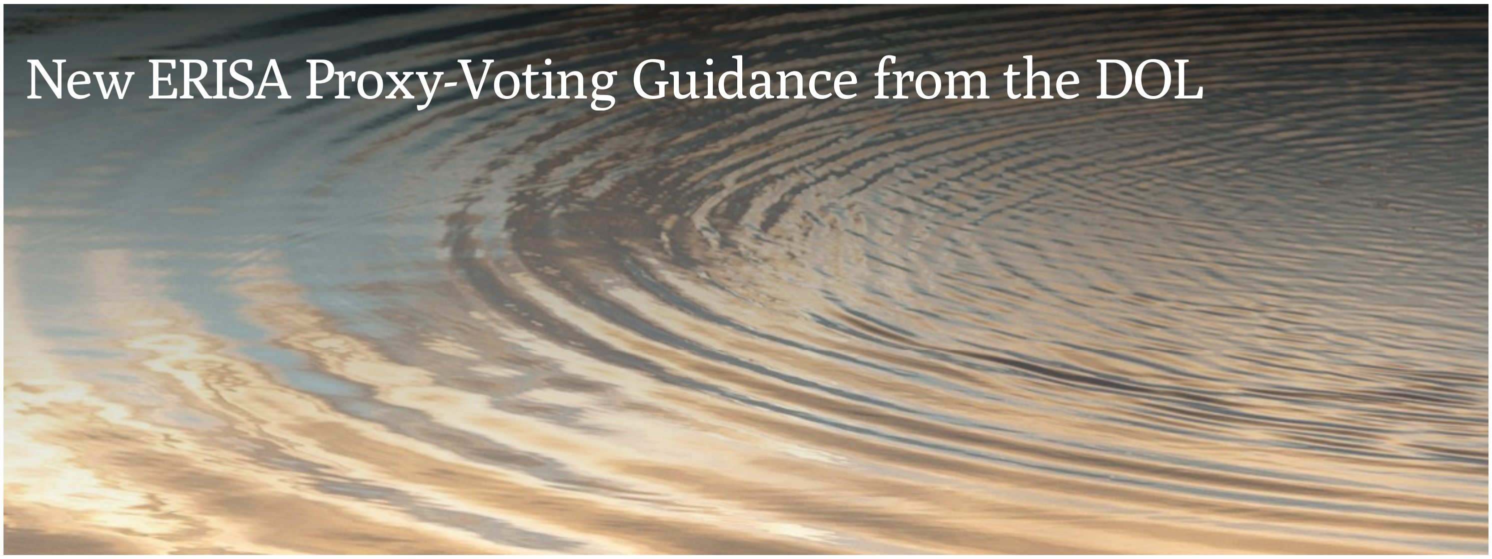
WINSTON & STRAWN LLP

BLOG

New ERISA Proxy-Voting Guidance from the DOL



OCTOBER 1, 2020

On August 31, 2020, the Department of Labor (DOL) closed its active summer by issuing proposed rules for plan fiduciaries with respect to voting proxies on behalf of a retirement plan. The DOL's explanation of the reason for the proxy rules dovetails with the rationale behind its recent proposed rules on environmental, social, and governance (ESG) investments. The DOL is emphasizing that fiduciaries must limit their focus to economic issues facing the plan. The proposed rules, however, may require plan fiduciaries to expend significant effort to determine whether they must or must not cast a proxy vote, undermining the goal of providing "clear guideposts." If the proposed rules are finalized, plan fiduciaries will likely need to make changes to their proxy procedures.

Background

Over the past dozen years, the DOL has addressed proxy voting requirements through Interpretive Bulletins and Field Assistance Bulletins. These forms of guidance are less formal than regulations, and can be issued without public comment. In April 2019, President Trump directed the DOL to study its existing guidance on the fiduciary responsibilities for proxy voting "to ensure consistency with current law and policies that promote long-term growth and maximize return on ERISA plan assets."

Prior to this latest guidance, it has been generally accepted that a fiduciary's responsibility to manage plan assets includes the responsibility to exercise shareholder rights associated with the plan's investments, such as proxy voting, unless it would result in the expenditures of plan assets out of proportion to the potential benefits for the plan. Proxy voting is usually addressed in the plan's investment policy, and commonly delegated to investment managers in a defined benefit plan and passed-through to participants in defined contribution plans.

