

FIDUCIARY DUTIES REGARDING PROXY VOTING AND SHAREHOLDER RIGHTS

On August 30, the Department of Labor (DOL) issued a notice of proposed rulemaking entitled, “Fiduciary Duties Regarding Proxy Voting and Shareholder Rights.” The proposal aims to clarify the obligations of fiduciaries covered by the Employee Retirement Income Security Act of 1974 (ERISA) with regard to the exercise of proxy voting and shareholder rights, generally. ERISA covers fiduciaries who oversee private sector retirement plans as well as many investment managers and service providers to ERISA plans.

The Department’s stated purpose for issuing the proposal is to clarify its expectations for fiduciaries as they carry out their obligations to vote proxies and exercise shareholder rights more generally.

BACKGROUND

The evolution of the DOL’s current policies regarding execution of shareholder rights by ERISA fiduciaries began with “Avon Letter” in 1988. The Avon Letter stated that, “the fiduciary act of managing plan assets which are shares of corporate stock would include the voting of proxies appurtenant to those shares of stock.” Many ERISA fiduciaries interpreted this as a requirement that fiduciaries should cast votes unless proxy voting was prohibitively expensive, for example the voting of proxies in foreign languages.

In 1994, the DOL issued an Interpretive Bulletins (IBs) to explain its views as to how fiduciaries should execute their obligations with respect to shareholder rights such as proxy voting. In this pronouncement, the DOL stated that fiduciaries’ primary obligation is to advance the economic interests of plan participants when voting proxies. However, a subsequently issued 2008 IB caused confusion among some ERISA fiduciaries as to their obligations related to shareholder engagement on environmental, social and governance (ESG) factors.¹

The Proposal states that the Avon Letter and other regulatory pronouncements from the DOL that followed have led to a misunderstanding by fiduciaries that they have an obligation to vote proxies in nearly all circumstances. The Department states that it is now seeking to clarify its views.

¹ https://www.groom.com/wp-content/uploads/2017/10/1792_DOL-Announces-New-Guidance-on-Proxy-Voting.pdf

REPEAL OF 2016 BULLETIN

The DOL has issued IBs in 1994, 2008 and 2016 on ERISA fiduciaries' exercise of shareholder rights. The 2008 IB was interpreted by many fiduciaries to encourage a cost-benefit analysis prior to exercising shareholder rights and determine that doing so would have a positive impact on the value of plan assets. The 2016 IB was intended to clarify that such a cost-benefit analysis was not a necessary prerequisite to voting. It also presented a broader interpretation of when it would be appropriate for ERISA fiduciaries to exercise shareholder rights with an eye toward advancing material ESG factors.

The Proposal released in August states that the 2016 IB is no longer an accurate representation of the DOL's views. If and when the Department issues a final rule, the DOL interpretation of fiduciary obligations in proxy voting has reverted back to the policies laid out in the 2008 IB. This means that the Department's current position is that ERISA fiduciaries must prioritize investment returns over all other factors when determining whether and how to exercise shareholder rights and "if the responsible fiduciary reasonably determines that the cost of voting (including the cost of research, if necessary, to determine how to vote) is likely to exceed the expected economic benefits of voting, the fiduciary has an obligation to refrain from voting."²

PROPOSED RULE REGARDING THE DETERMINATION WHETHER AND WHEN TO PARTICIPATE IN PROXY VOTING

In addition to the policy change effectuated by the DOL through its repeal of the 2016 IB, the DOL also proposed a new rule related to the exercise of shareholder rights by ERISA fiduciaries. If a rule is finalized, it makes the policy interpretation more formal from a legal perspective and more difficult for future administrations to change.

The Proposal would, for example, require ERISA fiduciaries determining whether and when to engage in proxy voting or the exercise of other shareholder rights to:

- Prioritize the financial returns over all other factors;
- Examine all material data relevant to the decision. They may rely on a proxy advisory firm's analysis but if they choose to do so the fiduciary is required to oversee the firm's activities and make sure its proxy voting guidelines are designed to prioritize financial returns; and
- Maintain records including records that "show the basis for particular proxy votes and exercises of shareholder rights."

If an ERISA fiduciary allows an asset manager or other service provider to exercise proxy voting or other shareholder rights with respect to plan assets, the fiduciary will be expected to require that entity to make a record of the rationale for their action to ensure it is designed to maximize the economic value of plan assets. The Proposal does not give clarity on what those disclosures should include.

Under the Proposal, fiduciaries will essentially be required to conduct a cost-benefit analysis to determine whether participating in proxy voting will advance the economic interests of the plan. The Proposal acknowledges that the conducting this cost-benefit analysis will, in itself, be costly

² <https://beta.regulations.gov/document/EBSA-2020-0008-0001>

for plans and suggests “permitted practices” under which the plan may adopt policies that will expedite the determination. Examples of “permitted practices” cited in the Proposal include:

- A policy that states that the default position will be to vote with management’s recommendations unless the propose presents unique conflicts or financial impacts;
- A policy that the plan will only vote on specified types of proposals it determines to be central to the issuer’s business or financially material; or
- A policy that the plan will not vote on proposals if the value of the holdings of the issuer are below a certain threshold in relation to the total value of plan assets.

The Proposal would also require fiduciaries to review proxy voting policies at least every two years.

CONCLUSION

The Proposal, if finalized in its current form, will impose substantial additional costs on ERISA plans and their asset managers. It also discourages participation in proxy voting and other forms of active ownership by ERISA plans. This is likely to undermine progress on ESG integration that is necessary to maximize long-term shareholder value and advance sustainable financial markets in the US. Ultimately, US retirement savers will bear the burden as their plans face higher administrative costs, additional financial risk and diminished returns.

There are likely to be significant changes before the rule is finalized and it is possible that the DOL will decide not to issue a final rule. PRI signatories have an opportunity to influence the outcome.

NEXT STEPS

October 5 is the deadline for submitting comments to the DOL.

The PRI has submitted a letter to the DOL asking for an extension so that comments are due in 90 days and we will notify you if an extension has been granted. We should assume, however, that comments are due October 5.

The PRI will also submit a response to the consultation, which we will make available to PRI signatories. Further resources – for example, an information webinar – will be set out in the coming days.

CONCLUSION

We recommend:

- In the first instance, PRI signatories write to the DOL requesting an extension to the consultation period.
- And, PRI signatories prepare to respond to the consultation no later than the deadline of October 5, 2020.

Written correspondence should be sent to:

Office of Regulations and Interpretations
Employee Benefits Security Administration

Room N-5655
U.S. Department of Labor
200 Constitution Avenue NW
Washington, DC 20210
Attention: Proxy Voting and Shareholder Rights NPRM

All submissions must include the agency name and Regulatory Identifier Number (RIN) for this rulemaking, RIN 1210-AB91.

Comments may be submitted electronically [here](#) or at <https://beta.regulations.gov/document/EBSA-2020-0008-0001>.

For questions or comments, email policy@unpri.org and to Heather Slavkin Corzo, Head of US Policy, at heather.slavkin.corzo@unpri.org.