



DOL final proxy-voting rule less stringent than proposed

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The recent Department of Labor (DOL) [final rule](#) on fiduciaries exercising proxy-voting rights and other shareholder actions takes a softer stance than the agency's initial proposal. The final rule backs away from the proposed requirement that fiduciaries analyze the economic impact of every potential shareholder action. Instead, the final rule substitutes a principles-based approach that requires a prudent process for deciding whether to take action. This article explains the new rule and notes the significant differences from the proposal. However, the rule's fate is uncertain, as the Biden administration is reviewing regulations that could hamper the president's climate-change agenda.

Taking shareholder action

The final rule codifies DOL's long-standing view that a fiduciary's responsibilities for stock investments include voting proxies and managing any other shareholder actions relating to the stock. When deciding whether to exercise these rights (and actually exercising them), fiduciaries must act solely in the economic interests of the plan and its participants. Like the proposal, the final rule makes clear that fiduciaries are not required to vote every proxy. However, in response to commenters' concerns, the rule significantly revises the standards fiduciaries must follow when deciding whether to vote.

The proposed rule provided a six-factor framework for fiduciaries considering whether to vote on a proxy proposal or take other shareholder action. Under that framework, fiduciaries would have had to consider the proxy proposal's impact on the economic value of the plan's investment by assessing risk and return over an appropriate investment horizon. The proposed rule would have required fiduciaries to vote only on proxy proposals that would have an economic impact on the plan and not vote on ones that wouldn't.

Commenters objected to this approach, arguing it required a burdensome analysis for every proxy proposal and might give rise to fiduciary liability for an incorrect decision to vote or not vote on a particular proposal.

To ease those concerns, the final rule abandons the economic-impact analysis and instead takes a principles-based approach. Under that approach, a fiduciary must act loyally and have a prudent process for deciding whether to vote (and can rely on two safe harbors for making that determination). The final rule does not dictate how a fiduciary must vote in any situation. However, the preamble notes that economic considerations nevertheless could require fiduciaries to vote a certain way. For example, if a shareholder proposal would require a corporation to incur costs without a demonstrable expected economic return, a fiduciary may — depending on the facts and circumstances — be obligated to vote against the proposal to protect the financial interests of plan participants.

Fiduciary framework

Like the proposal, the final rule's framework contains six considerations for fiduciaries deciding whether to vote a proxy or take other shareholder action. However, those considerations are less prescriptive in the final rule than DOL initially proposed. Instead, the rule establishes a structure for a fiduciary to evaluate prospective shareholder actions and document its decisions. Even under this looser framework, the final rule maintains the position that fiduciaries must evaluate all actions in light of the plan's and plan participants' economic interests and must not subordinate participants' interests to nonpecuniary goals.

When deciding whether to vote a proxy or otherwise exercise shareholder rights, plan fiduciaries must take six considerations into account:

- **Economic interest.** The fiduciary must act solely in the economic interest of the plan and its participants and beneficiaries. As discussed above, the proposal would have required an evaluation of the economic impact of any shareholder action on the plan, but DOL dropped that requirement from the final rule.
- **Pecuniary objectives.** 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.
- **Costs.** The fiduciary must consider any costs involved, such as the direct costs of voting, the possible impact on management fees from reducing the number of proxies voted, or any potential opportunity costs. The proposal included a broader assessment of an action's impact on a plan's investment performance, reflecting such factors as the relative size of the investment to the plan's assets as a whole. DOL simplified the requirement to address concerns when a plan retains multiple investment managers. However, the preamble to the final rule explains that the overall aggregate exposure — if known — to a single issuer may still be relevant in certain cases.

