



# DOL proposal would clarify proxy voting rules

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## In this article

[A brief history of proxy voting rules](#) | [Taking shareholder action](#) | [Delegation](#) | [Proxy voting](#) | [Request for comments](#) | [Related resources](#)

The latest [proposal](#) from the Department of Labor (DOL) would clarify the rules around proxy voting in ERISA-covered retirement, health and welfare plans, laying out fiduciary duties relating to shareholder actions and providing some examples of policies that plans may adopt for use in deciding whether to vote a particular proxy. By detailing fiduciary considerations around proxy voting, DOL seeks to erase the “persistent misunderstanding” that ERISA fiduciaries must vote all proxies. DOL also emphasizes that fiduciaries exercising shareholder rights must be guided solely by the plan’s economic interest, not by any non-pecuniary concerns, and formally withdraws Interpretive Bulletin (IB) 2016-01, which was more permissive on reflecting environmental, social and corporate governance (ESG) goals when voting shares. Comments on the proposal are due Oct. 5.

## A brief history of proxy voting rules

More than 25 years have passed since DOL took a stance on proxy voting in [IB94-2](#), which laid out the following framework for proxy voting:

- If no investment manager has been appointed, the trustee is generally responsible for voting proxies, unless the plan expressly provides that the trustee is subject to the direction of a named fiduciary.
- If an investment manager has been appointed, that manager has the exclusive authority to vote proxies, unless the plan document and investment management agreement expressly prohibit the investment manager from exercising voting rights. In that case, the trustee retains the voting rights — unless the named fiduciary has reserved the right to direct the trustee as to proxy voting.

## DOL proposal would clarify proxy voting rules

IB 94-2 was meant to encourage certain kinds of corporate activism likely to enhance the value of a plan's investment in a stock after taking into account the costs involved. The IB included a nonexhaustive list of issues a plan fiduciary could get involved in, such as actions regarding candidates for the boards of directors, types of executive compensation, merger and acquisition policies, debt financing and capitalization, long-term business plans and workplace practices.

IB 2008-2 superseded IB 94-2 and included a new discussion on the use of the proxy process to further legislative, regulatory or public policy goals. DOL reiterated its position that fiduciaries taking shareholder actions must be guided solely by the plan's economic interest, and further stated that fiduciaries risked violating their duty of loyalty by engaging in social investing. The IB explained that fiduciaries could engage in socially directed proxy voting only if they could articulate a clear basis for concluding the efforts — including the costs of research, if necessary, to determine how to vote — would benefit the plan's investment.

In IB 2016-01, DOL attempted to clear up confusion among fiduciaries, some of whom believed the 2008 guidance discouraged them from voting proxies and taking other prudent shareholder action. IB 2016-01 dropped the discussion of socially directed proxy voting that DOL added in IB 2008-2, and added several ESG concerns to the list of issues fiduciaries could get involved in (labeling it "shareholder engagement" rather than "shareholder activism"). Many fiduciaries and other stakeholders understood this guidance to be more permissive on ESG investing.

The latest proposal, however, takes a definitive step back from the 2016 IB, stating that it no longer represents the agency's views, and that DOL intends to remove the IB from the Code of Federal Regulations when the proposal is finalized. This is consistent with a rule DOL proposed earlier this year to curtail ESG investing by ERISA plans. That proposal would require ERISA fiduciaries to subordinate ESG goals to financial ones when making investment decisions for retirement plans. It would also require fiduciaries for nonindividual account plans to prove an ESG investment is economically indistinguishable from a non-ESG investment.

### Taking shareholder action

The proposed rule would codify DOL's view expressed in each of the IBs that a fiduciary's responsibilities for a stock investment includes voting proxies and managing any other shareholder actions relating to the stock. Deciding whether to exercise these rights (and actually exercising them) is a fiduciary act that must be made solely in the economic interests of the plan and its participants.

The proposal identifies six considerations a fiduciary must take into account when deciding whether to vote a proxy or exercise other shareholder rights:

- **Economic value.** The fiduciary can consider only those factors it prudently determines will affect the economic value of the plan's investment, based on a determination of risk and return over an

## DOL proposal would clarify proxy voting rules

appropriate investment horizon, and consistent with the plan's investment objectives and funding policy.

- **Impact on plan's investment performance.** The fiduciary must consider the likely impact of any action on the plan's investment performance, taking into account such factors as the relative size of the investment to the plan's assets as a whole and the costs involved with undertaking any necessary research.
- **Primacy of economic interest.** The fiduciary mustn't subordinate the interests of plan participants to any nonpecuniary objectives, and must ensure the plan doesn't sacrifice investment return or take on additional investment risk to promote nonfinancial goals.
- **Informed vote.** The fiduciary must investigate material facts that form the basis of any particular proxy vote. Alternatively, a fiduciary may use a proxy advisory firm with appropriate supervision, but only after determining that the firm's voting guidelines are consistent with the economic interests of the plan.
- **Records.** The fiduciary must maintain records of shareholder actions, including the rationale for taking each action.
- **Advisers.** The fiduciary must act prudently and diligently when selecting and monitoring advisers or people who otherwise assist with exercising shareholder rights (e.g., people who do research, make recommendations, provide recommendations or perform other administrative or recordkeeping services).

