds, because the Proposed Rule does not apply to such funds’ management of the underlying investments.

¹ Fiduciary Duties Regarding Proxy Voting and Shareholder Rights, 85 Fed. Reg. 55219 (proposed September 4, 2020).

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II. Background and Prior DOL Guidance

ERISA establishes certain minimum standards for plan fiduciaries, including that plan fiduciaries act “solely” in the interest of plan participants and beneficiaries and for the “exclusive purpose” of providing benefits to such plan participants and beneficiaries and defraying reasonable expenses.² It has been the long-held position of the DOL that proxy voting is a fiduciary obligation.³ The Proposed Rule addresses an ERISA fiduciary’s duties with respect to the exercise of shareholder rights to reflect the significant changes in how ERISA plans invest, as well as the overall modernization of the investment world, with the aim of addressing a “*persistent misunderstanding*” among some that fiduciaries must research and vote all proxies.⁴ The DOL’s rationale for the Proposed Rule is its view that its prior guidance has resulted in some fiduciaries incurring proxy-voting costs that outweigh the resulting benefits to plans. The DOL is of the view that plan fiduciaries may be overly reliant on the advice of third parties (e.g., proxy advisory firms) without taking into consideration the objectives of the party offering advice.⁵ The Proposed Rule is consistent with the DOL’s recent [proposed rule](#) on environmental, social and governance (“ESG”) investing, released in June 2020,⁶ which reflects the DOL’s view that fiduciaries must prioritize economic interests ahead of those that consider ESG-related factors, rejecting the considerations articulated in [DOL Interpretative Bulletin 2016-01](#),⁷ at least with respect to the exercise of shareholder rights by fiduciaries.

III. Provisions of Proposed Rule

In general, under the Proposed Rule, a fiduciary *must* vote a proxy where the fiduciary prudently determines that, after considering the factors noted below and the costs involved, the issue being voted on would have an economic impact on the plan. Conversely, a fiduciary *must not* vote a proxy where the issue would not have an economic impact on the plan.

² Section 404(a)(1)(A) of ERISA.

³ See Letter to Helmuth Fandl, Chairman of the Retirement Board, Avon Products, Inc., 1988 WL 897696 (Feb. 23, 1988). See also Interpretive Bulletin 94-2, 59 FR 38860 (July 29, 1994); Interpretive Bulletin 2008-02, 73 FR 61731 (Oct. 17, 2008); Interpretive Bulletin 2016-01, 81 FR 95879 (Dec. 29, 2016).

⁴ 85 Fed. Reg. 55219 at 55220.

⁵ 85 Fed. Reg. 55219 at 55228. (“First, the Department is concerned that responsible plan fiduciaries, in their efforts to decide whether or how to vote plan shares— and where applicable, to vote them— and exercise other shareholder rights, may impose costs on plans that exceed the consequent economic benefits to them. . . . Second, the Department has reason to believe that responsible fiduciaries may sometimes rely on third-party advice without taking sufficient steps to ensure that the advice is impartial and rigorous. Such action would fall short of ERISA’s standards of fiduciary care and loyalty in the exercise of plans’ shareholder rights. Both of these concerns point to the risk that a plan’s proxy voting activity sometimes will impair rather than benefit participants’ economic interests.”)

⁶ See previous Willkie client alert, [here](#).

⁷ 85 Fed. Reg. 55219 at 55221 (“In that regard, IB 2016–01 no longer represents the view of the Department regarding the proper interpretation of ERISA with respect to the exercise of shareholder rights by fiduciaries of ERISA covered plans. Accordingly, the Department intends to remove it from the Code of Federal Regulations when a final rule is adopted.”)

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a. Fiduciary Standards for Proxy Voting

The DOL maintains that proxy-voting rights are plan assets; thus, fiduciaries are subject to the duties of loyalty and prudence when considering whether to vote proxies. As such, the Proposed Rule requires that the fiduciary:

- i. Act solely in accordance with the plan's economic interests, considering only those factors that affect the particular investment's economic value over an appropriate investment horizon consistent with the plan's investment objectives and funding policy;
- ii. Consider the likely impact of a proxy vote on the investment performance of the plan based on factors, including the size of a plan's investment relative to total value, the plan's percentage ownership of the issuer and the costs involved;
- iii. Not subordinate the economic interests of the plan's participants or beneficiaries, nor sacrifice returns or incur additional risk for non-pecuniary (e.g., ESG) objectives;
- iv. Investigate material facts underlying a proxy vote and appropriately monitor and supervise a proxy advisor firm or other third-party service provider under proxy voting guidelines (e.g., the fiduciary must confirm that the service provider's recommendations are furthering the economic interests of the plan and its participants);
- v. Maintain records on proxy voting, including the justification for particular proxy voting choices; and
- vi. Exercise prudence and diligence in the selection and monitoring of those persons selected to advise or otherwise assist with the exercise of shareholder rights and recordkeeping and reporting services.

