

MEMO# 32727

September 1, 2020

DOL Issues Proposal on Fiduciary Duties Regarding Proxy Voting and Shareholder Rights

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TO: ICI Members
Pension Committee
Pension Operations Advisory Committee
Privacy Issues Working Group
SEC Rules Committee SUBJECTS: Pension RE: DOL Issues Proposal on Fiduciary Duties Regarding Proxy Voting and Shareholder Rights

The Department of Labor (DOL) has issued a new proposed regulation that would address the application of the prudence and exclusive purpose duties under the Employee Retirement Income Security Act (ERISA) with respect to proxy voting and exercises of other shareholder rights.[\[1\]](#) The proposed rule amends DOL's longstanding "investment duties" regulation.

Comments on the proposal are due 30 days after the proposal is published in the *Federal Register*. We are interested in hearing member views on the proposal. Please contact us if you have input to share. We plan to schedule a call for members to discuss the proposal and our comment letter.

Background and Purpose

Since the Clinton Administration, generally, each incoming administration has made slight modifications to DOL's guidance regarding the application of ERISA's fiduciary standards to the exercise of shareholder rights, including the voting of proxies, on securities held in ERISA plans. The Obama Administration issued Interpretive Bulletin (IB) 2016-01, replacing the Bush Administration's IB 2008-02, and reinstating the language of the Clinton Administration's IB 94-02. In 2018, the DOL under the Trump Administration issued Field Assistance Bulletin (FAB) 2018-01, providing guidance to its staff in national and regional offices, intended to "clarify" earlier DOL guidance issued in IB 2016-01.[\[2\]](#)

DOL proposes to replace IB 2016-01 with the new regulatory language, noting that the IB no longer represents the view of the Department.[\[3\]](#) DOL says that this sub-regulatory guidance and individual letters it has issued over the years affirmed that, in voting proxies

and in exercising other shareholder rights, plan fiduciaries must consider factors that may affect the value of the plan's investment and not subordinate the interest of participants and beneficiaries in their retirement income to unrelated objectives. DOL says it believes, however, that aspects of the guidance and letters may have led to some confusion or misunderstandings. The proposal is designed to address those issues through a notice and comment rulemaking process that will build a public record to help the DOL develop an improved investment duties regulation.

The proposal may have been prompted in part by a Trump executive order (EO) from April 2019 directing DOL to review positions that might result in ESG policies discouraging oil and gas investments.^[4] DOL does not, however, specifically mention the EO in explaining why it issued the proposal.

Proposal

DOL's stated goal for the proposal is to ensure that plan fiduciaries execute their ERISA duties in an appropriate and cost-efficient manner when exercising shareholder rights. According to DOL staff:

The proposal would clarify Employee Retirement Income Security Act fiduciary duties for proxy voting and monitoring proxy advisory firms. The proposed rule would reduce plan expenses by giving fiduciaries clear directions to refrain from spending workers' retirement savings to research and vote on matters that are not expected to have an economic impact on the plan.^[5]

While acknowledging that proxy voting guidance by the SEC would not apply to ERISA fiduciaries that are outside of the SEC's jurisdiction, DOL states that it was also appropriate to update its regulations to ensure more consistent conduct by all plan fiduciaries. In this respect, DOL notes that the Securities and Exchange Commission (SEC) issued guidance on August 21, 2019 regarding proxy voting responsibilities of investment advisers.^[6] That guidance described a number of steps investment advisers could take where the investment adviser has assumed the authority to vote proxies on behalf of a client to demonstrate that it is making voting determinations in a client's best interest and in accordance with the investment adviser's proxy voting policies and procedures. Among other things, the investment adviser must conduct a reasonable investigation into matters on which the adviser votes and vote in the best interest of each client for whom the adviser performs proxy voting services, and should consider reasonable measures to determine that it is casting proxy votes on.

DOL's new proposal would amend DOL's existing regulation that describes a fiduciary's investment duties under ERISA.^[7] The proposal includes provisions that would articulate general duties requiring fiduciaries to vote any proxy where the fiduciary prudently determines that the matter being voted upon would have an economic impact on the plan. It also prohibits fiduciaries from voting any proxy unless the fiduciary prudently determines that the matter has an economic impact on the plan.

The proposal makes the following major additions to the investment duties regulation regarding proxy voting and the exercise of shareholder rights:

1. The proposal lays out a list of obligations that fiduciaries must comply with when making decisions on exercising shareholder rights, including proxy voting, in order to meet their prudence and loyalty duties under ERISA section 404(a)(1)(A) and (B). The

stated obligations include:

- Act solely in accordance with the economic interest of the plan and its participants and beneficiaries considering only factors that they prudently determine will affect the economic value of the plan's investment;
- Consider the likely impact on the investment performance of the plan based on such factors as the size of the plan's holdings in the issuer relative to the total investment assets of the plan, the plan's percentage ownership of the issuer, and the costs involved;
- Not subordinate the interests of the participants and beneficiaries in their retirement income or financial benefits under the plan to any non-pecuniary objective, or sacrifice investment return or take on additional investment risk to promote goals unrelated to the financial interests of the plan's participants and beneficiaries or the purposes of the plan;
- Investigate material facts that form the basis for any particular proxy vote or other exercise of shareholder rights;
- Maintain records on proxy voting activities and other exercises of shareholder rights, including records that demonstrate the basis for particular proxy votes and exercises of shareholder rights; and
- Exercise prudence and diligence in the selection and monitoring of persons selected to advise or otherwise assist with exercises of shareholder rights.

