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Publications

DOL Proposes Rule Requiring Increased Proxy Voting Analysis and Recordkeeping

ATTORNEYS & PROFESSIONALS

Jim Cole
jcole@groom.com
202-861-0175

Michael Kreps
mkreps@groom.com
202-861-5415

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On September 4, 2020, the Department of Labor (the "Department") published a proposed regulation related to proxy voting and the exercise of certain shareholder rights (85 Fed. Reg. 55219, the "Proposed Rule") by fiduciaries for plans subject to the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). If published in its current form, the Proposed Rule would, as a practical matter, significantly change the fiduciary analysis and recordkeeping requirements for plans voting proxies held by virtue of the plans' investments.

Under the Proposed Rule, plan fiduciaries must research all material facts and analyze each proxy vote to determine if that vote would have an economic benefit to the plan with respect to the plan's investment in the stock of the corporate issuer. However, to minimize the increased costs of such investigations and analysis, the fiduciary may choose to use a permitted policy outlined in the regulations. The three permitted practices enumerated in the proposed regulation include voting proxies with management, voting only on certain types of corporate events (*e.g.*, mergers and acquisitions), or voting only if the corporate stock makes up a minimum threshold of the plan's investment holdings.

The preamble to the Proposed Rule notes that it is most likely to affect ERISA covered plans, entities holding stock as plan assets (*e.g.*, collective investment trusts, master trusts, and pooled separate accounts), investment managers, investment advisors, proxy advisory services, proxy research services, proxy voting services, banks, and insurance companies. While the Department also notes that the Proposed Rule does not cover the voting of shares inside mutual funds, it invites comments on the effects of the Proposed Rule on the exercise of shareholder rights for funds registered with the Securities Exchange Commission ("SEC") and selection of such funds as plan investments.

If finalized as published, those affected would have only 30-days to comply, which presumably would be before the end of the year. Comments to the proposed regulations are due on **Monday, October 5, 2020.**

The Proposed Rule reiterates the Department's long-held view that when voting (or not voting) proxies, plan fiduciaries must consider the economic significance of the

issue on the plan's investment. But it explicitly rejects the broader set of considerations previously articulated by the Department in Interpretative Bulletin 2016-01 ("IB 2016-01"). In that regard, the Proposed Rule is thematically consistent with the Department's recent proposed rule on environmental, social, and governance ("ESG") investing, which we summarized in a Groom Alert. In the preamble to the Proposed Rule, the Department notes that they will adjust the ESG and Proxy Voting regulations to have the same effective date.

I. Background

The Department has a long history of opining on fiduciaries' duties concerning proxy voting. The Department has been consistent in its view that proxy voting is a fiduciary obligation. However, the Department's more granular positions have shifted over time based on the particular administration's policy goals. Democratic administrations have tended to provide more leeway to fiduciaries in their proxy voting determinations while Republican administrations have taken a more restrictive approach.

For example, the Department issued guidance under the Bush Administration that, among other things, made it clear that plan fiduciaries should only consider factors related to the economic value of the plan investment when voting proxies. Under the Obama Administration, the Department next issued IB 2016-01, believing that the Bush Administration's guidance led to a misunderstanding that "may have worked to discourage ERISA plan fiduciaries who are responsible for the management of shares of corporate stock from voting proxies and engaging in other prudent exercises of shareholder rights."

In 2019, President Trump issued the Executive Order on Promoting Energy Infrastructure and Economic Growth. That Executive Order directed the Department to "complete a review of existing [Department] 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." The Department has now issued the Proposed Rule in response to the President's directive.

The Department's justification for the Proposed Rule is their belief that prior proxy voting guidance has resulted in fiduciaries incurring proxy voting costs exceeding the resulting benefits to plans. Moreover, the Department is concerned that plan fiduciaries may be over-relying on third parties' advice, such as proxy advisory firms, without sufficiently prudent consideration of that advice and the party offering it. The Department intends to harmonize its guidance with the SEC's recently published rules.

II. Proposed Rule

The Proposed Rule would amend the "investment duties" regulation (29 CFR § 2550.404a-1) and address the prudence and exclusive purpose duties under sections 404(a)(1)(A) and 404(a)(1)(B) of ERISA in the context of proxy voting and other exercises of shareholder rights by the responsible ERISA plan fiduciaries. Although aspects of the Proposed Rule are consistent with prior guidance, some notable changes could broadly impact plan administration.

