

DOL's Proposed Rule Solidifies Shareholder's Rights, Including Proxy Voting

The term “fiduciary” can have many meanings. A fiduciary’s fundamental role is to act on another person’s behalf, such as when acting as a trustee of a trust. When Congress passed the Employee Retirement Income Security Act of 1974 (ERISA), one significant aspect of that legislation was to ensure that retirement plan administrators and other plan fiduciaries act “solely in the interest of the participants and beneficiaries”.

Since ERISA’s enactment over 45 years ago, Congress, the Department of Labor (DOL), and the Internal Revenue Service (IRS) have continued to issue regulations and other guidance to protect plan assets for participants and their beneficiaries. On August 31, 2020, the DOL issued a [proposed rule](#) intended to clarify an ERISA fiduciary’s duties with respect to shareholder rights, including proxy voting on corporate stock (a proxy vote generally occurs when an individual or an organization casts a ballot on behalf of a shareholder who is not directly voting on a particular issue.)

The proposed rule would amend DOL Regulation 2550.404a-1 (known as the “Investment Duties” regulation), by adding a new subpart (e) *Proxy Voting and Exercise of Shareholder Rights*. The DOL issued this proposed rule in part to correct a “persistent misunderstanding” that ERISA fiduciaries must vote on all proxies presented to them. There have also been substantial changes in how plan administrators invest their plan assets and in how the investment industry operates as a whole. The proposed rule is intended to align the Investment Duties regulation with these changes and with recent SEC guidance on the proxy voting process.

This proposed rule would apply to ERISA-covered pension, health, and other welfare plans (such as qualified defined contribution and defined benefit plans, certain 403(b) plans, and certain self-insured health plans) that hold shares of corporate stock. The proposed rule would apply to plans that hold stock either directly or indirectly through an ERISA-covered intermediary (such as a common trust or a master trust). The proposed rule would not apply to plans that hold stock through a registered investment company, such as a mutual fund.

Why the DOL Issued the Proposed Rule

The DOL is effectively codifying its existing position regarding plan fiduciaries who are considering whether to exercise a proxy vote (or other shareholder rights) or who are already exercising such rights. The proposed rule makes clear that such activities are subject to the general ERISA fiduciary duty rules that require fiduciaries to conduct such actions

- prudently and solely in the interests of plan participants and beneficiaries,
- for the exclusive purpose of providing benefits to participants and beneficiaries, and
- to defray the reasonable expenses of administering the plan.

Fiduciary Considerations

The proposed rule also includes the following list of specific factors that fiduciaries must consider when deciding whether to vote on a proxy (or other exercise of shareholder rights) or when actually voting a proxy.

- **Act solely in the plan’s economic interest.** Fiduciaries must only consider factors that will affect the plan investment’s economic value. This decision must align with the plan’s investment objectives and funding policy.
- **Consider the effect on the plan’s investment performance.** Fiduciaries must consider multiple factors—including comparing the amount of stock owned by the plan to the total amount of plan assets, determining

the plan's ownership in the stock issuer, and calculating any expenses related to the vote or other exercise of shareholder rights.

- **Do not subordinate the participants' and beneficiaries' interests.** Fiduciaries cannot sacrifice investment return or take on additional risk to support goals that do not align with the plan's or a participant's and beneficiary's financial interests.
- **Investigate material facts.** Fiduciaries may not follow an advisory firm's recommendations without appropriate supervision or verifying that the firm's voting guidelines and its guidelines for exercising shareholders' rights line up with the economic interests of the plan and its participants and beneficiaries.
- **Maintain records.** Fiduciaries must document their activities—including their reason for voting a certain way.
- **Exercise prudence and diligence when selecting and monitoring advisory firms.** Fiduciaries must also research any applicable administrative services and recordkeeping and reporting services.

Applying the Considerations

After considering the previous list of factors, a plan fiduciary would be allowed to vote by proxy only if the fiduciary determines that the vote would affect the plan's economic interests. In addition to considering the required list of factors, the fiduciary would also need to consider the costs involved (including any research costs).

Setting Parameters

The proposed rule allows fiduciaries to establish specific parameters in their proxy voting policies as to when voting authority will (or won't) be exercised. Such parameters must be "reasonably designed to serve the plan's economic interest" and must be reviewed by the fiduciary at least every two years. The proposed rule provides three examples of such policies.

- Relying on the issuer's voting recommendations for proposals that the fiduciary has determined are unlikely to significantly affect the plan's investment.
- Focusing only on the types of proposals determined by the fiduciary to be substantially related to the corporation's business activities or that are likely to significantly affect the value of the plan's investment.
- Not voting on proposals where the plan's holding in a particular stock is below a threshold that the fiduciary determines is sufficiently small enough that the vote's outcome will not have a material effect on the plan's overall investments.

Plan Trustees Generally Responsible for Proxy Voting

The proposed rule states that plan trustees are responsible for proxy voting unless either the trustee is subject to the directions of a named fiduciary, or a named fiduciary has delegated authority to an investment manager. If the fiduciary has delegated authority to an investment manager, the investment manager generally has exclusive authority to vote proxies.

Investment managers that offer a pooled investment vehicle to more than one employee benefit plan must attempt to reconcile any conflicting investment policies. The investment manager must vote (or not vote) in a way that "reflects such policies in proportion to each plan's economic interest in the pooled investment vehicle." The investment manager may require fiduciaries of each participating plan to accept one general investment policy. Before doing so, fiduciaries would need to determine whether the investment and voting policies comply with ERISA.

Authorized Third Parties Must Document Voting Decisions

The proposed rule states that when a fiduciary delegates proxy voting authority to an investment manager or to a proxy voting firm, the fiduciary must require such investment manager or proxy advisory firm to document the rationale for its proxy voting decisions or recommendations, including demonstrating that the decision or recommendation was based on an expected economic benefit to the plan.

DOL Intends to Eliminate Interpretive Bulletin 2016-01

In 2016, the DOL issued Interpretive Bulletin (IB) 2016-01. This Bulletin gave plan fiduciaries greater flexibility, including allowing them to consider environmental, social, and governance factors—sometimes called “socially responsible” factors—when voting proxies.

The new proposed rule states that the DOL no longer believes that IB 2016-01 properly reflects an ERISA fiduciary’s proxy voting responsibilities. As a result, the DOL plans to remove IB 2016-01 from the Code of Federal Regulations when it finalizes this proposed rule.

Next Steps

The DOL is requesting comments on the proposed rule. Comments must be submitted on or before October 5, 2020.

Plan fiduciaries that invest in corporate stock directly or indirectly should start reviewing their proxy voting policies (and begin considering possible updates for when the final rule is issued). Plan fiduciaries should also ensure that they will be able to fully document their proxy voting activities.

Ascensus will continue to follow any new guidance as it is released. Visit ascensus.com for the latest developments.