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DEPARTMENT OF LABOR

Employee Benefits Security Administration

29 CFR Parts 2509 and 2550

RIN 1210-AB91

Fiduciary Duties Regarding Proxy Voting and Shareholder Rights

AGENCY: Employee Benefits Security Administration, Department of Labor.

ACTION: Proposed rule.

SUMMARY: The Department of Labor (Department) is proposing to amend the “Investment duties” regulation issued in 1979 to address the application of the prudence and exclusive purpose duties under the Employee Retirement Income Security Act of 1974 (ERISA) to the exercise of shareholder rights, including proxy voting, the use of written proxy voting policies and guidelines, and the selection and monitoring of proxy advisory firms. This document also states that Interpretive Bulletin 2016-01 no longer represents the view of the Department regarding the proper interpretation of ERISA with respect to the exercise of shareholder rights by fiduciaries of ERISA-covered plans, and notes that it will be removed from the Code of Federal Regulations when a final rule is adopted.

DATES: Comments on the proposal must be submitted on or before [INSERT DATE 30 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

ADDRESSES: You may submit written comments, identified by RIN 1210-AB91, to either of the following addresses:

- *Federal eRulemaking Portal:* www.regulations.gov. Follow the instructions for submitting comments.
- *Mail:* Office of Regulations and Interpretations, Employee Benefits Security Administration, Room N-5655, U.S. Department of Labor, 200 Constitution Avenue NW, Washington, DC 20210, Attention: Proxy Voting and Shareholder Rights NPRM.

Instructions: All submissions received must include the agency name and Regulatory Identifier Number (RIN) for this rulemaking. Persons submitting comments electronically are encouraged not to submit paper copies. Comments will be available to the public, without charge, online at www.regulations.gov and www.dol.gov/agencies/ebsa and at the Public Disclosure Room, Employee Benefits Security Administration, Suite N-1513, 200 Constitution Avenue NW, Washington, DC 20210.

Warning: Do not include any personally identifiable or confidential business information that you do not want publicly disclosed. Comments are public records posted on the internet as received and can be retrieved by most internet search engines.

FOR FURTHER INFORMATION CONTACT: Jason A. DeWitt, Office of Regulations and Interpretations, Employee Benefits Security Administration, (202) 693-8500. This is not a toll-free number.

Customer Service Information: Individuals interested in obtaining information from the Department of Labor concerning ERISA and employee benefit plans may call the Employee

Benefits Security Administration (EBSA) Toll-Free Hotline, at 1-866-444-EBSA (3272) or visit the Department of Labor's website (www.dol.gov/ebsa).

SUPPLEMENTARY INFORMATION:

A. Background

Title I of the Employee Retirement Income Security Act of 1974 (ERISA) establishes minimum standards for the operation of private-sector employee benefit plans and includes fiduciary responsibility rules governing the conduct of plan fiduciaries. In connection with proxy voting, the Department's longstanding position is that the fiduciary act of managing plan assets includes the management of voting rights (as well as other shareholder rights) appurtenant to shares of stock, and that fiduciaries must carry out their duties relating to the exercise of such rights prudently and solely for the economic benefit of plan participants and beneficiaries.¹

The Department has decided to propose a regulation regarding the application of ERISA's fiduciary duties to the exercise of shareholder rights by ERISA-covered plans due to significant changes in the way ERISA plans invest and in the investment world more broadly since the Department first spoke formally on these topics, a persistent misunderstanding among some stakeholders that ERISA fiduciaries are required to vote all proxies, and in light of recent actions by the Securities and Exchange Commission (SEC) related to the proxy voting process.

¹ Throughout this preamble, the Department's discussion of plan fiduciaries includes named fiduciaries under the plan, along with any persons that named fiduciaries have designated to carry out fiduciary responsibilities as permitted under ERISA section 405(c)(1).