- **Material facts.** The fiduciary must evaluate material facts that form the basis of any particular proxy vote. The proposed rule used the term “investigate,” but DOL made the change to avoid suggesting that fiduciaries must perform their own investigation. Instead, fiduciaries must consider all material information that is known or reasonably knowable.
- **Records.** The fiduciary must maintain records of proxy votes and shareholder actions. The final rule removes the proposed requirement to document the rationale for taking each action, but the preamble notes that the extent of the documentation needed will depend on individual circumstances, including the subject of the vote and its potential economic impact on the plan.
- **Advisors.** The fiduciary must act prudently and diligently when selecting and monitoring advisors or others who assist with exercising shareholder rights (e.g., by doing research, providing recommendations or performing other administrative or recordkeeping services). This provision is unchanged from the proposal. In the preamble, DOL notes that this requirement essentially restates the general fiduciary obligations that apply when selecting and monitoring service providers. Fiduciaries generally should assess the provider’s qualifications, quality of services offered and the reasonableness of fees charged for those services. The process also must avoid self-dealing, conflicts of interest or other improper influence.

Delegation to investment managers

Like the earlier proposal, the final rule codifies that the responsibility for exercising shareholder rights remains exclusively with the trustee, unless the trustee is directed by the named fiduciary or voting has been delegated to an investment manager.

Monitoring. Under the final rule, fiduciaries don’t have to require that investment managers document the rationale for proxy-voting decisions. This provision in the proposed rule was intended to facilitate monitoring the investment manager’s voting decisions to ensure they were based solely on the expected economic interests of the plan and its participants and beneficiaries. However, commenters expressed concerns that this provision created a higher monitoring standard than what applies for other fiduciary delegations, including the duty to monitor every proxy vote.

To address these concerns, DOL struck the documentation requirement, replacing it with a general duty to prudently monitor an investment manager’s proxy-voting activities to determine if they are consistent with the final rule. The preamble notes that fiduciaries can still review the records maintained by an investment manager registered as an investment advisor with the Securities and Exchange Commission (SEC). Under SEC rules, registered investment advisors have to keep a record of each proxy vote cast on behalf of a client and retain any documents that are material to a voting decision or memorialize the basis for the decision.

Pooled trusts. 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 proxy-voting policy. The investment manager can require each participating plan to accept the terms of that 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

Proxy advisors

The final rule's provisions on proxy advisors — and DOL's commentary in the preamble — are similar to the rules relating to investment managers. Before retaining a proxy advisor, a fiduciary must determine that the advisor's proxy-voting guidelines are consistent with the final rule's fiduciary obligations. This requirement is more stringent than the proposal, which would have required only that the advisor's voting guidelines comply with the economic-interest requirement. A fiduciary also has a general duty to monitor the advisor's proxy-voting activities, but needn't require documentation of the rationale for the advisor's proxy-voting decisions.

Proxy-voting safe harbors

To help fiduciaries establish prudent processes for determining whether to vote on a particular proxy proposal, the rule includes two safe harbor proxy-voting policies. However, DOL explicitly states that the safe harbors are neither minimum requirements nor the exclusive means for meeting the rule's fiduciary requirements. Under the final rule, a plan fiduciary may adopt one, both or neither of the following safe harbor proxy-voting policies:

- A policy to vote to only proposals of a type that the fiduciary has prudently determined are substantially related the issuer's business activities or expected to have a material effect on the value of the plan's investment
- A policy of refraining from voting on proposals or types of proposals when the plan's holding in the issuer is below a quantitative threshold that's small enough for the fiduciary to prudently determine the vote isn't expected to have a material effect on the plan's investment performance

The final rule recasts two proposed "permitted practices" to form the new safe harbors. The final rule excludes a third proposed practice, which would have let fiduciaries adopt a policy to follow the voting recommendation of the stock issuer's management on proxies unlikely to have a significant impact on the plan's investment. In response to commenters, DOL makes clear in the preamble that the two practices retained in the final rule are safe harbors, rather than merely being permitted practices.

Periodic review. Fiduciaries that adopt proxy-voting policies must periodically review them. Consistent with its principles-based approach, the final rule drops the proposed requirement to review these policies every two years. However, the preamble states that a two-year review cycle would be consistent with general industry practice, so DOL expects fiduciaries will review proxy-voting policies with roughly the same frequency.

