DOL's Final ERISA Proxy Voting Rule Largely Changed to Principles-Based Approach

A Practical Guidance® Article by
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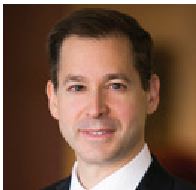

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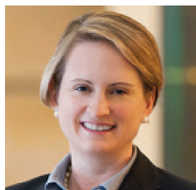

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The U.S. Department of Labor (DOL) has released its final rule on the application of ERISA fiduciary duties—specifically the duties of prudence and loyalty—to proxy voting and the exercise of shareholder rights. 85 Fed. Reg. 81,658 (Dec. 16, 2020). It takes effect on January 15, 2021, with delayed applicability dates for certain provisions. It adds an additional subsection to the DOL's final "financial factors" regulation that was published in the Federal Register in November. See 85 Fed. Reg. 72,846 (Nov. 13, 2020).

The proposed regulation, published in September 2020, had been controversial in a number of respects, with much of the criticism focused on what were considered to be overly prescriptive rules requiring fiduciaries to undertake, and document, a specific cost-benefit analysis before voting any proxies or exercising shareholder rights. See 85 Fed. Reg. 55,219 (Sept. 4, 2020). In response to the comments, the DOL has eliminated many of those prescriptive requirements, resulting in what the DOL describes as a principles-based rule designed to provide certainty on

fiduciaries' responsibilities under ERISA with respect to proxy voting while offering more flexibility on how those responsibilities may be met. Some of the required steps in the proposal have been effectively replaced by safe harbors. The result, while still possibly requiring changes to existing practices to ensure compliance (as discussed under Observations, below), should be viewed as more consistent with those practices developed in the wake of the DOL's previous guidance in this area.

The DOL's description of the final rule notes several areas where the rule is intended to align with U.S. Securities and Exchange Commission (SEC) guidance on proxy voting. See below for a chart comparing key elements of the final DOL rule and the SEC guidance.

Background

The DOL's guidance on proxy voting for ERISA plans dates back to the 1980s, taking the position (stated in a 1988 advisory opinion) that the fiduciary act of managing plan assets that are shares of stock includes voting proxies appurtenant to that stock. Subsequent guidance in 1994, 2008, and 2016 emphasized that these votes should be based on the economic interests of the plan, but with some variations on the ability to take cost and "noneconomic" considerations into account when deciding whether or how to vote proxies. All of this was in the form of subregulatory guidance, which the current administration does not consider to be binding.

There are a number of reasons leading to this final rule. One is the DOL's interest in providing greater certainty in the form of binding guidance subject to the notice-and-comment rulemaking process. In addition, there is the ability to take into account more recent developments in the proxy voting area— including the SEC's proxy reform initiative, the evolving role and significance of proxy advisory firms, and views on incorporating and considering "nonpecuniary factors" into proxy voting decisions.

In conjunction with finalizing the rule, the DOL withdrew or nullified its prior subregulatory guidance that was still in effect: Interpretive Bulletin 2016-01 and Field Assistance Bulletin 2018-01.

Basic Rule

The new rule begins with a statement of the DOL's "longstanding position," dating back to at least 1988, that "[t]he fiduciary duty to manage plan assets that are shares of stock includes the management of shareholder rights appurtenant to those shares, such as the right to vote proxies." That having been established, the rule text states the general fiduciary standard to be applied when dealing with proxy votes and other shareholder rights with respect to such shares of stock, which is based on the ERISA fiduciary duties of prudence and loyalty:

> When deciding whether to exercise shareholder rights and when exercising such rights, including the voting of proxies, fiduciaries must carry out their duties prudently and solely in the interests of the participants and beneficiaries and for the exclusive purpose of providing benefits to participants and beneficiaries and defraying the reasonable expenses of administering the plan.

The previous subregulatory guidance had addressed shareholder activism, sometimes more favorably and sometimes less favorably. In the preamble to the final rule, the DOL expressed the view that activities intended to monitor or influence the management of corporations can be consistent with a fiduciary's obligations under ERISA, if the responsible fiduciary concludes that the activities—by the plan alone, or together with other shareholders—are appropriate under the rule. But the DOL added that the use of plan assets to further policy-related or political issues, such as environmental, social, and governance (ESG) issues, would violate the rule unless undertaken "solely in accordance with the economic interests of the plan and its participants and beneficiaries." The DOL allowed that a plan fiduciary could make the economic interest determination by considering a credible economic analysis provided by a shareholder proponent—it need not incur expenses to perform its own analysis. But the DOL further expressed the view that it would not be appropriate for plan fiduciaries to incur expenses to undertake shareholder activism–type activities, such as engaging in direct negotiations with management or sponsoring proxy fights on environmental or social issues, unless concluding that such activities (alone or together with other shareholders) are appropriate after applying the considerations under the rule.