The Department first addressed this topic during a time of widespread shareholder activism and corporate takeovers that had placed an intense focus on shareholder voting by ERISA plans. For instance, a 1985 Senate hearing highlighted the “pivotal role” pension funds were being forced to play in takeover attempts,² which according to a January 1985 Department report had reached “epidemic proportions.”³ A significant factor viewed as contributing to the rise of takeovers was the “widespread conviction” that fund managers and other fiduciaries were obligated under ERISA to tender their shares to the highest cash bidder.⁴ On the other hand, investment managers were seen as reluctant to vote shares against anti-takeover proposals of a current or prospective client,⁵ potentially creating a conflict of interest with their fiduciary obligations to plan participants and beneficiaries.⁶ One proposed solution was to require the voting of shares to be directed by plan sponsors themselves rather than investment managers.⁷

The Department released one of its first official statements on proxy voting in 1988, in the form of an opinion letter to Avon Products, Inc. (the “Avon Letter”). “In general,” the Department stated, “the fiduciary act of managing plan assets which are shares of corporate stock

² Testimony of Robert Monks, Department of Labor’s Enforcement of the Employee Retirement Income Security Act, Hearings before the S. Subcomm. on Oversight of Gov. Mgmt., S. Hrg. 99-310 (June 25-26, 1985), at 5 (1985 ERISA Hearings).

³ Office of Pension and Welfare Benefit Programs, Summary of Conclusions from Public Hearings (Jan. 1985) (1985 DOL Report), included in 1985 ERISA Hearings, at 454, 498 (“Projections are that ERISA plans will hold more than half of all the equity securities in the United States before the turn of the century. Perhaps not entirely by coincidence, take-over fever reached epidemic proportions in 1984.”).

⁴ Testimony of Ian Lanoff, 1985 ERISA Hearings, at 26 (former administrator of Department’s benefits office testifying that “some representatives of corporate America have blamed the pension plans for always taking the short-term view in takeover situations, and always tendering. And they somehow construe this as being required by ERISA or their fiduciary responsibilities.”); 1985 DOL Report, included in 1985 ERISA Hearings, at 498; Joint Department of Labor/Department of Treasury Statement of Pension Investments (Jan. 31, 1989), reprinted in 16 Pens. & Ben. Rep. (BNA) 215 (Feb. 6, 1989).

⁵ 1985 DOL Report, included in 1985 ERISA Hearings, at 495 (citing written statement by Professor Roger F. Murray).

⁶ Testimony of Robert Monks, 1985 ERISA Hearings, at 10.

⁷ 1985 DOL Report, included in 1985 ERISA Hearings, at 10, 494-95 (citing written statement by Professor Roger F. Murray).

would include the voting of proxies appurtenant to those shares of stock.”⁸ While ERISA allows named fiduciaries to designate investment managers to manage plan assets,⁹ ERISA also requires named fiduciaries “to periodically monitor the activities of the investment manager with respect to the management of plan assets,”¹⁰ a duty that encompasses the monitoring of decisions made and actions taken by investment managers with regard to proxy voting.¹¹ The Avon Letter and subsequent sub-regulatory guidance from the Department (outlined below) has resulted in a misplaced belief among some stakeholders that fiduciaries must always vote proxies, subject to limited exceptions, in order to fulfill their obligations under ERISA.¹²

⁸ Letter to Helmuth Fandl, Chairman of the Retirement Board, Avon Products, Inc. 1988 WL 897696 (Feb. 23, 1988).

⁹ ERISA sections 405(c)(1), 402(c)(3).

¹⁰ Avon Letter.

¹¹ The Department also issued a second opinion letter on proxy voting in 1990, in which it reiterated—as it has consistently done in the years since—that fiduciaries must discharge their duties relating to proxy voting solely in the interest of participants and beneficiaries and for the exclusive purpose of providing plan benefits. See Letter to Robert Monks, 1990 WL 1085069 (Jan. 23, 1990).

