

insights

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DOL revises guidance regarding exercise of shareholder rights by ERISA fiduciaries

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At the end of 2016, the U.S. Department of Labor (DOL) issued Interpretive Bulletin 2016-1 which provides updated guidance regarding fiduciary obligations with respect to corporate stock held by employee benefit plans that are subject to ERISA. The guidance addresses proxy voting, investment policy statements, and the exercise of shareholder rights.

Interpretive Bulletin 2016-1 is significant because it reverses guidance the DOL provided in 2008 with respect to these topics. Specifically, Interpretive Bulletin 2016-1 reverts to guidance the DOL issued in Interpretive Bulletin 94-2 with a few modifications. Interpretive Bulletin 2016-1 became effective on December 29, 2016.

INTERPRETIVE BULLETIN 94-2

In 1994, the DOL issued Interpretive Bulletin 94-2 providing guidance to ERISA fiduciaries regarding proxy voting with respect to corporate stock held as plan assets, the nature and scope of investment policy statements, and shareholder activism by plan fiduciaries.

Proxy Voting

Interpretive Bulletin 94-2 provides that the duty to manage plan assets includes the voting of proxies with respect to stock held by an ERISA plan. The duty to vote proxies lies exclusively with the plan trustee unless (1) the trustee is subject to the direction of a named fiduciary, or (2) the power to manage, acquire, or dispose of plan assets has been delegated to an investment manager. If the management of plan assets has been delegated by a named fiduciary to an investment manager, such manager has the exclusive authority to vote proxies (unless the named fiduciary expressly reserved such voting rights). The investment manager remains the responsible fiduciary even if it delegates the authority to exercise voting rights with respect to stock held by the plan to another person.

Interpretive Bulletin 94-2 states that, in voting proxies, a responsible fiduciary must consider factors that may affect the value of the stock and cannot subordinate the interests of participants and beneficiaries to unrelated objectives. It also states that responsible fiduciaries are required to vote proxies on issues that may affect the value of the plan's investment. However, in deciding whether to vote proxies with respect to stock of foreign corporations, responsible fiduciaries may take into account the costs of voting.

The fiduciary who appoints the investment manager must monitor the manager's activities, including proxy voting decisions. The investment manager or any other fiduciary responsible for voting proxies must maintain the necessary records to permit such monitoring.

Investment Policy Statement

Interpretive Bulletin 94-2 notes that maintenance of a written investment policy is consistent with the fiduciary duties under ERISA. An investment policy is considered one of the documents governing the plan and, consequently, compliance with such a policy is required under ERISA unless such compliance violates ERISA. For example, an investment manager is not required to take an action that complies with the investment policy if such action is imprudent. The investment policy should include a proxy voting policy. In designing the investment policy, the drafting fiduciary should take into account the plan's funding and liquidity needs as well as other ERISA requirements such as the duty to diversify plan assets.

Merely providing a written investment policy to an investment manager does not relieve a named fiduciary of his or her duties with respect to the plan. The fiduciary must continue to monitor the actions of the investment manager and the investment manager must maintain records necessary to permit such review.

Shareholder Activism

With respect to shareholder activism, Interpretive Bulletin 94-2 notes that an investment policy that addresses shareholder efforts to monitor or influence corporate management is consistent with ERISA if the responsible fiduciary determines that there is a reasonable expectation of enhancing the value of the plan's investment by engaging in such activities after taking into account the related costs. Likely circumstances in which shareholder activities might be reasonably expected to enhance stock value might include stock held as long-term investments or stock subject to restrictions on disposition. Shareholder activities may include active monitoring and communication activities relating to the independence and expertise of candidates for the corporate board, the appropriateness of executive compensation, corporate policy regarding mergers and acquisitions, the extent of debt financing, the financial and non-financial measures of corporate performance, among other factors.

INTERPRETIVE BULLETIN 08-2

In 2008, the DOL issued Interpretive Bulletin 08-2 which superseded the guidance in Interpretive Bulletin 94-2 with respect to proxy voting policies, written investment policy statements and the exercise of shareholder rights. Although Interpretive Bulletin 08-2 retained much of the language of Interpretive Bulletin 94-2, it changed the emphasis in several key areas. For example, in reference to fiduciary duties with respect to stock held by an ERISA plan, the term "economic value" is substituted for "value" throughout the Bulletin. Other changes are noted below.

Proxy Voting

Interpretive Bulletin 08-2 clarifies that, in voting proxies, a responsible fiduciary "shall consider only those factors that relate to the economic value of the plan's investment." A responsible fiduciary must not vote proxies if the cost of voting, including research, is likely to exceed the economic benefit of voting, or if voting results in the imposition of trading or other restrictions.

If investment managers have been appointed to manage plan assets, the plan fiduciary's periodic monitoring must ascertain whether the investment manager has acted "solely in the participants' and beneficiaries' interest in the economic value of the plan assets." The investment manager or other responsible fiduciary must maintain records, not only with respect to voting procedures and voting decisions, but also with respect to any cost-benefit analyses supporting its voting decisions.