Where the DOL believes there has been considerable confusion, as confirmed by a number of the comments it received, is as to whether ERISA fiduciaries are required by ERISA to vote proxies on every proposal. That appeared to be the message given by the DOL guidance in the 1980s, and subsequent guidance only allowed for narrow instances in which fiduciaries could forgo voting because of cost considerations (where the cost of voting would likely exceed the expected economic benefit) or associated trading restrictions (an issue that had been raised in connection

with voting proxies on some foreign securities). To clear up this confusion, the final rule explicitly states that the fiduciary duty to manage shareholder rights "does not require the voting of every proxy or the exercise of every shareholder right."

The proposal would have required fiduciaries to engage in a process to determine the economic versus noneconomic impact of a matter before deciding whether it would be permissible to vote a proxy. Specifically, it had said that a plan fiduciary would be required to vote any proxy where the fiduciary prudently determined that the matter being voted on would have an economic impact on the plan, taking costs of voting into account, and, conversely, not to vote any proxy unless having made that determination. Commenters noted that requiring this determination of whether to vote could generate cost, effort, and liability greater than that actually needed to vote the proxy. Recognizing this concern, the DOL was persuaded that the focus should rather be on whether a fiduciary has a prudent process in place. Instead, the final rule lists principles with which fiduciaries must comply when deciding whether to exercise shareholder rights and when actually exercising those rights, in order to meet ERISA's prudence and loyalty standards:

A. Act solely in accordance with the economic interest of the plan and its participants and beneficiaries.

B. Consider any costs involved.

- The preamble says that the types of costs that would be relevant would depend on the particular facts and circumstances. Relevant costs could include, for example, direct costs to the plan, ability to reduce a plan's management fees if proxies are not voted on nonmaterial matters, and limitations on a plan's ability to sell voted shares until after the upcoming shareholder meeting.

C. Not subordinate the interests of the participants and beneficiaries in their retirement income or financial benefits under the plan to any nonpecuniary objective or promote nonpecuniary benefits or goals unrelated to those financial interests.

- The "nonpecuniary objective" terminology incorporates the standards from the broader "financial factors" regulation that was published in final form in November 2020, of which the proxy voting/shareholder rights rule is now a part.

D. Evaluate material facts that form the basis for any particular proxy vote or other exercise of shareholder rights.

- The proposal had said "investigate." The DOL replaced that word with "evaluate," to remove any implication that the plan fiduciaries must conduct their own investigation at the plan's expense. The fiduciary's responsibility, said the DOL, is to "consider information material to a matter that is known or that is available to and reasonably should be known by the fiduciary," which the fiduciary may satisfy by retaining a proxy advisory firm.

E. Maintain records on proxy voting activities and other exercises of shareholder rights.

- Commenters had expressed concern about the proposal's "particularized recordkeeping mandates," which they argued were both "unnecessary and costly." While emphasizing its view that compliance with the duty to monitor necessitates proper documentation of the activities being monitored, the DOL agreed that a "less prescriptive approach" to recordkeeping would be appropriate, so while it retained the general recordkeeping requirement, it removed the requirement to maintain documents necessary to demonstrate the basis for a particular vote. The DOL observed that the extent of documentation needed to satisfy the monitoring obligation would depend on individual circumstances, including the subject of the proxy vote and its potential economic impact. The DOL added that for SEC registered investment advisers, the DOL intended that the recordkeeping obligations under this rule be applied in a manner that aligns with the proxy voting recordkeeping obligations under the Investment Advisers Act of 1940.

F. Exercise prudence and diligence in the selection and monitoring of persons, if any, selected to advise or otherwise assist with exercises of shareholder rights, such as providing research and analysis, recommendations regarding proxy votes, administrative services with voting proxies, and recordkeeping and reporting services.

- As a general matter, according to the preamble, fiduciaries will be expected to assess the qualifications of the provider, the quality of services offered, and the reasonableness of fees charged in light of the services provided, with due consideration of the need to avoid self-dealing, conflicts of interest, or other improper influence. The DOL added that, to the extent applicable, fiduciaries will be expected to review the provider's proxy voting policies and/or guidelines, and to take appropriate action if the recommendations and other activities of the provider are not being carried out in a manner consistent with those policies and/or guidelines.

With regard to delegation, the rule further provides that where the authority to vote proxies or exercise shareholder rights is delegated to an investment manager or a proxy voting firm, a plan fiduciary should be responsible for prudently monitoring the delegated firm's proxy voting activities and determining whether those activities are consistent with the general responsibilities described by the rule. The rule adds that a fiduciary may not adopt a practice of following the recommendations of a proxy advisory firm, or similar service provider, without first determining that the firm's guidelines are consistent with the fiduciary's obligations under the rule, reflecting a general concern by the DOL that fiduciaries might be accepting advisory firms' proxy voting policies without sufficient review for ERISA compliance.

- In response to comments suggesting the DOL was creating a higher standard for fiduciary monitoring of proxy voting activities than would ordinarily apply under ERISA, the DOL eliminated a requirement to document the rationale for specific proxy voting decisions. But the DOL noted that an SEC rule requires such documentation by SEC-registered advisers, which it said may be helpful to the monitoring plan fiduciaries.

