Proskauer

Special DOL Proxy Voting Rule Set to Take Effect on December 1, 2023 – Potential Action Items for ERISA Fiduciary Investment Managers

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In late 2022, the U.S. Department of Labor (the "DOL") issued final regulations (the "Final Rules") which address the extent to which ERISA fiduciaries may consider environmental, social and governance ("ESG") factors when making investment decisions and exercising shareholder rights, such as voting proxies, on behalf of ERISA-covered clients. For a detailed discussion of the Final Rules, see here.

Although the Final Rules generally became effective on January 30, 2023, a special investment policy rule applicable to ERISA fiduciaries of pooled investment vehicles holding "plan assets" of more than one ERISA plan (a "Pooled Plan Asset Vehicle") is set to first take effect on December 1, 2023. This special rule might require action in advance of the effective date. Importantly, this special rule does not apply to pooled investment vehicles or accounts that are not subject to ERISA (e.g., a private investment fund that is under the "ERISA 25% limit" or operated as a "venture capital operating company" or "VCOC"). It also generally does not apply to ERISA-covered separately managed accounts or "funds-of-one," other than with respect to such an entity's investment into a Pooled Plan Asset Vehicle.

The special rule portion of the Final Rules provides (in relevant part) as follows:

- To the extent an investment manager of a Pooled Plan Asset Vehicle is subject to an investment policy statement ("IPS") (which includes any proxy voting policy) that conflicts with another ERISA plan's IPS, the investment manager must reconcile, insofar as possible, those conflicting policies (assuming compliance with each policy would be consistent with ERISA);
- In the case of proxy voting, to the extent permitted by applicable law, the investment manager must vote (or abstain from voting) the relevant proxies to reflect such policies in proportion to each ERISA plan's economic interest in the Pooled Plan Asset Vehicle; and

- Such an investment manager may, however, develop its own ERISA-compliant IPS and require participating ERISA plans to accept such IPS, including any proxy voting policy, before they are allowed to invest. In such cases, an independent ERISA plan fiduciary must assess whether such IPS and proxy voting policy are consistent with applicable ERISA requirements before deciding to retain the investment manager.

Accordingly, investment managers of Pooled Plan Asset Vehicles should assess whether their existing documentation includes language sufficient to get comfortable that either (i) investing ERISA plans are not subject to an IPS or proxy voting policy that conflicts with the IPS or proxy voting policy of the Pooled Plan Asset Vehicle or (ii) to the extent an investing ERISA plan is or may be subject to such a conflicting IPS or proxy voting policy, the ERISA plan has expressly or effectively agreed that its conflicting IPS or proxy voting policy will not apply and that instead the IPS and proxy voting policy of the Pooled Plan Asset Vehicle will apply.

Although we believe it would be prudent to perform such an assessment, in our experience, the offering materials provided to investors (such as a confidential offering memorandum) contain detailed information about investment objectives and guidelines and there is typically language in Pooled Plan Asset Vehicles' governing documents (in particular, subscription documents) that potentially may be relied upon to establish that the Pooled Plan Asset Vehicle's investment objectives, guidelines and policies have been accepted by the investor and control – for example, whereby investors represent along the lines of one or more of the following:

- ***the investor has received, carefully read and understands the [offering materials], and the investor's investment and participation in the [Pooled Plan Asset Vehicle] will not violate, conflict with or cause the investor to be in default under the terms of the investor's governing documents or any applicable law to which the investor is subject***
- ***the investor has been informed of and understands the investment objectives and policies of the [Pooled Plan Asset Vehicle]***
- ***the terms of the governing documents of the [Pooled Plan Asset Vehicle] comply with the investor's governing instruments and applicable laws governing the investor***

Nonetheless, if an investment manager of a Pooled Plan Asset Vehicle is unsure whether its existing documentation provides sufficient comfort in this regard, it should consider whether or not to have its ERISA plan investors expressly agree to such matters in writing prior to December 1, 2023. Importantly, the DOL refused to bless the use of a negative consent mechanism in order to obtain such an agreement from investors. Of course, investment managers are also free to comply with the Final Rules by reconciling any such conflicting policies (of different ERISA investors) to the extent possible, though this may not be practical or feasible in many circumstances.

On a going forward basis, investment managers of Pooled Plan Asset Vehicles may want to ensure that their form documentation clearly sets forth the obligations of the parties in this regard in order to remove any potential uncertainty.

Similarly, investment managers of ERISA plan investors (e.g., ERISA plan trusts or separately managed accounts or "funds-of-one" for such trusts) that are invested in, or considering investing in, a Pooled Plan Asset Vehicle, should consider reviewing the Pooled Plan Asset Vehicle's IPS and proxy voting policy (to the extent applicable) to ensure they comply with the requirements of the Final Rules and to determine whether any action is necessary in regards to any conflicting or non-compliant policies. In addition, such investment managers should assess whether their own proxy voting policies (if any) comply with the requirements of ERISA and the Final Rules – in particular, although the Final Rules provide that an ERISA fiduciary investment manager may (but is not required to) adopt and follow prudently designed proxy voting policies, as of December 1, 2023, any such policy must not (i) prohibit voting on matters that the fiduciary prudently determines are expected to have a significant effect on the value of the investment or investment performance after taking into account the costs involved, or (ii) require the fiduciary to vote when the fiduciary prudently determines that the matter being voted upon is not expected to have such an effect after taking into account the costs involved.

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As always, Proskauer is here to help investment managers of Pooled Plan Asset Vehicles and ERISA plans assess whether any action is required to be taken in order to comply with the Final Rules.

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