In sum, the fiduciary must perform or oversee reasonable investigations and analysis when making the decisions to vote (or not), and be prepared to demonstrate the expected economic benefit of the proxy vote. A plan fiduciary must require documentation of the rationale for proxy-voting decisions recommended by third parties.

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b. Proxy Voting Policies

The Proposed Rule provides that a plan may adopt proxy voting policies and/or guidelines that are consistent with ERISA's fiduciary duties, as well as certain duties owed based on state corporate laws.⁸ These policies, if adopted, must be made available to plan participants, either as part of the plan's investment policy statement or as a separate document.⁹ Further, the plan fiduciary must review the policies at least once every two years. To address concerns regarding the increased aggregate costs incurred with the fiduciaries' duties to ascertain each proxy vote's economic impact on a plan, the Proposed Rule provides that fiduciaries may incorporate certain standing rules into proxy voting policies, which would reduce the need for fiduciaries to consider proxy votes that are unlikely to have an economic impact on the plan (subject to certain "overrides" if a different voting decision would be prudent). The Proposed Rule includes the following examples of "permitted practices" that may be adopted:

- i. Voting proxies in accordance with the recommendation of a corporation's management team on matters that are unlikely to have a significant economic impact on the plan (with additional analysis undertaken for those matters involving a conflict interest or a significant economic impact);
- ii. Voting proxies only on specific proposals that are substantially related to corporate activities (e.g., mergers and acquisitions, dissolutions, conversions, consolidations, corporate buy-backs, issuance of additional dilutive securities, and contested elections for directors); and
- iii. Abstaining from voting proxies or particular types of proposals unless a plan's investment in a specific issuer exceeds a specific quantitative threshold (as a material impact on the investment performance is otherwise unlikely).

The Proposed Rule notes that the adoption of any of these enumerated permitted practices would not preclude a fiduciary from voting in any particular case in which it is subsequently determined that the proxy matter being voted on would have an economic impact on the plan after considering relevant costs, or vice versa.

⁸ 85 Fed. Reg. 55219 at 55225.

⁹ 85 Fed. Reg. 55219 at 55225. ("To facilitate transparency, the Department also reminds fiduciaries that proxy voting guidelines must be made available to plan participants, either as a separate document or by including them in the plan's existing investment policy statement. When an investment manager's rationale on a vote for recurring issues is to follow a uniform internal policy, the manager should document the reasons for any vote that goes against the policy, which would generally only require a brief explanation directly in the proxy-voting record.")

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c. Pooled Investment Vehicles

The Proposed Rule also includes a provision that would be relevant for investment managers that manage pooled investment vehicles (such as a “plan asset” hedge fund) that hold the assets of plans governed by ERISA. In that case, each individual plan could be subject to an investment policy statement that conflicts with the policy of other plan investors. ERISA would otherwise require the investment manager to reconcile, to the extent possible, the conflicting policies. However, the Proposed Rule gives these investment managers two options: The manager would vote (or abstain from voting) the relevant policies to reflect the policies in proportion to each plan’s economic interest in the pooled vehicle. Alternatively, the investment manager may develop an investment policy statement that is consistent with ERISA (including the investment duty requirements), and require the participating plans to accept the investment manager’s investment policy statement, including any proxy voting policy, before they are allowed to invest in the fund. In that case, the fiduciary must assess whether the investment manager’s investment policy statement and proxy voting policy are consistent with ERISA (including the investment duty requirements) before deciding to retain the investment manager.

IV. Comment Period

The comment period for the Proposed Rule shall remain open until October 5, 2020. We will provide further updates on this issue as the DOL considers comment letters and moves to finalize the Proposed Rule.

If you have any questions regarding this client alert, please contact the following attorneys or the Willkie attorney with whom you regularly work.

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