A. Fiduciary Standards for Proxy Voting

The Proposed Rule maintains the Department's position that proxy voting rights are plan assets, and therefore, fiduciaries are subject to the duties of loyalty and prudence when considering whether to vote proxies. The Proposed Rule would require fiduciaries to satisfy the following conditions:

- Act solely in accordance with the plan's economic interests, considering only factors that affect the particular investment's value over an appropriate investment horizon;
- Consider the likely impact of a proxy vote on investment performance with respect to the plan's investment in the issuer of the stock, given the size of a plan's investment relative to total value, the plan's percentage ownership, and costs;
- Not subordinate financial interests, sacrifice returns, or take on additional risk for non-pecuniary objectives;
- Investigate material facts underlying a proxy vote, including an obligation to appropriately monitor a proxy advisor firm or other service providers under proxy voting guidelines;
- Maintain records on proxy voting and the justification for particular proxy voting choices; and

- Exercise prudence and diligence in selecting and monitoring any service provider related to proxy voting, including administrative, recordkeeping, and reporting services.

Under the Proposed Rule, a fiduciary *must* vote a proxy where the issue could have an economic impact on the plan but *must not* vote a proxy where the matter would not have an economic impact on the plan. The Department states that "the expenditure of plan resources is generally warranted only when proposals have a meaningful bearing on share value or when plan fiduciaries have determined that the interests of the plan are unlikely to be aligned with the positions of a company's management."

To the extent that a named fiduciary has delegated responsibility for voting proxies to another (*e.g.*, an investment manager), the Proposed Rule would require the fiduciary to ensure that the other party satisfies the conditions by requiring documentation of "the rationale for proxy voting decisions… [s]ufficient to demonstrate that the decision… [w]as based on the expected economic benefit to the plan, and that the decision… [w]as based solely on the interests of participants and beneficiaries in obtaining financial benefits under the plan."

B. Proxy Voting Policies

The Proposed Rule would codify a requirement that plans have proxy voting policies and/or guidelines. Fiduciaries would be required to review the policies at least every other year and make the policies available to plan participants, either as part of the plan's investment policy statement or a separate document. In recognition of the difficulty and increased cost to plans of determining a proxy vote's economic impact on a plan on a case-by-case basis, the Proposed Rule would allow fiduciaries to incorporate certain standing rules into proxy voting policies. The Proposed Rule provides examples of the following "permitted practices":

- Voting proxies per management's recommendations (with conditions for additional analysis of matters involving conflicts of interest or a significant economic impact);
- Voting proxies only on specific proposals that are substantially related to business activities (*e.g.*, mergers and acquisitions, dissolutions, conversions, consolidations, corporate buy-backs, issuance of additional dilutive securities, and contested elections for directors); and
- Refrain from voting proxies unless a plan's investment in a specific issuer exceeds a specific quantitative threshold.

C. IB 2016-01

The Proposed Rule would rescind IB 2016-01 because, according to the Department, that guidance no longer reflects the agency's views. The Department is effectively rejecting its prior position that a plan fiduciary need only consider whether the issue up for vote would affect the value of the plan's investment more than the cost of voting shares. Thus, when considering whether the cost of voting shares would prohibit the plan fiduciary from taking action, IB 2016-01 does not require plan fiduciaries to consider whether the plan's individual exercise of its voting rights would affect the value of the plan's investment but rather whether the votes of all shareholders would affect the value of the plan's investment. In other words, IB 2016-01 permits fiduciaries to consider whether they expect the plan's vote, either alone or together with votes of other shareholders, to have an effect on the value of the plan's investment, versus the additional cost of voting shares. The Proposed Rule would abandon this decision-making framework by requiring an evaluation of the economic benefits of voting the proxy with respect to that particular plan investment, fundamentally changing how fiduciaries are required to analyze proxy voting decisions.

III. Conclusion and Outlook

The Proposed Rule represents an important evolution in the Department's views on proxy voting. Although many of the concepts are consistent with longstanding interpretations of ERISA, the Proposed Rule would have a material impact on plan fiduciaries' proxy voting policies and practices, particularly concerning how fiduciaries conduct a cost-benefit analysis. The Department has requested comments on "all facets" of the Proposed Rule as well as approximately 30 specific issue areas. Interested stakeholders should consider submitting comments by the October 5, 2020, deadline.

The Department has a strong incentive to finalize the Proposed Rule this year. If President Trump does not win a second term, it is entirely possible – if not likely – that a Democratic administration would seek to unwind the rule. That unwinding is considerably easier to do if the rule is not final *and* effective. It is also worth noting that the ultimate fate of the rule could be in the hands of the next Congress, which has the ability to overturn agency rules under Congressional Review Act.

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