¹² See, e.g., Barbara Novick, *Revised and Extended Remarks at Harvard Roundtable on Corporate Governance Keynote Address “The Goldilocks Dilemma”* (Nov. 6, 2019), www.blackrock.com/corporate/literature/publication/barbara-novick-remarks-harvard-roundtable-corporate-governance-the-goldilocks-dilemma-110619.pdf, at 15 (Avon Letter indicated “that asset managers should generally vote shares as part of their fiduciary duty”); Daniel M. Gallagher, *Outsized Power & Influence: The Role of Proxy Advisers*, Washington Legal Foundation (Aug. 2014), <https://s3.us-east-2.amazonaws.com/washlegal-uploads/upload/legalstudies/workingpaper/GallagherWP8-14.pdf>, at 3; Business Roundtable Comment Letter on SEC Proposed Amendments to Rule 14a-8 (Feb. 3, 2020), www.sec.gov/comments/s7-22-19/s72219-6742505-207780.pdf, at 2-3 (“many institutional investors historically interpreted SEC and Department of Labor rules and guidance as requiring institutional investors to vote every share on every matter on a proxy”) (citing Gallagher); Manifest Information Services Ltd, *Response to ESMA Discussion Paper ‘An Overview of the Proxy Advisory Industry: Considerations on Possible Policy Options’* (June 2012), www.esma.europa.eu/file/10536/download?token=ou-vCUE0, at 37 (comment letter from European proxy voting agency describing DOL proxy guidance as concerning “duties of . . . fiduciaries . . . to vote the shares in companies held by their pension plans”); Charles M. Nathan, *Future of Institutional Share Voting Revisited: A Fourth*

In 1994, the Department issued its first interpretive bulletin on proxy voting, Interpretive Bulletin 94-2 (IB 94-2).¹³ IB 94-2 recognized that fiduciaries may engage in shareholder activities intended to monitor or influence corporate management in situations where the responsible fiduciary concludes that, after taking into account the costs involved, there is a reasonable expectation that such shareholder activities (by the plan alone or together with other shareholders) will enhance the value of the plan's investment in the corporation. The Department expected that increased shareholder engagement by pension funds – encouraged by the new interpretive bulletin – would improve corporate performance and help ensure companies treated their employees well.¹⁴ However, the Department also reiterated its view that ERISA does not permit fiduciaries, in voting proxies or exercising other shareholder rights, to subordinate the economic interests of participants and beneficiaries to unrelated objectives.

In October 2008, the Department replaced IB 94-2 with Interpretive Bulletin 2008-02 (IB 2008-02).¹⁵ The Department's intent was to update the guidance in IB 94-2 and to reflect interpretive positions issued by the Department after 1994 on shareholder engagement and socially-directed proxy voting initiatives. IB 2008-02 stated that fiduciaries' responsibility for

Paradigm (Sep. 27, 2011), <https://corpgov.law.harvard.edu/2011/09/27/future-of-institutional-share-voting-revisited-a-fourth-paradigm/> (“the current system for voting portfolio securities by application of uniform voting policies . . . is perceived as successfully addressing the commonly understood fiduciary duty of institutional investors to vote all of their portfolio securities on all matters”); see also U.S. Department of Labor, Transcript of Press Conference on Corporate Activist Role in Pension Planning (July 28, 1994), at 15-16 (then-Secretary Robert Reich stating that IB 94-2 “makes very clear that . . . pension fund managers, trustees, [and] fiduciaries have an obligation to vote proxies” unless the costs “substantially outweigh” the benefits) (1994 DOL Press Conference).

¹³ 59 FR 38860 (July 29, 1994).

¹⁴ See 1994 DOL Press Conference, at 2-4, 10, 15-16; see also Leslie Wayne, *U.S. Prodding Companies to Activism on Portfolios*, N.Y. Times (July 29, 1994), www.nytimes.com/1994/07/29/business/us-prodding-companies-to-activism-on-portfolios.html (quoting official stating that the Department is “trying to encourage corporations to be activist owners,” and that “such activism is consistent with your fiduciary duty and we expect it will improve your corporate performance”).