Proposed Rules

The guidance issued by the DOL on August 31, 2020, was in the form of proposed regulations, rather than an Interpretive Bulletin or Field Assistance Bulletin, in order to both revoke the DOL's prior guidance as well as amend a regulation dated back to 1979. The DOL stated that the goal of the rule is to address a "persistent misunderstanding" that ERISA fiduciaries are required to vote all proxies, and are spending resources researching (i.e., hiring proxy research firms) votes on issues having no economic impact on the plan. The DOL is sensitive that many proxies are related to social or governance issues, which the DOL presumes does not have an economic impact on the plan's investment.

The new regulations would create a two-part obligation approach, under which the fiduciary faces an affirmative obligation on one hand and a prohibition on the other. Specifically, under the proposed DOL guidance, when a plan fiduciary is confronted with a proxy matter, the plan fiduciary must consider the cost involved with voting and whether the matter being voted on would have an economic impact on the plan's investment. If it does, the fiduciary *must* vote the proxy. The new guidance provides that the plan fiduciary is actually barred from voting the proxy unless it determines that the matter would have an economic impact on the plan. This dual responsibility creates real issues for plan fiduciaries who must therefore analyze each proxy or risk violating their fiduciary duties.

The proposed rule sets forth specific standards requiring fiduciaries to:

A. Act solely in accordance with the economic interest of the plan considering only factors that they prudently determine will impact the economic value of the plan's investment based on a determination of risk and return over an appropriate investment horizon consistent with the plan's objectives and funding policy;

B. Consider the likely impact on the plan's investment performance based on such factors as the size of the plan's holdings in the issuer relative to the total plan assets, the plan's percentage ownership of the issuer, and the costs involved with voting;

C. Not subordinate the financial interests of the participants to any non-pecuniary objective, or sacrifice investment return or take additional investment risk to promote goals unrelated to those financial interests;

D. Investigate material facts that form the basis for any vote;

E. Maintain records on proxy voting activities, including the basis for particular votes; and

F. Exercise prudence and diligence in selecting and monitoring persons selected to advise on or assist with such voting rights.

Where the authority to vote proxies has been delegated to an investment manager or other entity, in order to properly monitor such delegate to ensure these standards are satisfied, the DOL stated that the plan fiduciary should require the investment manager to provide documentation to establish that each proxy voting decision was based on the expected economic benefit to the plan, and was based solely on the financial interests of the plan's participants and beneficiaries.

The DOL proposal specifically provides that a fiduciary is *prohibited* from following recommendations of a proxy advisory firm or other service provider without determining that the provider's proxy voting guidelines are consistent with the plan's economic interest. The DOL is especially critical of proxy advisory firms when describing the proposal. If a fiduciary intends to rely on a proxy advisory firm if the new rules are finalized, the fiduciary will need to conduct due diligence on the firm to ensure it conducts a rigorous and independent review of the proxy issue.

The proposal would require that plan fiduciaries review any proxy voting policies every two years, which the DOL notes is its understanding of the industry standard for reviewing investment policy statements. Interestingly, the DOL states 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.

Permitted Practices

In acknowledgement that it may be difficult to know whether a proxy matter will affect the plan's economic interest without conducting an expensive study, the proposed regulations outlines certain "Permitted Practices" plan fiduciaries may adopt to assess proxy voting proposals. The proposal includes the following examples:

A. 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.

B. 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.

C. 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).

The proposal would require plan fiduciaries who adopt such policies or parameters to review them at least once every two years.

Impact of Proposed Changes

If the DOL's proxy voting rules are finalized, investment committees and trustees will likely have to change the method of handling proxies. For example, if proxy voting has been delegated to an investment manager, it is typical for the manager's agreement to provide that it will vote proxies according to the manager's underlying proxy voting guidelines, which may not align with the DOL's new proposed guidance. In addition, defined contribution plans usually pass through voting rights, and are required to do so for Company Stock funds, but the plan fiduciaries may still need to evaluate the cost of passing through the voting rights. The comment period was a short 30-days, so the regulations may be finalized in the near term.

5 Min Read

Author

Joseph S. Adams

Related Locations

Chicago

Related Topics

ERISA | Environmental, Social & Governance (ESG) | Department of Labor

Related Capabilities

Labor & Employment | ERISA Litigation | Environmental, Social & Governance (ESG)

Related Regions

North America

Related Professionals

Joseph S. Adams

This entry has been created for information and planning purposes. It is not intended to be, nor should it be substituted for, legal advice, which turns on specific facts.