The DOL cautioned fiduciaries from applying an "overly expansive" view as to what would be in the "economic interest" of a plan. Avoiding costs incurred by a corporation to delay a shareholder meeting due to lack of a quorum could qualify, but "vague or speculative notions that proxy voting may promote a theoretical benefit to the global economy that might redound, outside the plan, to the benefit of plan participants would not be considered an economic interest under the final rule." This echoes observations made in the "financial factors" rulemaking.

The DOL emphasized, in response to comments, that it was not its intention to judge the value of specific proposals or take a position on the merits of particular topics. Rather, its objective was to address the standards according to which plan fiduciaries must make judgments on how to vote, to ensure that those decisions are made in accordance with ERISA.

Safe Harbors

In a change from the proposal, the final rule takes what had been presented as in the nature of prescriptive requirements, or steps strongly suggested to meet those requirements, and converts them into safe harbors.

Under this approach, the final rule permits fiduciaries to meet their obligations by adopting proxy voting policies, with those policies providing that the authority to vote a proxy is to be exercised pursuant to specific parameters prudently designed to serve the plan's economic interest. The fiduciaries would then be obligated to periodically review these policies for continued compliance. ("Periodically" replaced a mandatory two-year minimum review schedule from the proposal, to avoid technical violation concerns, although the DOL noted its understanding that general industry practice is to review investment policy statements approximately every two years.)

The safe harbor provision, which is intended to present a cost-effective alternative to retaining a proxy advisory firm to provide advice on each vote, permits a plan to adopt either or both of the following types of policies on figuring out whether to vote (as opposed to how to vote):

A. A policy to limit voting resources to 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 investment.

- The use of "value of investment" in place of the proposal's "plan investment" is intended to make clear that the evaluation could be by an investment manager for a pooled fund, rather than just at the individual plan level.

B. A policy of refraining from voting on proposals or particular types of proposals when the plan's holding in a single issuer relative to the plan's total investment assets is below a quantitative threshold, which threshold the fiduciary prudently determines, considering its percentage ownership of the issuer and other relevant factors, is sufficiently small that the matter is not expected to have a material effect on the plan's investment performance—or, in the case of an investment manager, on the investment performance of assets under management.

- The DOL declined to set or suggest a cap on percentage ownership to use for this safe harbor, not having received sufficient information from the comments to do so.
- This safe harbor also does not specify a performance period for determining whether a material effect exists, leaving it to the fiduciary to prudently determine an appropriate performance period to use in this policy.
- In response to comments, the DOL did not retain a third proposed policy approach—voting in accordance with management recommendations—due to concerns

about whether management could be assumed to be acting in a plan's best interest.

However, these policies must be subject to a prudence "override." The rule adds that no proxy voting policies can preclude submitting a proxy vote when the fiduciary "prudently determines that the matter being voted upon is expected to have a material effect on the value of the investment or the investment performance of the plan's portfolio (or investment performance of assets under management in the case of an investment manager) after taking into account the costs involved," or preclude refraining from voting when the fiduciary "prudently determines that the matter being voted upon is not expected to have such a material effect after taking into account the costs involved." While this suggests a variation on the more prescriptive cost-benefit approach that was being eliminated, the DOL described its intent as being to protect fiduciaries by shielding them from liability to the extent they deviate from policies adopted pursuant to the safe harbors based on specific facts and circumstances.

Allocation of Proxy Voting Responsibility

The rule incorporates prior guidance on which of a plan's fiduciaries is responsible for voting proxies or exercising other shareholder rights. The general rule, which follows from the statute, is that the plan's trustee is responsible for exercising shareholder rights, except to the extent that either:

- The trustee is subject to the directions of a named fiduciary pursuant to ERISA Section 403(a)(1) –or–
- The power to manage, acquire, or dispose of the relevant assets has been delegated by a named fiduciary to one or more investment managers pursuant to ERISA Section 403(a)(2).

Further, where a delegation has been made to an investment manager, the investment manager has exclusive authority to vote proxies or exercise other shareholder rights, except to the extent the plan, trust document, or investment management agreement expressly provides that the responsible named fiduciary has reserved to itself (or to another named fiduciary so authorized by the plan document) the right to direct a plan trustee in this regard.

Notably, though, the rule does not apply to voting, tender, and similar rights that are passed through to plan participants and beneficiaries, as may be the case for company stock or mutual fund shares in a participant-directed individual account plan, such as a 401(k) plan or employee stock ownership plan (ESOP). The DOL acknowledged in response to comments that the rule was not intended to address pass-through voting. However, the DOL added that this "should not be read as an indication that plan trustees and other plan fiduciaries do not have fiduciary obligations with respect to such practices," describing its prior guidance in this area, including its 404(c) regulation.

