DOL Issues Final Rule on Proxy Voting by ERISA Plans

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January 8, 2021

The U.S. Department of Labor (the "DOL") recently issued a final rule (the "Final Rule") under the Employee Retirement Income Security Act of 1974 ("ERISA") to clarify plan fiduciaries' duties with respect to proxy voting and other shareholder activities. The Final Rule affirms the DOL's long-standing view that proxy voting and other shareholder activities are part of a fiduciary's obligation to manage plan investments in accordance with the ERISA duties of prudence and loyalty. Consistent with another recent rulemaking by the DOL with respect to ESG investments (see our prior alert here), the Final Rule generally requires fiduciaries to consider only the economic interest of the plan and its participants in making decisions relating to proxy voting and other shareholder actions. Notably, the Final Rule clarifies that fiduciaries are not required to vote every proxy or exercise every shareholder right.

The Final Rule prescribes how fiduciaries may discharge their duties of prudence and loyalty under ERISA when deciding whether to exercise a shareholder right and when exercising a shareholder right. Among other things, the Final Rule requires fiduciaries to evaluate material facts that form the basis for any particular proxy vote or other shareholder action, and to maintain records on such actions. Helpfully, with respect to the decisions on whether to vote a proxy, the Final Rule allows fiduciaries to adopt the safe harbor policies provided in the Final Rule [1] or any other proxy voting policies that are prudently designed to serve the plan's economic interest.

For those fiduciaries that engage proxy advisory firms or other service providers to assist with proxy voting or other shareholder activities, the Final Rule requires that fiduciaries exercise prudence and diligence in selecting and monitoring such service providers. Specifically, fiduciaries may not follow the recommendations of a proxy advisory firm without determining that such firm's proxy voting guidelines are consistent with the fiduciary obligations set forth in the Final Rule. The Final Rule further clarifies that, when a plan fiduciary has delegated the authority to vote proxies or engage in other shareholder activities to an investment manager or proxy advisory firm, the fiduciary remains responsible for prudently monitoring such activities.

The Final Rule also addresses the obligations of investment managers managing a pooled investment vehicle, such as a "plan assets" fund, that holds assets of more than one plan. In such case, managers must reconcile any conflicting proxy voting policies among the investing plans to the extent possible. Alternatively, managers may require investing plans to accept the manager's own proxy voting guidelines as a condition to investing in the fund.

Fundamentally, the Final Rule is consistent with the DOL's prior guidance on proxy voting and other shareholder engagement by ERISA plans. In this regard, we do not expect the current approach to proxy voting and other shareholder activities to change significantly for most ERISA plans and their fiduciaries, but fiduciaries should take note of the recordkeeping obligation set forth in the Final Rule, as well as the obligation to monitor proxy advisory firms or other service providers. Investment managers and other ERISA fiduciaries should evaluate whether their current proxy voting policies and practices comport with the fiduciary obligations set forth in the Final Rule.

The Final Rule will generally become effective on January 15, 2021 and apply prospectively to proxy voting and other shareholder decisions made after the effective date, but fiduciaries will have until January 31, 2022 to comply with the requirement to determine whether the proxy voting guidelines of an investment manager, proxy advisory firm or other service provider are consistent with the Final Rule.

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[1] The two safe harbor policies provided in the Final Rule are: (1) a policy that voting resources will focus only on particular types of proposals that the fiduciary has prudently determined are substantially related to the issuer's business activities or are expected to have a material effect on the value of the plan's investment, and (2) a policy of refraining from voting on proposals or types of proposals when the size of the plan's holding in the issuer is below quantitative thresholds that the fiduciary prudently determines, considering its percentage

ownership of the issuer and other relevant factors, is sufficiently small that the matter being voted upon is not expected to have a material effect on the investment performance of the plan's portfolio (or assets under management in the case of an investment manager).

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