¹⁵ 73 FR 61731 (Oct. 17, 2008).

managing proxies includes both deciding to vote or not to vote.¹⁶ IB 2008-02 further stated that the fiduciary duties described at ERISA sections 404(a)(1)(A) and (B) require that in voting proxies the responsible fiduciary shall consider only those factors that relate to the economic value of the plan's investment and shall not subordinate the interests of the participants and beneficiaries in their retirement income to unrelated objectives. In addition, IB 2008-02 stated that votes shall only be cast in accordance with a plan's economic interests. IB 2008-02 explained that if the responsible fiduciary reasonably determines that the cost of voting (including the cost of research, if necessary, to determine how to vote) is likely to exceed the expected economic benefits of voting, the fiduciary has an obligation to refrain from voting.¹⁷ The Department also reiterated in IB 2008-02 that any use of plan assets by a plan fiduciary to further political or social causes "that have no connection to enhancing the economic value of the plan's investment" through proxy voting or shareholder activism is a violation of ERISA's exclusive purpose and prudence requirements.¹⁸

In 2016, the Department issued Interpretive Bulletin 2016-01 (IB 2016-01), which reinstated the language of IB 94-2 with certain modifications.¹⁹ IB 2016-01 reiterated and confirmed that, "in voting proxies, the responsible fiduciary [must] consider those factors that may affect the value of the plan's investment and not subordinate the interests of the participants and beneficiaries in their retirement income to unrelated objectives."²⁰

¹⁶ Id. at 61732.

¹⁷ Id.

¹⁸ Id. at 61734.

¹⁹ 81 FR 95879 (Dec. 29, 2016).

²⁰ Id. at 95882. In addition, the Department issued a Field Assistance Bulletin to provide guidance on IB 2016-01 on Apr. 23, 2018. See FAB 2018-01, www.dol.gov/sites/dolgov/files/ebsa/employers-and-advisers/guidance/field-assistance-bulletins/2018-01.pdf.

The Department has tried to convey in its sub-regulatory guidance that fiduciaries need not vote all proxies. A fiduciary's duty is only to vote those proxies that are prudently determined to have an economic impact on the plan after the costs of research and voting are taken into account. Nevertheless, a misunderstanding that fiduciaries must research and vote all proxies continues to persist, causing some plans to expend their assets unnecessarily on matters not economically relevant to the plan. As discussed below, this problem has been exacerbated by the fact that since 1988 the amount and types of shareholder proposals have increased substantially.²¹ Therefore, the Department has decided to propose rule amendments that expressly state that fiduciaries must not vote in circumstances where plan assets would be expended on shareholder engagement activities that do not have an economic impact on the plan, whether by themselves or after the costs of engagement are taken into account. The designation of any final rule resulting from this notice of proposed rulemaking as regulatory or deregulatory will be informed by public comments received on the proposal. Details on the estimated costs of this proposed rule can be found in the rule's economic analysis.

B. Purpose of Regulatory Action

For the reasons outlined above and the reasons that follow, the Department believes that it should address issues regarding the application of fiduciary obligations under sections 403(c) and 404(a) of ERISA with respect to exercises of shareholder rights, including proxy voting, through a proposed regulation that amends the "Investment duties" regulation at 29 CFR 2550.404a-1 and provides a public notice and comment process. In that regard, IB 2016-01 no longer represents the view of the Department regarding the proper interpretation of ERISA with

²¹ See *infra* at notes 79 to 85.

respect to the exercise of shareholder rights by fiduciaries of ERISA-covered plans.

Accordingly, the Department intends to remove it from the Code of Federal Regulations when a final rule is adopted.

i. General Principles

ERISA mandates that fiduciaries discharge their duties “solely in the interest” and “for the exclusive purpose” of providing benefits to participants and their beneficiaries.²² The Supreme Court has described this duty as requiring that fiduciaries act with an “eye single” to the interests of participants and beneficiaries,²³ and appellate courts have described ERISA’s fiduciary duties as “the highest known to the law.”²⁴ The Department similarly has rejected a construction of ERISA that would render the statute’s tight limits on the use of plan assets illusory and that would permit plan fiduciaries to expend trust assets to promote myriad public policy preferences, including through shareholder engagement activities, voting proxies, or other investment policies.²⁵

ii. Changes in the Investment Landscape

The financial marketplace and the world of shareholder engagement have changed considerably since the Department released the Avon Letter over thirty years ago. Several trends

²² ERISA section 404(a)(1). See also ERISA section 403(c)(1) (“[T]he assets of a plan shall never inure to the benefit of any employer and shall be held for the exclusive purposes of providing benefits to participants in the plan and their beneficiaries”).