Mutual Funds

Some of the commenters raised questions on how the rule applies to mutual funds in which ERISA plans have invested:

- **Proxy voting by mutual funds.** In response to requests to do so, the DOL confirmed that the rule does not apply to the exercise of shareholder rights on securities owned or held by mutual funds because ERISA does not govern the management of mutual fund assets.
- **Plan fiduciary review of mutual fund proxy voting practices.** One commenter asked about the standards that apply to plan fiduciaries in reviewing, analyzing, or making judgments on mutual fund proxy voting practices with respect to securities owned or held by the mutual fund. The DOL said that these issues are outside the scope of this rule, but rather are part of the investment duties of plan fiduciaries in deciding whether to invest in a particular mutual fund, as addressed by the broader "financial factors" regulation. The DOL noted that "[w]hether a particular [mutual] fund's proxy voting activities would constitute a pecuniary factor and, if so, how much weight it should be given in an investment decision, are factual questions that should be resolved by the responsible fiduciary based on surrounding circumstances."
- **Voting proxies of mutual funds.** Because the rule, by its terms, covers the exercise of proxy voting and shareholder rights for "shares of stock," which could be read to exclude mutual fund investments, some have questioned whether the new rules would apply to voting proxies on mutual fund shares. However, in response to comments about the impact of the rule on the ability to achieve a quorum at fund shareholder meetings, the DOL responded that the changes from the proposal "significantly" eliminated any provisions that might impede achieving a quorum for shareholder meetings, "including those held by funds," and noted that the safe harbors are sufficiently flexible to permit policies that allow voting proxies for fund shares while refraining from voting other types of shares. Implicit in these statements is the DOL's view that the rule applies to the voting of mutual fund proxies.

Pooled Investment Funds Subject to ERISA

A potential issue flagged in the proposal (also discussed in prior guidance) had been circumstances in which a pooled investment fund has in place an investment policy statement that conflicts with the policies of one or more plan investors. Despite requests to remove this provision, the final rule, like the proposal, requires the fund manager to reconcile conflicting investment policies as much as possible and, in the case of proxy voting, to the extent permitted by applicable law, to vote (or abstain from voting) proxies to reflect individual plan investor policies in proportion to each plan's economic interest in the fund.

However, again like the proposal and also consistent with prior guidance, the rule provides that the fund manager may require investing plans to accept the manager's investment policy statement, including any proxy voting policy, before they are allowed to invest. This is consistent with current general practice in the industry. The rule adds that, in such cases, the fiduciaries of the investing plans must assess whether the manager's investment policy statement and proxy voting policy are consistent with Title I of ERISA and this rule before deciding to retain the manager and invest in the fund.

Effective/Applicability Dates

The proxy voting/shareholder rights rule goes into effect, and generally becomes applicable, on January 15, 2021. There are three exceptions to this date, for which compliance is not required until January 31, 2022:

- Requirement for plan fiduciaries responsible for proxy voting/shareholder rights to (A) evaluate material facts that form the basis for any particular proxy vote or other exercise of shareholder rights, and (B) maintain records on these activities. However, this extended applicability date is not available to investment advisers subject to the new SEC proxy voting rule, based on the DOL's view that its new rule is consistent with the SEC rule.
- Requirement that a plan fiduciary not adopt a practice of following recommendations of a proxy advisory or similar firm without first determining that the firm's proxy voting guidelines are consistent with the new DOL rule.
- Requirement that an investment manager of a pooled investment fund reconcile or follow, to the extent possible, the conflicting proxy voting and other investment policies of the ERISA plans that invest in the fund.

Observations

The final rule, while retaining the basic goal of emphasizing the importance of voting proxies and exercising shareholder rights in accordance with a plan's economic interests, has been substantially revised to address the key concerns expressed in the comments. By changing from a prescriptive approach to a largely principles-based approach, the DOL has mitigated many of the main problems, burdens, and cost drivers identified in comments on the proposal. Among other things, this approach has permitted the Office of Management and Budget to change the designation of the rule from being "economically significant" in the proposal, by reason of likely having an annual effect on the economy of $100 million or more, to no longer being "economically significant" in the final.

In many respects, the final rule may be viewed as more consistent with general industry practices that have developed based on prior DOL guidance. That said, some have expressed concerns about potentially burdensome aspects of the rule, specifically the explicit recordkeeping and monitoring requirements, as well as the pooled investment funds provision. While these can be traced to prior guidance, their current formulation may merit additional attention to ensure compliance.

The specific new rules that fiduciaries will want to consider addressing, which have the benefit of an extended applicability date, are as follows:

- **Evaluating material facts of proxy votes or other shareholder rights and keeping records of having done so (unless already subject to SEC requirements in that regard).** Plan fiduciaries and investment managers responsible for proxy voting will want to review their proxy voting processes and procedures for compliance with the new rules and, if not already in place, develop a process for any necessary recordkeeping.
- **Oversight over the guidelines followed by proxy advisory firms.** While plan fiduciaries may already conduct these types of reviews when hiring proxy advisers, they will want to revisit their approaches to doing so in light of the new rules, and carry out guideline reviews for their current proxy advisers to ensure that these have been done in accordance with the new rule and are appropriately documented.
- **Ability of plan asset fund managers to require plan investors to agree to the manager's investment**

guidelines, including proxy voting guidelines, which as such would overrule the plans' possibly conflicting investment guidelines with respect to their assets invested in the fund. In our experience, the fund documents for those funds treated as holding ERISA "plan assets," such as bank collective investment trusts, typically have language to the effect that the fund documents supersede the plan documents with respect to the plan's assets invested in the fund, in either the fund's governing document or the investors' subscription or participation agreements, or both. But in view of the new rule, fund managers will want to confirm that the language in their documents is sufficiently specific to address investment guidelines generally and proxy voting guidelines specifically and supplement the language as appropriate. Plan asset fund managers will also want to review their proxy voting policies for compliance with the final rule.