Although Interpretive Bulletin 08-2 reiterates the general rule that a responsible fiduciary has a duty to vote proxies on issues that may affect the economic value of a stock investment, it notes that the fiduciary must take into account costs, in deciding whether and how to vote. In contrast, Interpretive Bulletin 94-2 limited such cost-benefit analysis to voting proxies with respect to foreign stocks. Relevant costs include, but are not limited to, developing proxy resolutions, engaging proxy voting services, and developing an analysis of the likely net effect of a particular issue on the economic value of the plan's investment.

Investment Policy Statement

With respect to the investment policy, Interpretive Bulletin 08-2 emphasizes that such policy must comply, not only with ERISA, but also with the requirements of Interpretive Bulletin 08-2, and that the terms of the investment policy may not subordinate the economic interests of participants and beneficiaries to unrelated objectives.

Shareholder Activism

With respect to shareholder activism, Interpretive Bulletin 08-2 states that a fiduciary must not use an investment policy to "promote myriad public policy preferences."

Socially-Directed Proxy Voting, Investment Policies and Shareholder Activism

Interpretive Bulletin 08-2 adds a new section specifically addressing socially-directed fiduciary activities. The Bulletin states that a fiduciary risks violating the exclusive purpose rule under ERISA if it attempts to further legislative, regulatory or public policy issues through its proxy votes. Interpretive Bulletin 08-2 states:

Because of the heightened potential for abuse in such cases, fiduciaries must be prepared to articulate a clear basis for concluding that the proxy vote, the investment policy, or the activity intended to monitor or influence the management of the corporation is more likely than not to enhance the economic value of the plan's investment before expending plan assets.

Interpretive Bulletin 08-2 states that the use of plan assets to "further political or policy issues through proxy resolutions that have no connection to enhancing the economic value of the plan's investment" violates ERISA.

Interpretive Bulletin 2016-01

The DOL now believes that Interpretive Bulletin 08-2 discouraged responsible fiduciaries from voting proxies and exercising shareholder rights. Specifically, the DOL believes that Interpretive Bulletin 08-2 has been interpreted to require a cost-benefit analysis concluding that shareholder action will more likely than not increase the economic value of stock held by the plan before the fiduciary can take such action.

To the contrary, in Interpretive Bulletin 2016-1 the DOL states that a cost-benefit analysis is only required in special circumstances and that many proxy votes involve few, if any, additional expenses to the plan. The DOL notes that fiduciary participation in proxy voting and other shareholder activities is important because most ERISA plans have a significant portion of their assets invested in publicly traded stock and it is widely believed that changes in management or management reform are the most effective way to impact stock value.

The DOL is also concerned that Interpretive Bulletin 08-2 created confusion in light of DOL guidance in Interpretive Bulletin 2015-1 regarding plan investment strategies that take into account environmental, social and governance (ESG) factors. The DOL notes in Interpretive 2016-1 that many institutional investors and money managers currently engage in proxy voting and other shareholder activities with respect to ESG issues. Finally, the DOL notes that the 2008 financial crisis highlighted the dangers of shareholder inattention and the benefits of shareholder activism.

To that end, Interpretive Bulletin 2016-1 withdraws Interpretive Bulletin 08-2 and incorporates the language of Interpretive Bulletin 94-2 with the following modifications.

Proxy Voting

With respect to proxy voting, Interpretive Bulletin 2016-1 reiterates that ERISA requires responsible fiduciaries to vote proxies on issues that may affect the value of stock held by the plan. However, in special cases, if proxy voting may involve extraordinary costs or unusual requirements, the fiduciary must weigh such costs against the expected effect of the vote on the value of the plan assets.

Investment Policy Statement

Interpretive Bulletin 2016-1 states that investment policies may include policies concerning economically targeted investments (that is, investments with economic benefits other than the investment return to shareholders), incorporating ESG factors, or integrating ESG tools and metrics to evaluate plan investments or choose among equivalent investments.

Shareholder Activism

Interpretive Bulletin 2016-1 lists additional issues on which shareholder monitoring and communication with management may be warranted, including governance structures and practices (especially involving board composition), transparency and accountability in corporate decision-making, responsiveness to shareholders, corporate plans on climate change preparedness and sustainability, governance and compliance policies and practices for avoiding criminal liability and ensuring employee compliance with applicable laws, diversity, equal employment, and policies and practices to address environmental or social factors

Overall, Interpretive Bulletin 2016-1 grants to plan fiduciaries responsible for proxy voting and the exercise of shareholder rights with respect to stock held by an ERISA plan greater leeway to take into account factors in addition to the economic value of the stock held by the plan. Plan sponsor should review their investment policies for ERISA plans in light of Interpretive Bulletin 2016-1.

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