

DOL Finalizes Proxy Voting and Shareholder Rights Rule

December 18, 2020 | Client Update | 6-minute read

The U.S. Department of Labor (“DOL”) issued a [final rule](#) on December 11, 2020 to clarify how and when the ERISA fiduciary duties apply to the exercise of shareholder rights, including proxy voting, proxy voting guidelines and the use of proxy advisory firms. The final rule requires fiduciaries to put the economic interest of plan participants and beneficiaries first and to ensure that voting decisions advance these interests. Accordingly, the final rule will make it more difficult for ERISA fiduciaries to vote their proxies in support of social, environmental and political matters without justifying or documenting how these votes advance pecuniary interests.

– Who is subject?

The final rule generally applies to fiduciaries of private-sector retirement plans, such as company-sponsored defined benefit pension plans, as well as managers of private investment funds that are subject to ERISA. Fiduciaries of public-sector pension plans are **not** subject.

– What does the final rule provide?

The DOL adopted the amendments to clarify that, when exercising shareholder rights, ERISA plan fiduciaries may not subordinate the financial interests of plan participants and beneficiaries under a plan to non-pecuniary objectives. The amendments are meant to improve the guidance on how ERISA’s fiduciary duties of prudence and loyalty apply to exercising shareholder rights, including voting proxies, proxy voting guidelines and the selection and monitoring of proxy advisory firms.

– Why did the DOL amend the rule?

The DOL states that the Investment Duties rule needed amending, in part, to eliminate the confusion in the market perhaps caused in part by DOL-issued sub-regulatory guidance and letters over the years. Moreover, the manner in which ERISA plans invest and the global investment landscape has also changed over time.

The DOL also wanted to clarify that all proxies do not need to be voted. The DOL is concerned that, with the volume and breadth of proposals put to shareholder vote, plan assets are being unnecessarily spent to research and vote on proposals involving matters that were unlikely to affect the value of the plan’s investments. Lastly, the DOL believed it was necessary to modernize standards for ERISA plan fiduciaries in light of the increased role of proxy advisory firms in the proxy voting process.

– What are some of the main differences between the DOL’s December final rule and its September proposed rule?

While the final rule incorporates much of the [proposed rule](#) published in the *Federal Register* on September 4, 2020, there are modifications worth noting. The most significant difference is that the final rule adopts more of a principles-based approach than the proposed rule. One of the main reasons for this change, the DOL explains, is that many commenters expressed concerns that the prescriptive nature of the proposed rule could have potentially burdened issuers with higher costs along with a greater exposure to liability. The DOL adds that the principles-based approach requires fiduciaries to adopt a process for executing shareholder rights under which fiduciaries execute their duties (1) prudently; (2) solely in the interests of the plan participants and beneficiaries; and (3) exclusively for the purpose of providing benefits to participants and beneficiaries and defraying the administrative plan expenses.

Other changes worth highlighting include that the final rule:

1. Drops the proposed safe harbor where fiduciaries adopt a policy to vote in agreement with management on matters that are economically insignificant to the plan. The final rule adds that the remaining safe harbors, as modified, are not meant to be an exclusive list. Rather, fiduciaries may create and adopt other policies or means that satisfy the rule's requirements;
2. Requires fiduciaries to evaluate rather than investigate material facts prior to voting or exercising a shareholder right;
3. Reduces the complexity or level of economic analysis required for certain determinations;
4. While still requiring general recordkeeping, omits the duty to record the basis for exercising a shareholder right; and
5. Requires fiduciaries to review proxy voting policies periodically rather than at least once every two years as proposed.

– **Must all proxies be voted according to DOL?**

No. The final rule clarifies that the fiduciaries are not required to vote every proxy or exercise every shareholder right. The final rule mentions that, after applying the principles established under the final rule, there may be instances where a fiduciary determines that there is an obligation to refrain from voting.

– **What principles must fiduciaries follow to meet their prudence and loyalty duties?**

When making decisions on whether to exercise shareholder rights, and when exercising these rights, including proxy voting, the final rule establishes principles that ERISA plan fiduciaries must follow to fulfill their prudence and loyalty duties. The fiduciaries must:

1. Act solely in accordance with the economic interest of the plan and its participants and beneficiaries;
2. Consider any costs involved;
3. Not subordinate the economic interests of the plan participants and beneficiaries to any non-pecuniary objectives, or promote non-pecuniary interests unrelated to those economic interests;
4. Evaluate material facts that form the basis for any particular proxy vote or other exercise of shareholder rights. Unlike in the proposed rule, fiduciaries are not required to investigate material facts; however, fiduciaries should evaluate material information that is known or known to be reasonably available;
5. Maintain records on proxy voting activities and other exercises of shareholder rights; and
6. Exercise prudence and diligence in selecting, using and monitoring service providers. This includes, but is not limited to, the use of investment managers and proxy advisory firms. For example, fiduciaries may not follow the recommendations of a proxy advisory firm without determining that the firm's proxy voting guidelines are consistent with the above five principles.

– **Are there safe harbors?**

The final rule establishes two modified safe harbors, meaning that if fiduciaries elect to adopt certain proxy voting policies and parameters, their fiduciary duties will be considered satisfied for determining whether to vote proxies. A plan may adopt either or both "safe harbor" policies that are set forth in the final rule as follows:

1. The policy only permits voting on proposals that address topics that are substantially related to the issuer's business or material to the value of the plan's investment.
2. The policy limits voting on proposals depending on the proportion of the plan's investment in the issuer being sufficiently small such that the topic is not expected to materially affect the investment performance of the plan's portfolio.

The final rule adds that this is a nonexclusive list and fiduciaries may be able to satisfy the needed requirements by other means or policies. The final rule excludes the proposed safe harbor where fiduciaries adopt a policy to vote in agreement with management on matters that are unlikely to have a significant impact on the value of the plan's investment.

– **Are there different or special procedures for ESG-related proposals or matters?**

No. Fiduciaries are required to follow the same six principles stated above.

– **What is the effective date?**

The final rule is effective 30 days after publication in the *Federal Register*. Delayed compliance until January 31, 2022 is permitted for certain recordkeeping and proxy-voting policy requirements. The final rule replaces previous Labor Department guidance, Interpretive Bulletin 2016-01 as stated in the Code of Federal Regulations, with respect to the exercise of shareholder rights by fiduciaries of ERISA-covered plans.

– **What's next?**

This final rule is meant to align with the DOL's recent [amendments](#) published in November 2020 on related provisions requiring plan fiduciaries to select investments solely based on pecuniary considerations and essentially curtailing ESG-related investing. We discussed that proposed rule [here](#).

It is too early to tell whether or the extent to which the Biden Administration will keep the final rules.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

Chaoyuan (Charles) Shi

+1 212 450 3346

charles.shi@davispolk.com

This communication, which we believe may be of interest to our clients and friends of the firm, is for general information only. It is not a full analysis of the matters presented and should not be relied upon as legal advice. This may be considered attorney advertising in some jurisdictions. Please refer to the firm's privacy notice for further details.