Moreover, given the increased focus on proxy voting by regulators in general, now is a good time for ERISA plan fiduciaries to review and update their current proxy voting policies for compliance with the final rule, as well as the SEC's guidance if applicable.

Because the rule went into effect before President Joseph Biden's inauguration on January 20, 2021, any changes by the new administration would require notice-and-comment rulemaking—a process likely to require at least three to six months. As such, it would seem reasonable for plan fiduciaries and investment management firms to prepare for compliance with the rule, under the assumption that it will remain in effect in its current form for the foreseeable future.

Comparison of DOL Final Proxy Voting Regulation to SEC Proxy Voting Guidance for Investment Advisers

The chart below compares the requirements in the DOL's final regulation on Fiduciary Duties Regarding Proxy Voting and Shareholder Rights (DOL Final Regulation) for ERISA plan fiduciaries to the SEC's 2019 Guidance Regarding Proxy Voting Responsibilities and 2020 Supplement to Commission Guidance Regarding Proxy Voting Responsibilities of Investment Advisers (SEC Guidance), and is intended to assist SEC-registered investment advisers in evaluating the DOL rule as it would apply to discretionary proxy voting services to their ERISA plan clients.

Issue	DOL Final Regulation	SEC Guidance	Observations
Applicability	Decisions with respect to the management of shareholder rights, such as the right to vote proxies with respect to shares of stock held by ERISA-covered employee benefit plans. Does not apply to voting, tender, and similar rights with respect to such securities that are passed through pursuant to the terms of an individual account plan to participants and beneficiaries with accounts holding such securities.	Decisions regarding voting of equity securities by investment advisers for their clients.	The DOL Final Regulation applies to ERISA plan fiduciaries, but not to IRAs or other non-ERISA accounts. In the preamble to the final rule, the DOL clarified that the regulation would not apply to a mutual fund manager's proxy voting decisions because mutual fund management is not regulated by ERISA. However, the DOL suggested that ERISA plan fiduciaries consider mutual funds' proxy voting policies when deciding whether to invest in a mutual fund. In contrast to the proposed rule, the DOL's statements suggest its view that the final

			rule applies to a fiduciary's decisions to vote proxies with respect to mutual fund shares held by a plan. The SEC Guidance applies broadly to votes with respect to equity securities by SEC-registered investment advisers on behalf of clients, without regard to the type of client account.
Standard of care	Fiduciary under ERISA: Must act prudently and solely in the interests of the plan's participants and beneficiaries and for the exclusive purpose of providing benefits to participants and beneficiaries and defraying reasonable plan expenses.	Fiduciary under Advisers Act: Must act in the best interest of the client and must not place the investment adviser's own interests ahead of the client.	While proxy voting is subject to a "fiduciary standard" under both rulesets, there are some differences in fiduciary obligations under ERISA and the Advisers Act. While not discussed in the DOL Final Regulation, which is focused on duty of prudence and loyalty issues, the ERISA prohibited transaction rules—and their restrictions on conflicts of interest—would also apply.
Duty of care	Act prudently. Must evaluate material facts that form the basis for any particular voting decision or other exercise of shareholder rights. Consider any costs involved.	Must have a reasonable understanding of the client's objectives and must make voting determinations that are in the client's best interest. Should conduct an investigation reasonably designed to confirm the information used to make voting determinations is accurate and complete. May agree that the investment adviser would not exercise voting authority in circumstances under which voting would impose costs, such as opportunity costs for the client resulting from restricting the use of securities for lending in order to preserve the right to vote, or on certain types of matters	Both rulesets require the fiduciary to make determinations based on the facts at issue in a proxy vote. Intending to clarify that plan fiduciaries can rely on prudently selected and monitored proxy advisory firms, the DOL amended the requirement in the proposal that the plan fiduciary must investigate material facts to require the fiduciary to evaluate material facts. ERISA's "prudence" is generally viewed as a "higher" standard, though from a practical perspective it is unclear what additional procedures and diligence the ERISA standard would require over the Advisers Act duty of care.

