

Biden Administration Requests Review of DOL’s Final “ESG” Rules for ERISA Fiduciaries – What Does that Mean for the DOL’s Final Proxy Voting Rules?

Employee Benefits & Executive Compensation Blog on February 5, 2021

On October 30, 2020, the U.S. Department of Labor (the “DOL”) issued a final rule on “ESG” investing (summarized [here](#)) which requires ERISA plan fiduciaries to base investment decisions on financial factors alone, prohibits fiduciaries from selecting investments based on non-pecuniary considerations, and which could restrict “do-good” or “ESG” investing (the “ESG Rule”). However, the fate of the ESG Rule is currently unclear, as the Biden administration directed the DOL to review the rule in a [fact sheet](#) issued on January 20, 2021.

In a separate (but related) rulemaking, the DOL published in the [Federal Register](#) on December 16, 2020, a final rule confirming its position that ERISA’s fiduciary duties of prudence and loyalty apply to an ERISA plan fiduciary’s exercise of shareholder rights, including proxy voting, proxy voting policies and guidelines, and the selection and monitoring of proxy advisory firms (the “Proxy Voting Rule”). The Proxy Voting Rule went into effect on January 15, 2021 (although certain aspects of this rule have later compliance dates, as discussed below).

The ESG Rule and the Proxy Voting Rule were each structured in a manner that would amend the DOL’s “investment duties” regulation at 29 C.F.R. 2550.404a-1. When the DOL finalized the ESG Rule, it reserved a section of the amended regulation for the final Proxy Voting Rule. It is uncertain what action the Biden administration will take with respect to the ESG Rule following its review thereof, but it is very possible that the Proxy Voting Rule will have the same fate given how intertwined the two rules are.

The Proxy Voting Rule reflects the DOL's attempt at clarifying its prior proxy voting guidance that "may have led to confusion or misunderstandings on the part of plan fiduciaries." In particular, the DOL acknowledged that there is a view among some that ERISA plan fiduciaries are required to vote **all** proxies or exercise every shareholder right – the Proxy Voting Rule makes clear that is **not** the case. The Proxy Voting Rule instead takes a principles-based approach and details the obligations of fiduciaries when making such decisions in order to satisfy their duties of prudence and loyalty, which include the following:

- act solely in accordance with the economic interest of the plan and its participants and beneficiaries;
- consider any costs involved;
 - relevant costs will depend on the facts and circumstances, and could include: direct costs to the plan of determining how to vote and actually submitting the vote; potential reduction of management fees by reducing the number of proxies voted that have no economic consequence for the plan; any out-of-the-ordinary costs or unusual requirements, such as may be the case of voting proxies on foreign corporation shares; or any opportunity costs of voting, such as forgone earnings from recalling securities on loan or any restrictions on selling the underlying shares.
- not subordinate the interests of the participants and beneficiaries in their retirement income or financial benefits under the plan to any non-pecuniary objective, or promote non-pecuniary benefits or goals unrelated to those financial interests of the plan's participants and beneficiaries;
- evaluate material facts that form the basis for any particular proxy vote or other exercise of shareholder rights;
- maintain records on proxy voting activities and other exercises of shareholder rights; and
- exercise prudence and diligence in the selection and monitoring of persons (if any) who have been delegated authority to exercise shareholder rights, or who have been selected to advise or otherwise assist with the exercise of shareholder rights.
 - note, however, that a fiduciary may adopt a practice of following the recommendations of a proxy advisory (or similar) firm only if the fiduciary first determines that the service provider's proxy voting guidelines are consistent with the requirements above.

The Proxy Voting Rule also provides an optional safe harbor for plan fiduciaries that adopt and follow proxy voting policies with specific parameters that are prudently designed to serve the plan's economic interest. The safe harbor is intended to reduce compliance burdens with respect to decisions as to **whether to vote** proxies, and does not apply with respect to decisions as to **how to vote** proxies. The safe harbor permits a plan to adopt either or both of the following (though these are not meant to be the exclusive means for compliance):

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

If adopted, a proxy voting policy must be reviewed periodically by the plan fiduciary, and may not prohibit the fiduciary from (i) voting the proxy, if 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 plan assets under management in the case of an investment manager) after taking into account the costs involved, or (ii) refraining from voting the proxy, if 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.

The Proxy Voting Rule also reiterates the DOL's longstanding position that the responsibility for voting proxies rests with the plan trustee, unless the plan trustee is being directed by the plan's named fiduciary or voting authority has been delegated to an investment manager. If authority to manage plan assets has been delegated to an investment manager, the investment manager will have the exclusive authority to vote proxies unless the applicable plan documents or investment management agreement specifically provide otherwise.

An investment manager of a pooled investment vehicle that holds assets of more than one employee benefit plan must either (i) reconcile (insofar as possible) any conflicts in the proxy voting policies of such plans, and vote (or abstain from voting) the relevant proxies in proportion to each plan's economic interest in the pooled investment vehicle, or (ii) develop an investment policy statement consistent with the Proxy Voting Rule that the participating plans must accept before they are allowed to invest in the pooled investment vehicle.

The Proxy Voting Rule does not apply to shareholder rights that are passed through to participants and beneficiaries of individual account plans. In such a case, the plan trustee must follow the direction of the plan participant or beneficiary, but only if the direction is consistent with the plan terms and not contrary to ERISA.

The Proxy Voting Rule went into effect on January 15, 2021 and applies to the exercise of shareholder rights after such date; provided, that (i) fiduciaries that are not SEC-registered investment advisers have until January 31, 2022 to comply with the requirements to evaluate material facts providing the basis for exercising a shareholder right and to maintain records on proxy voting activities, and (ii) all fiduciaries have until January 31, 2022 to comply with the requirement to confirm that a proxy firm upon whom the fiduciaries intend to rely has proxy voting guidelines that comply with the Proxy Voting Rule and the requirements relating to investment managers of pooled investment vehicles.

The Proxy Voting Rule also removes from the Code of Federal Regulations the DOL's Interpretive Bulletin 2016-01, which may have been interpreted to permit consideration of a broader set of factors when making determinations regarding proxy voting, as it no longer reflects the DOL's views on the exercise of shareholder rights.

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As noted above, although both the ESG Rule and the Proxy Voting Rule are currently effective, the fate of such rules remains uncertain. We are monitoring the status of such rules, and are always available to assist plan fiduciaries, investment managers and other plan service providers in their compliance efforts related thereto.

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