²³ *Pegram v. Herdrich*, 530 U.S. 211, 235 (2000) (quoting *Donovan v. Bierwirth*, 680 F.2d 263, 271 (2d Cir. 1982)).

²⁴ See, e.g., *Tibble v. Edison Int’l*, 843 F.3d 1187, 1197 (9th Cir. 2016).

²⁵ See IB 2016-01, 81 FR at 95881.

underlie the Department's current action to clarify its previous guidance regarding an ERISA fiduciary's obligations:

- *Increase in the percentage of corporate America's stock held by, and plan assets managed by, institutional investors, diminishing the scope of proxy voting obligations attributable to ERISA fiduciaries:* In 2007 institutional investors owned 76.4 percent of the 1,000 largest American companies, a 63 percent increase over their 47 percent ownership of America's largest companies in 1987.²⁶ This growth in institutional ownership has continued. By 2017, institutional investors owned 80.3 percent of the 500 largest American companies.²⁷ Additionally, institutional investor ownership in U.S. corporate equities grew from \$1.1 trillion in 1985 to \$25.4 trillion in 2019.²⁸ Contrary to the Department's projections in 1985,²⁹ the share of individual stock holdings in private pension funds decreased from almost 22 percent in 1985 to about 5 percent in 2019.³⁰ ERISA plan assets were about 27 percent invested in corporate debt and equity instruments in 1993,³¹ but by 2017 this figure had declined to approximately 11 percent.³² This decrease in the share of ERISA plan assets invested

²⁶ The Conference Board, *Institutional Investment Report: Trends in Institutional Investor Assets and Equity Ownership of U.S. Corporations* (Sept. 2008.); see also Barry Burr, *Institutional Investors Increase Ownership of U.S. Companies to All-Time High*, Pensions & Investments, (Sept. 5, 2008).

²⁷ Charles McGrath, *80% of Equity Market Cap Held by Institutions*. Pensions & Investments, (April 25, 2017).

²⁸ Department calculations based on U.S. Federal Reserve statistics. Institutional investors include retirement and pension funds, insurance companies, mutual funds, closed-end funds, exchange-traded funds, brokers and dealers, and nonfinancial corporate businesses.

²⁹ See *supra* note 3 (quoting 1985 DOL Report estimating that ERISA plans will hold more than half of all equity securities before the turn of the century).

³⁰ Department calculations based on U.S. Federal Reserve statistics.

³¹ DOL calculation based on statistics from U.S. Department of Labor, Employee Benefits Security Administration, *Private Pension Plan Bulletin: Abstract of 1993 Form 5500 Annual Reports*, (Winter 1996), Table A3, www.dol.gov/agencies/ebsa/researchers/statistics/retirement-bulletins/private-pension-plan-bulletins-abstract-1993.

³² DOL calculation based on statistics from U.S. Department of Labor, Employee Benefits Security Administration, *Private Pension Plan Bulletin: Abstract of 2017 Form 5500 Annual Reports*, (Sept. 2019), Table C4,

- in individual securities was accompanied by a corresponding increase in securities held through institutions such as mutual funds, reducing the volume of proxy voting rights that ERISA fiduciaries hold in individual securities of corporate issuers
- *Broader diversification of ERISA plan assets:* Since the 1980s, the scope and type of plan investments has changed, which has significantly reduced the volume of securities directly held by plans. The development and growth of financial vehicles such as exchange-traded funds, sector-based equity products, hedge funds, as well as an increased focus on passive investing, have altered the investment landscape in which ERISA fiduciaries now operate. ERISA plans have taken advantage of these new investment vehicles. For example, alternative investments like hedge funds, private equity, and venture capital firms have grown dramatically since 1990.³³ The share of large private pension plan assets held in alternative investments, such as hedge funds and private equity, nearly quadrupled between 2008 and 2017.³⁴
 - *Change in proxy voting behavior:* In concert with a marked increase in the size of the investment marketplace controlled by institutional investors, there also has been a substantial change in investor voting behavior and proxy voting policies. ISS Analytics, a data analytics service of Institutional Shareholder Services—the largest proxy advisory firm, which controls approximately 60 percent of the market—has documented several changes in proxy voting trends, observing that “investor voting

www.dol.gov/sites/dolgov/files/EBSA/researchers/statistics/retirement-bulletins/private-pension-plan-bulletins-abstract-2017.pdf.