2. A new provision explains that fiduciaries must vote proxies only when the fiduciary prudently determines that the matter being voted upon would have an economic impact on the plan and are prohibited from voting proxies unless the fiduciary prudently determines that the matter being voted upon would have an economic impact.
3. A new provision outlines certain "Permitted Practices" under which plan fiduciaries may adopt proxy voting policies and parameters reasonably designed to serve the plan's economic interest. The proposal would require plan fiduciaries who adopt such policies or parameters to review them at least once every two years. The following examples of such potential practices are presented:
 - A policy of voting proxies in accordance with the recommendations of management of the issuer on proposals or types of proposals the fiduciary has prudently determined are unlikely to have a significant impact on the value of the plan's investment.
 - A policy that voting resources will focus only on types of proposals that the fiduciary has prudently determined are substantially related to the corporation's business activities or likely to have a significant impact on the value of the plan's investment, such as proposals relating to corporate events (mergers and acquisitions transactions), corporate repurchases of shares, issuances of additional securities with dilutive effects on shareholders, or contested elections for directors.
 - A policy of refraining from voting on proposals or types of proposals when the size of the plan's holdings in the stock subject to the vote are below quantitative thresholds that the fiduciary prudently determines, considering its percentage ownership of the issuer and other relevant factors, are sufficiently small that the outcome of the vote is unlikely to have a material impact on the investment performance of the plan's portfolio (or assets under management in the case of an investment manager).
4. A new provision also mandates that plan fiduciaries must require that investment managers and proxy voting or advisory firms sufficiently document the rationale for proxy voting decisions or recommendations to demonstrate to the plan fiduciary that

the decision or recommendation was based on the expected economic benefit to the plan.

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endnotes

[1] The proposal is *available at* <https://www.dol.gov/sites/dolgov/files/ebsa/temporary-postings/fiduciary-duties-regarding-proxy-voting-and-shareholder-rights.pdf>. DOL's fact sheet on the proposal is *available at* <https://www.dol.gov/agencies/ebsa/about-ebsa/our-activities/resource-center/fact-sheets/fiduciary-duties-regarding-proxy-voting-and-shareholder-rights>, and its news release is *available at* <https://www.dol.gov/newsroom/releases/ebsa/ebsa20200831>.

[2] ICI Memorandum No. 31192, dated May 3, 2018, *available at* https://www.ici.org/my_ici/memorandum/memo31192.

[3] See page 9 of the proposed rule.

[4] On April 10, 2019, the White House issued an Executive Order on Promoting Energy Infrastructure and Economic Growth (the EO). The stated goal of the EO is to promote private investment in US energy infrastructure, with a focus on crude oil and natural gas. The EO included a number of directives to DOL and appears focused on limiting the impact of ESG influences on curtailing investment in the fossil fuel energy industry. One of the directives to DOL was to "complete a review of existing Department of Labor guidance on the fiduciary responsibilities for proxy voting to determine whether any such guidance should be rescinded, replaced, or modified to ensure consistency with current law and policies that promote long-term growth and maximize return on ERISA plan assets." Section 5(b) of the EO, *available at* <https://www.whitehouse.gov/presidential-actions/executive-order-promoting-energy-infrastructure-economic-growth/>. See ICI Memorandum No. 31723, dated April 22, 2019, *available at* https://www.ici.org/my_ici/memorandum/memo31723.

[5] See statement from Acting Assistant Secretary of the department's Employee Benefits Security Administration (EBSA) Jeanne Klinefelter Wilson in DOL News Release, *available at* <https://www.dol.gov/newsroom/releases/ebsa/ebsa20200831>.

[6] See Commission Guidance Regarding Proxy Voting Responsibilities of Investment Advisers, 84 FR 47420 (Sept. 10, 2019) (2019 SEC Guidance). See ICI Memorandum No. 31916, dated August 22, 2020, *available at* https://www.ici.org/my_ici/memorandum/memo31916. For a description of the SEC's adoption of its proxy advice rule amendments and supplemental guidance for investment advisers, see ICI Memorandum No. 32636, dated July 24, 2020, *available at* https://www.ici.org/my_ici/memorandum/memo32636.

[7] Note that this proposal is designed to fit within the regulatory framework put forward in DOL's proposal regarding ESG investments. This regulation would be inserted into the subsection (e) that was marked as "reserved" in the ESG proposal. See 85 Fed. Reg. 39113,

at 39128 (June 30, 2020), *available at*
<https://www.govinfo.gov/content/pkg/FR-2020-06-30/pdf/2020-13705.pdf>. See ICI
Memorandum No. 32552, dated June 24, 2020, *available at*
https://www.ici.org/my_ici/memorandum/memo32552.

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