		where the cost of voting would be high, or the benefit to the client would be low. Adviser must adopt policies and procedures reasonably designed to ensure it votes proxies in its clients' best interest. Adviser should also consider whether certain types of matters may necessitate that the adviser conduct a more detailed analysis than what may be entailed by application of its general voting guidelines, to consider factors particular to the issuer or the voting matter under consideration. When determining whether to conduct such an issuer-specific analysis, or an analysis specific to the matter to be voted on, an investment adviser should consider the potential effect of the vote on the value of a client's investments. An investment adviser should consider identifying in its voting policy the factors that it will consider in determining which matters require company-specific evaluation, and how it will evaluate voting decisions on such matters.	The SEC would permit the client and adviser to agree to the extent to which costs and benefits should be considered in a decision to vote proxies.
Duty of loyalty/ conflicts	Act solely in the economic interest of the plan and its participants. Not subordinate the interests of the participants and beneficiaries in their retirement income or financial benefits under the plan to any nonpecuniary objective, or promote nonpecuniary benefits or goals unrelated	Adviser must provide full and fair disclosure of conflicts of interest. Adviser must make full and fair disclosure of all material facts relating to the advisory relationship. Adviser must eliminate or at least expose through full and fair disclosure all	Where the SEC Guidance permits advisers to disclose and obtain consent to conflicts of interest, the DOL would require any votes to be solely in the interest of the plan and its participants. The DOL Final Regulation does not permit fiduciaries to exercise proxy voting rights with the goal of advancing

	to those financial interests of the plan's participants and beneficiaries.	conflicts of interest which might incline adviser— consciously or unconsciously—to render advice that is not disinterested. Adviser must obtain informed consent of disclosed conflicts and information from its clients.	nonpecuniary goals unrelated to the financial interests of the plan's participants and beneficiaries. In contrast, the Advisers Act standards would generally allow clients and advisers to define proxy voting objectives by agreement, subject to full and fair disclosure.
Per se obligation based on economic interest	A fiduciary is not required to vote every proxy or exercise of every shareholder right. The fiduciary must have a prudent process for determining whether to exercise shareholder rights, considering costs among other factors.	The SEC Guidance does not preclude an investment adviser from voting or not voting if neutral from an economic perspective.	A significant change from the proposal to the DOL Final Regulation was to no longer require a fiduciary to vote only where it can confirm an economic impact on the plan. The change seems to better align with the SEC Guidance, which provides advisers with more flexibility in determining whether to vote proxies. Cost is a relevant consideration under both rulesets.
Delegation	Plan sponsor/named fiduciaries can delegate proxy voting responsibilities, including to nondiscretionary advisers and consultants and to discretionary managers. Where a named fiduciary delegates discretionary authority to manage plan assets to an investment manager, the presumption is that authority over proxy voting is delegated as well, unless expressly reserved to another identified party.	Similarly, clients and advisers can agree to the scope of the adviser's proxy voting authority. Absent an express agreement to a narrower scope, the adviser's proxy voting authority is implied when it has discretion over the management of client assets.	Both allow the fiduciary to delegate its proxy voting duties, to define the scope of authority by express agreement, and imply authority where the adviser has discretion (unless otherwise agreed).

Requirements for delegating responsibility	Must exercise prudence and diligence in the selection and monitoring of persons selected to advise and assist with proxy voting (including providers of research, analysis, recommendations, and administrative, recordkeeping and reporting services). Fiduciary may not adopt a practice of following the recommendations of a proxy advisory firm or other service provider without a determination that such firm or service provider's proxy voting guidelines are consistent with the fiduciary's obligations. Where discretionary authority is delegated, the responsible plan fiduciary must prudently monitor the proxy voting activities of such investment manager or proxy advisory firm and determine whether such activities are consistent with the requirements of this rule.	If using a proxy advisory firm, must still make voting determinations in the client's best interest, and disclose conflicts and obtain informed consent. In order to meet these obligations, adviser should, among other things: • Review proxy advisory firm's policies and procedures • Implement policies and procedures to identify and evaluate the proxy advisory firm's conflicts of interest, and ability to recommend or execute votes as instructed • Consider whether the proxy advisory firm appropriately updates its methodologies, guidelines, and voting recommendations • Evaluate whether the proxy advisory firm has the capacity and competency to adequately analyze matters for which the adviser is responsible for voting • Consider third-party information sources used by the proxy advisory firm • Review proxy advisory firm's permitted use of automated or prepopulated votes, and conduct a periodic sampling of prepopulated votes provided by the proxy advisory firm • Disclose to clients the role of automated voting	Both rulesets impose supervisory requirements on the delegating fiduciary. ERISA fiduciaries may want to consider the SEC's guidance in determining an appropriate process for meeting their duties with respect to selecting and monitoring proxy advisers and managers, and what additional steps may be required to satisfy the prudence obligation. Although the DOL agrees that it would be important for a fiduciary to consider the proxy advisory firm's conflict of interest disclosure required under recent SEC guidance, and that a fiduciary should consider whether potential conflicts may affect the quality of services to be provided, the DOL does not believe it appropriate to expressly require review of such disclosure because the provision could become outdated as disclosure obligations change over time.