Pass-through voting

For clarity, the final rule explains that its requirements don't apply when plans pass voting rights on to participants (known as "pass-through" or "participant-directed" voting). Some 401(k) plans let participants use plan funds to invest in securities not offered directly by the plan. These "self-directed brokerage" features typically pass voting rights on those investments to participants. In addition, plans with company stock funds pass voting and tender rights through to participants to comply with ERISA Section 404(c) requirements (29 CFR [§ 2550.404c-1](#)).

Although the final rule doesn't apply in these cases, the preamble makes clear that the trustee and other plan fiduciaries still have fiduciary obligations with respect to pass-through voting — particularly when following participants' voting directions on company stock. The preamble confirms that fiduciaries can rely on DOL's prior guidance on participant-directed voting, including the 404(c) regulations.

Mutual funds

The preamble explains that the rule doesn't apply to proxies for shares held by mutual funds. The rule apparently does apply to proxies for a mutual fund itself — i.e., a vote to elect mutual fund directors — even though neither the rule nor the preamble explicitly states this.

Commenters wondered whether the final rule would require fiduciaries to determine if a mutual fund's voting practices are consistent with ERISA's duty of loyalty before deciding to invest in the fund. DOL says that question is beyond the scope of the proxy-voting rule. However, a fund's proxy-voting policies could be a relevant consideration under DOL's recent [final regulation](#) on selecting plan investments. That rule requires fiduciaries to base any investment action only on pecuniary factors and act in the primary interest of plan participants and beneficiaries. Whether a particular fund's proxy-voting activities are a pecuniary factor and, if so, how much weight to give those practices are factual questions a fiduciary should resolve based on the circumstances.

Stance on social investing

Like the proposed rule, the final rule formally withdraws Interpretive Bulletin 2016-01, which some fiduciaries viewed as permissive on considering environmental, social and corporate governance (ESG) goals when voting shares. DOL's recent guidance has taken a firm stance against social investing, consistently stating that fiduciaries must always be guided only by the plan's economic interests and not

any nonpecuniary concerns. Although the agency acknowledges that ESG goals sometimes might properly be viewed as pecuniary factors, the preamble to this rule cautions fiduciaries not to take an overly expansive view of what votes and issues are in a plan's economic interests.

Effective date

The final rule generally took effect Jan. 15, 2021, and applies to proxy votes and other exercises of shareholder rights after that date. However, the rule extends the compliance deadline to Jan. 31, 2022, for the following requirements:

- For fiduciaries who aren't SEC-registered advisors to evaluate material facts that form the basis for a proxy vote or other shareholder action or to maintain records on proxy votes or other shareholder actions (SEC-registered advisors must already comply with similar requirements under the Investment Advisers Act and other SEC guidance)
- To determine that a proxy advisory firm or other service provider's proxy-voting guidelines are consistent with the rule's fiduciary obligations
- To assess whether an investment manager's investment policy and proxy-voting statements are consistent with Title I of ERISA and the final rule

More to come?

The new administration is likely to take a much more favorable view of social investing as part of President Biden's climate change agenda. The administration is currently reviewing the final rule requiring fiduciaries to select plan investments based on financial factors. That review might include the proxy-voting rule, which is an addition to the financial-factors rule. However, the path toward reversing the rules — which are already in effect — is neither short nor straightforward. DOL would have to go through a notice and comment period, which would take several months. DOL could suspend enforcement of the rules in the meantime, but has yet to indicate if it will do so. For now, fiduciaries will need to abide by the new rule (subject to the transition period for certain provisions noted above).

Related resources

Non-Mercer resources

- [Regulatory freeze pending review](#) (White House, Jan. 20, 2021)
- [Final rule](#), Fiduciary duties regarding proxy voting and shareholder rights (Federal Register, Dec. 16, 2020)
- [News release](#) on proxy-voting rule (DOL, Dec. 11, 2020)

- [Final rule](#), Financial factors in selecting plan investments (Federal Register, Nov. 13, 2020)

Mercer Law & Policy resources

- [Investment advice PTE takes effect as DOL hints at more changes](#) (Feb. 17, 2021)
- [DOL finalizes more fiduciary investment guidance](#) (Dec. 22, 2020)
- [DOL proposal would clarify proxy-voting rules](#) (Sept. 15, 2020)

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