³³ World Economic Forum, *Alternative Investments 2020: An Introduction to Alternative Investments*, at 8 (July 2015), www3.weforum.org/docs/WEF_Alternative_Investments_2020_An_Introduction_to_AI.pdf.

³⁴ Victoria Ivashina & Josh Lerner, *Looking for Alternatives: Pension Investments around the World, 2008 to 2017* at Table 5 (Aug. 24, 2018). www.bostonfed.org/-/media/Images/research-conference-2018/papers/looking-for-alternatives-pension-investments-around-the-world-2008-to-2017.pdf. These statistics are based on a balanced panel of 210 equally weighted large private pension plans.

behavior among owners of U.S. companies has changed significantly—perhaps almost revolutionarily—over the past two decades.”³⁵ According to ISS Analytics, “for the overwhelming majority of share capital represented in the U.S., voting is certainly no longer a compliance exercise.”³⁶ Instead, “proxy voting policies are becoming more complex, as investors continue to add to the list of factors they consider in their review and analysis of governance practices, including board independence, board accountability, diversity, myriads of executive compensation factors, shareholder rights, and environmental and social factors.”³⁷

- *Mixed evidence on effectiveness of shareholder voting:* As discussed above, one factor prompting the rise in shareholder activities by ERISA fiduciaries was the belief that participating in such activities was likely to enhance the value of a plan’s investment in a particular security.³⁸ Since that time, however, research regarding whether proxy voting has reliable positive effects on shareholder value and a plan’s investment in the corporation has yielded mixed results.³⁹

³⁵ Kosmas Papadopoulos, *The Long View: US Proxy Voting Trends on E&S Issues from 2000 to 2018*, Harvard Law School Forum on Corp. Gov. & Fin. Reg. (Jan. 31, 2019), <https://corpgov.law.harvard.edu/2019/01/31/the-long-view-us-proxy-voting-trends-on-es-issues-from-2000-to-2018> (2019 ISS Proxy Voting Trends).

³⁶ *Id.*

³⁷ *Id.*

³⁸ See discussion, *supra*.

³⁹ Regarding the mixed evidence on whether shareholder engagement improves firm value, see, e.g., Matthew R. Denes, Jonathan M. Karpoff & Victoria B. McWilliams, *Thirty Years of Shareholder Activism: A Survey of Empirical Research*, 44 J. Corp. Fin. 405, 407 (2017); Tracie Woidtke, *Public Pension Fund Activism and Firm Value: An Empirical Analysis*, Manhattan Institute (2015), https://media4.manhattan-institute.org/pdf/lpr_20.pdf; Maria Goranova & Lori Verstegen Ryan, *Shareholder Activism: A Multidisciplinary Review*, 40 Journal of Management 1230, 1251-1253 (July 2014) (collecting research regarding the “equivocal results” of shareholder activism on corporate performance); James R. Copland, David F. Larcker & Brian Tayan, *The Big Thumb on the Scale: An Overview of the Proxy Advisory Industry* (May 2018), www.gsb.stanford.edu/sites/gsb/files/publication-pdf/cgri-closer-look-72-big-thumb-proxy-advisory.pdf; see also Dorothy S. Lund, *The Case Against Passive Shareholder Voting*, 43 J. Corp. Law 493, 526 (2018) (“In light of the fact that any investment in voting will likely generate higher costs than benefits for the fund, it is surprising that passive funds vote at all.”); David Yermack, *Shareholder Voting and Corporate Governance*, 2 Ann. Rev. