

DOL's Proposed New Proxy Voting Rule Could Be a Game Changer for ERISA Fiduciaries

A Practical Guidance® Article by Julie K. Stapel, Morgan, Lewis & Bockius, LLP



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Keeping up the steady stream of new and proposed guidance coming from the U.S. Department of Labor (DOL), the Employee Benefits Security Administration issued a proposed regulation on September 4, 2020 that would require significant changes in how ERISA fiduciaries consider and approach proxy voting and the exercise of other shareholder rights. 85 Fed. Reg. 55,219 (Sept. 4, 2020).

The Proposed Regulation

The proposed regulation, if adopted as proposed, would change the longstanding conventional wisdom, based on past DOL guidance, that voting proxies is a part of the fiduciary act of managing plan assets and that a fiduciary may not simply determine not to vote proxies, subject only to limited and narrow exceptions. The proposed regulation, in contrast, takes the position that ERISA actually requires fiduciaries NOT to vote proxies unless the fiduciary prudently determines that the matter being voted upon would have an economic impact on the plan, taking into account factors such as the size of the plan's investment in the issuer, both as a percentage of plan assets and as a percentage of the issuer. Given that institutional employee benefits plans tend to be well diversified, it may prove difficult to meet this threshold.

The proposed regulation also suggests that fiduciaries may adopt a policy of voting with management on matters that

a fiduciary views as unlikely to have a significant impact on the value of the plan's investment or a policy of refraining from voting proxies when the plan's holdings are below a quantitative threshold of the plan's overall holdings. The DOL solicited comments on what threshold level would be appropriate, mentioning 5% as one possibility.

Another departure from current common practice is the proposed regulation's statement that a fiduciary may not adopt a practice of following the recommendations of proxy advisory firms or proxy service providers without determining that such advisory firm or service is applying the cost-benefit analysis set forth in the proposed regulation. Many institutional employee benefit plans and their advisors use proxy-voting firms in a variety of ways. The proposed regulation would change that relationship and subject it to monitoring obligations that may be difficult to satisfy.

The proposed regulation would have a significant impact on the voting of proxies on shareholder proposals related to economic, social, and governance (ESG) issues. It would be very difficult to justify the voting of proxies on ESG issues given the regulations' required focus on the economic impact of the vote on the plan. For this reason, the regulations can be seen as a continuation of the DOL's attack on fiduciaries' consideration of ESG factors in connection with plan investments, following its release in June of proposed regulations limiting the use of ESG factors in the selection of investment funds in defined contribution plans.

Comments on the proposed regulation are due on October 5, 2020, and we expect to see active commenting. If finalized as proposed, we expect ERISA fiduciaries will need to reevaluate their current proxy voting practices in light of these changes.

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Julie K. Stapel helps employee benefit plan sponsors and financial service providers with the investment, and management of employee benefit plan assets. She advises clients on ERISA fiduciary and prohibited transaction rules, and their impact on investment products and services, and helps those clients use investment documentation and other tools to manage potential fiduciary risks while providing top-quality benefits and services. She also works with plan sponsors and financial service providers to address ERISA-related compliance issues.

Julie helps clients negotiate investment-related agreements of virtually every type, including investment management, trust, securities lending and transition management agreements, as well as many different types of trading agreements. She represents employee benefit plan investors in all types of private fund investments, negotiating fund documentation and side letters to address ERISA and other risk management issues. She also counsels financial services and investment management clients on ERISA compliance.

Co-leader of the firm's Fiduciary Duty Task Force, Julie also advises on fiduciary governance, including the formation and operation of benefit plan fiduciary committees.

She works with plan fiduciaries to implement ERISA compliance best practices and manage fiduciary risks. She also helps clients remain in compliance with ERISA's ever-changing reporting and disclosure obligations.

Julie speaks frequently on ERISA-related topics. She has spoken before the Committee on the Investment of Employee Benefit Assets (CIEBA), the ERISA Industry Committee (ERIC), the John Marshall School of Law, and at various events sponsored by *Pension and Investments* magazine. In addition to these speaking engagements, she regularly addresses client fiduciary committees and investment staff, performing fiduciary training and presenting updates on changes in the law. She is also president of the Chicago Chapter of Worldwide Employee Benefits Network (WEB).

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