Permitted policies	Subject to the requirement to periodically review the proxy voting policy and the ability to prudently design specific parameters to serve the plan's economic interest, fiduciary may adopt the following optional policies that do not establish minimum requirements or the exclusive means for satisfying these responsibilities: • Focus resources on types of proposals that are substantially related to the issuer's business activities or are expected to have a material effect on the value of the investment • Refrain from voting on proposals where the plan's holdings are below a quantitative threshold, such that its vote is not expected to have a material effect on the investment performance • No policies shall preclude submitting a proxy vote when the fiduciary prudently determines that the matter being voted on is expected to have a material effect on the value of the investment or the investment performance of the plan's portfolio, or refrain from voting when the fiduciary prudently determines that the matter being voted upon is not expected to have such a material effect after taking into account the costs involved	Subject to full and fair disclosure and informed consent: • Vote in accordance with recommendations of the management of the issuer, subject to conditions requiring additional analysis because of heightened management conflicts, or where the matter is of particular interest to the client • Focus resources on types of proposals based on the client's preferences, such as those substantially related to the corporation's business activities • Refrain from voting where the cost of voting would be too high or would not be reasonably expected to have a material effect on the client's investment • Vote in favor of all proposals made by particular shareholder proponents	The DOL Final Regulation was modified to create safe harbors for plan fiduciaries, providing more flexibility. The DOL made this change to address concerns raised by commenters that the requirements would potentially increase costs and liability exposure along with creating difficult circumstances of determining whether a matter would have an economic impact, and that the fiduciary might prudently determine that there are risks to plan investments that could result from not voting even when the matter being voted upon itself would not have an economic impact. Note that the DOL's safe harbors are different from the policies highlighted in the SEC Guidance.

Pooled investment vehicles	Investment manager of a plan asset pooled investment vehicle must reconcile conflicting policies of plan investors and vote proxies in proportion to each plan's economic interests in the investment vehicle (consistent with its duty to follow any particular policy only to the extent consistent with ERISA). Alternatively, the manager can require investing plans to adopt the manager's policy statement, but then the responsible fiduciaries for the investing plans must assess whether the manager's policy are consistent with ERISA and the DOL Proxy Proposal before retaining the manager.	Where an investment adviser undertakes proxy voting responsibilities on behalf of multiple funds, pooled investment vehicles, or other clients, it should consider whether it should have different voting policies for some or all of these different funds, vehicles, or other clients, depending on the investment strategy and objectives of each.	Both rulesets raise the prospect of the investment manager/adviser possibly having to operate under different and potentially conflicting proxy voting policies, but the SEC Guidance appears to leave this more to the judgment of the investment adviser. As a practical matter, managers of pooled investment vehicles generally require investors to agree to the manager's voting policy, but the DOL Final Regulation potentially imposes a greater burden on investing plan fiduciaries in deciding whether to accept such provisions. The DOL noted that commenters did not question whether an ERISA fiduciary should assess an investment manager's investment policy statement for consistency with ERISA prior to accepting it.
Documentation and recordkeeping requirements	Maintain records on proxy voting activities and other exercises of shareholder rights.	Fiduciary must review and document adequacy of voting policies and procedures at least annually, to ensure they have been formulated reasonably and implemented effectively. Maintain records documenting the annual review of policies and procedures.	The DOL Final Regulation imposes a less prescriptive approach to recordkeeping obligations than the proposal. As a general matter, the DOL stated that ERISA's prudence obligation carries with it a requirement to maintain records and document fiduciaries' decisions. But the DOL removed the obligation to maintain records for specific proxy votes.

			The DOL noted that SEC Rule 204-2 requires investment advisers to maintain a record of each proxy vote cast on behalf of a client, retain documents created by the adviser that were material to a decision on how to vote or that memorialize the basis for that decision, and maintain each written client request for information on how the adviser voted proxies on behalf of the client and any written response by the investment adviser to any (written or oral) client request for information on how the adviser voted proxies on behalf of the requesting client. The DOL suggested that these requirements may be helpful to responsible plan fiduciaries in fulfilling their monitoring requirements.

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Related Content

Lexis

- 85 Fed. Reg. 81,658 (Dec. 16, 2020)(final DOL rule on proxy voting)
- 85 Fed. Reg. 55,219 (Sept. 4, 2020)(proposed DOL rule on proxy voting)
- 85 Fed. Reg. 55,082 (Sept. 3, 2020)(final SEC rule, “Exemptions from the Proxy Rules for Proxy Voting Advice”)
- 85 Fed. Reg. 55,155 (Sept. 3, 2020)(“Supplement to Commission Guidance Regarding Proxy Voting Responsibilities of Investment Advisers”)
- DOL Interpretive Bulletin 2016-01, 81 Fed. Reg. 95,879 (Dec. 29, 2016)
- DOL Field Assistance Bulletin 2018-01
- ARTICLE: Now Is the Time to Designate Proxy Advisors as Fiduciaries under ERISA, 25 Stan. J.L. Bus. & Fin. 1
- ARTICLE: MUTUAL FUND VOTING OF PORTFOLIO SHARES: WHY NOT DISCLOSE?, 23 Cardozo L. Rev. 1419