## Delegation

The proposal would codify previous guidance that the responsibility for exercising shareholder rights would remain exclusively with the trustee, unless the trustee is directed by the named fiduciary or voting has been delegated to an investment manager.

When an investment manager is responsible for voting proxies and the investment vehicle is a pooled trust containing the assets of more than one employee benefit plan, the investment manager can develop its own investment policy — including a policy on proxy voting — and require each participating plan to accept the terms of the policy before investing, subject to a fiduciary assessment that the policy is consistent with ERISA. In absence of such a policy, the investment manager would have to:

- Reconcile, to the extent possible, any conflicting investment policy statements
- Vote proxies (or abstain from voting) in proportion to each plan's relative investment in the fund

## Documentation

When the authority for shareholder actions has been delegated, the investment manager or adviser would have to document the rationale for its recommendations or proxy voting decisions. The documentation would have to be sufficient to demonstrate that the decision was made based on the expected economic benefit to the plan, and solely in the economic interest of the plan's participants.

## Proxy voting

Although the proposal applies to all shareholder actions generally, it includes a separate section relating specifically to proxy voting. In the preamble, DOL notes that proxy voting policies have become more complex — even as an increase in institutional investing by ERISA plans has led to a decline in the percent of plan assets invested in individual stocks. Further, DOL is unconvinced that proxy voting leads to increased shareholder value, and is concerned that some proxy voting has led to plan assets being used to promote ESG agendas rather than in the economic interest of plan participants.

## To vote or not to vote

In the preamble, DOL explains — several times and in several different ways — its desire to clear up any ambiguity relating to when and if a plan fiduciary (or designee) should vote a proxy for shares of stock held in the plan's investments. Accordingly, the proposed regulation requires that a plan fiduciary determine if the matter being voted on would have an economic impact on the plan using the six considerations listed above and taking into account the costs (e.g., the costs of research) involved with voting. The fiduciary then:

- **Must** vote any proxy when the matter being voted on would have an economic impact on the plan
- **Must not** vote any proxy when the matter being voted on wouldn't have an economic impact on the plan

## Permitted practices

DOL is concerned that the cost of determining whether individual proxies will have an economic impact may outweigh any potential benefit that could accrue from casting the vote. To help fiduciaries focus their resources on the matters most likely to have an economic impact, the proposal includes a list of "permitted practices" under which fiduciaries may adopt proxy voting policies for a plan.

Having a proxy voting policy wouldn't prevent (or create fiduciary liability for) the responsible fiduciary from deciding to vote or not vote after assessing the economic impact of a particular matter being voted on, even if that decision runs counter to the proxy voting policy. Adopting a proxy voting policy is

voluntary, and the examples in the proposal are not the only acceptable ones. Fiduciaries would have to review any voting policy at least once every two years.

DOL intends the permitted practices to be flexible, and the list is not all-inclusive. For instance, a proxy voting policy might — but doesn't need to — include any of the following provisions:

- Following the voting recommendations of the stock issuer's management on types of proposals the plan's fiduciary has prudently determined are unlikely to have a significant economic impact on the plan, subject to additional conditions the fiduciary determines might require additional analysis
- Focusing voting resources on types of proposals substantially related to the stock issuer's business activities or likely to have a significant economic impact on the plan (e.g., proposals related to corporate events, share buy-backs, new share issuances, or contested director elections)
- Refraining from voting on proposals where the plan's holding in the stock, relative to the plan's total invested assets, is below a quantitative threshold prudently determined by the fiduciary to be low enough such that the outcome of the vote is unlikely to materially affect the plan's investment

## Request for comments

Comments may generally address the specific provisions of the proposal and all facets of the proposed rule. In addition, DOL scattered several requests for comments throughout the proposal, including whether a maximum materiality threshold for voting a proxy should be defined, whether the two-year review period for proxy voting policies is appropriate, and whether the list of permitted practices for proxy voting policies should be expanded. Comments are due Oct. 5.

## Related resources

### Non-Mercer resources

- [Proposed rule on proxy voting and shareholder rights](#) (Federal Register, Sept. 4, 2020)
- [Fact sheet](#) (DOL, Aug. 31, 2020)
- [News release](#) (DOL, Aug. 31, 2020)
- [Proposed rule on financial factors in selecting plan investments](#) (Federal Register, June 30, 2020)

### Mercer Law & Policy resource

- [DOL proposal would curtail social investing](#) (July 7, 2020)

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