

## DOL Issues Guidance on Shareholder Engagement and Pension Fund Investments

January 23, 2017

On December 28, the US Department of Labor ("DOL") issued [Interpretive Bulletin 2016-01](#) (published in the Federal Register on December 29, 2016), setting forth its views concerning the legal standards under Sections 402, 403, and 404 of Part 4 of Title I of the Employee Retirement Income Security Act of 1974 ("ERISA") with respect to voting of proxies on securities held in employee benefit plan investment portfolios, the maintenance of and compliance with employee benefit plan investment policies (including proxy voting policies), and the exercise of other legal rights of a corporate shareholder. Under Interpretive Bulletin 2016-01 ("IB 2016-01"), plan fiduciaries who are voting proxies or exercising other shareholder rights need not engage in a cost-benefit analysis but instead should consider whether such actions, when taken together with other shareholders, are reasonably expected to enhance the value of the plan's investment, unless the attendant costs of the particular action to be taken are not in the plan's best interest.

Part 4 of Title I of ERISA sets forth rules of fiduciary responsibility for plan fiduciaries of private sector employee benefit plans. The DOL, in Interpretive Bulletin 94-2 ("IB 94-2") (codified at 29 CFR 2509.94-2 but later replaced by Interpretive Bulletin 2008-2 ("IB 2008-2"), which is codified at 29 CFR 2509.08-2), stated its view that as part of the act of managing plan assets, a plan fiduciary is responsible for the voting of proxies and other exercises of shareholder rights. Unless delegated to an investment manager or retained by the plan's named fiduciary, such responsibility is to be carried out by the plan's trustee.

IB 94-2 also recognized that, in addition to proxy voting, a fiduciary may engage in other shareholder actions intended to monitor or influence corporate management provided that the fiduciary concludes "that there is a reasonable expectation that such monitoring or communication with management, by the plan alone or together with other shareholders, is likely to enhance the value of the plan's investment in the corporation, after taking into account the costs involved." In other words, plan fiduciaries may not subordinate the economic interests of plan participants and beneficiaries to unrelated objectives in voting proxies or in exercising other shareholder rights. However, IB 94-2 also noted that a reasonable expectation as to the enhancement of investment value "may exist in various circumstances, for example where plan investments in corporate stock are held as long-term investments or where a plan may not be able to easily dispose such an investment."

In its preamble to IB 2016-01, the DOL stated its concern that some plan fiduciaries have read IB 2008-2 "to articulate a general rule that broadly prohibits ERISA plans from exercising shareholder rights, including voting of proxies, unless the plan has performed a cost-benefit analysis and concluded in the case of each particular proxy vote or exercise of shareholder rights that the action is more likely than not to result in a quantifiable increase in the economic value of the plan's investment." (The DOL noted that it had corrected a similar reading with respect to economically targeted investments when it issued Interpretive Bulletin 2015-01; see our alert on IB 2015-01, [Climate Change and Pension Fund Investments](#).) The DOL corrected that reading, explaining that the presumption should be reversed: "proxies should be voted as part of the process of managing the plan's investment in company stock unless a responsible fiduciary determined that the time and costs associated with voting proxies in respect of certain types of proposals or issuers may not be in the plan's best interest." The DOL believes that in most cases, "proxy voting and other shareholder engagement does not involve a significant expenditure of funds by individual plan investors because activities are engaged in by institutional investment managers appointed as the responsible plan fiduciary ... [and] [t]hose

investment managers often engage consultants, including proxy advisory firms, in an attempt to further reduce costs of researching proxy matters and exercising shareholder rights." Moreover, the DOL noted that as long-term investors, in some cases with significantly indexed portfolios, selling shares and finding replacements may not be a prudent solution for an employee benefit plan investor; changing or reforming management may be the preferred course of action of a prudent investment fiduciary.

Accordingly, the DOL, in withdrawing IB 2008-02 and replacing it with IB 2016-1 (which the DOL characterizes as reinstating IB 94-2 "with minor updates"), has concluded that the changes to IB 94-2 in IB 2008-2 "are out of step with important domestic and international trends in investment management and have the potential to dissuade ERISA fiduciaries from exercising shareholder rights, including the voting of proxies, in areas that are increasingly being recognized as important to long-term shareholder value." Thus, in reviving IB 94-2, the DOL deleted several sentences in IB 2008-2 that emphasized the cost-benefit analysis that must be applied to each decision as to whether and how to exercise shareholder rights, including proxy voting.

When discussing statements of investment policy in IB 2016-01, the DOL amplified IB 94-2 by explaining that such a policy provides plan fiduciaries with "guidelines or general instructions concerning various types or categories of investment management decisions, which may include proxy voting decisions as well as policies concerning economically targeted investments or incorporating environmental, social or governance (ESG) factors in investment policy statements or integrating ESG-related tools, metrics and analyses to evaluate an investment's risk or return or choose among equivalent investments."

The section of IB 94-2 titled "Shareholder Activism" has become "Shareholder Engagement" in IB 2016-01, and the entire section of IB 2008-2 titled "Socially-Directed Proxy Voting, Investment Policies and Shareholder Activism" in which the DOL articulated a required "more likely than not" cost-benefit analysis for each shareholder action taken by a plan fiduciary has been deleted. Examples of areas in which a plan fiduciary may monitor and communicate with corporations in which the plan holds interests now include "governance structures and practices, particularly those involving board composition,... transparency and accountability in corporate decision-making, responsiveness to shareholders,... the nature of long-term business plans including plans on climate change preparedness and sustainability, governance and compliance policies and practices for avoiding criminal liability and ensuring employees comply with applicable laws and regulations, the corporation's workforce practices (e.g., investment in training to develop its work force, diversity, equal employment opportunity), [and] policies and practices to address environmental or social factors that have an impact on shareholder value..."

Predictably, IB 2016-01 has been greeted by some as having created, without adequate notice, comment, and study, negative impacts on investors and businesses and by others as a welcome clarification of ERISA. For those pension funds that, with the encouragement of IB 2015-01, have begun to incorporate ESG considerations, such as preparedness for climate change, into their investment management process, IB 2016-01 is a natural extension of that earlier guidance to proxy voting and other forms of shareholder engagement. Proxy advisory firms, such as ISS and Glass Lewis, may provide a cost-effective way for plan fiduciaries to evaluate proxy proposals and monitor corporate governance, and, as a result, such firms may come to wield greater influence over corporate actions. However, it remains to be seen how the winds of change in Washington may affect the DOL and its ERISA guidance like IB 2015-01 and IB 2016-01. We will keep you informed.

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