Practical Guidance

- DOL’s Proposed New Proxy Voting Rule Could Be a Game Changer for ERISA Fiduciaries
- Latest Volley in ESG Back and Forth: DOL Finalizes “Financial Factors” Rule
- SEC Amends Rules on Proxy Voting Advice and Provides Guidance on Investment Adviser Voting Responsibilities
- ERISA Fiduciary Duties
- ERISA Plan Investment Vehicles
- Investment Committee Issues for Defined Contribution Plans

Michael B. Richman, Partner, Morgan, Lewis & Bockius LLP

Michael B. Richman counsels clients on the fiduciary responsibility rules under the Employee Retirement Income Security Act (ERISA), including the ERISA prohibited transaction rules. He advises plan sponsors on investment matters for defined benefit and defined contribution plans. He also counsels banks, investment adviser firms, and broker-dealer firms on ERISA compliance for ERISA plan separately-managed accounts, collective investment funds, private funds, and other arrangements. Additionally, he provides guidance to IRA custodians on permissible IRA investments and investment restrictions.

Michael also advises clients on fiduciary governance of ERISA plans, as well as on prohibited transaction and fiduciary responsibility issues in proposed transactions and transactions under government investigation. Michael prepares requests to the US Department of Labor (DOL) for prohibited transaction exemptions and advisory opinions.

Before joining Morgan Lewis, Michael was counsel in the benefits and executive compensation, and investment management groups at one of the world's largest global law firms.

A frequent writer, Michael has authored or co-authored a book, book chapters, and a number of articles on ERISA, benefits, and securities issues.

Julie K. Stapel, Partner, Morgan, Lewis & Bockius LLP

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).

Craig A. Bitman, Partner, Morgan, Lewis & Bockius LLP

Craig A. Bitman provides clients with a range of knowledge and skills in all aspects of employee benefits and executive compensation law, and he also practices in the firm's institutional investor and private investment funds practices. Craig leads the firm's employee benefits and executive compensation practice and has served as a member of the firm's Advisory Board.

His client roster includes a diverse mix of businesses, trusts, and individuals, including financial services companies, public pension plans, life insurance companies, transportation and logistics providers, entertainment companies, and multiemployer trust funds. He spends a significant percentage of his time devoted to assisting these entities and individuals in complying with the Employee Retirement Income Security Act's (ERISA) complex fiduciary duties.

A member of the National Association of Public Pension Attorneys, Craig often speaks and writes on topics affecting plan sponsors and service providers. His experience in the space has earned him recognition by *Chambers USA: America's Leading Lawyers for Business*, *Best Lawyers*, *PLC*, *Legal 500* and others.

Lindsay B. Jackson, Partner, Morgan, Lewis & Bockius LLP

Lindsay B. Jackson counsels broker-dealers, investment advisers, banks, insurance companies, institutional investors (including ERISA plan fiduciaries), and various intermediaries on the standards applicable to designing and providing advisory, brokerage, banking, custodial, and administrative products and service offerings. Lindsay has in-depth knowledge of the developing rules and market practices in the distribution of advice products, services, and offerings to retail investors, including, in particular, those investing through IRAs, SEPs, SIMPLES, 403(b) plans, and ERISA plans.

Clients turned to Lindsay in developing their responses to the now vacated US Department of Labor fiduciary rule, including developing business strategies, creative solutions, and effective disclosures as well as engaging with the regulators to seek clarifying guidance and harmonization with the other federal and state laws governing the space. Leveraging her knowledge of the retail investor space, Lindsay now focuses on implementation issues related to the US Securities and Exchange Commission's Regulation Best Interest and developing fiduciary standards in the states.

Lindsay also counsels financial services firms on their compliance with the prohibited transaction rules under ERISA and the Internal Revenue Code, including issues raised by investments in proprietary funds and products, householding assets for fee discounts, cash sweep, receiving shareholder servicing, revenue sharing and other third-party payments in connection with advisory services, and principal trading. Additionally, she helps pension plans and pension investment consultants and managers negotiate ERISA plan investments in private equity funds, hedge funds, collective investment trusts, separately managed accounts, and other investment vehicles.

Daniel R. Kleinman, Partner, Morgan, Lewis & Bockius LLP

Daniel R. Kleinman advises businesses on the fiduciary responsibilities provisions (Title I) of the Employee Retirement Income Security Act (ERISA). He also counsels these clients on related tax, corporate, and securities laws in connection with the structuring and marketing of investment products (including private equity and hedge funds) and financial services to employee benefits plans. Additionally, Daniel handles issues related to the regulation of broker-dealers and investment advisers under US federal and state securities laws.

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Natalie R. Wengroff advises financial institutions on compliance with US state and federal regulation, including fiduciary responsibilities and ERISA matters. She also advises broker-dealers and investment advisors regarding their obligations under federal securities laws and self-regulatory organization rules such as Financial Industry Regulatory Authority (FINRA). Prior to joining Morgan Lewis, Natalie represented independent broker-dealers and financial advisors before state securities and banking commissioners.

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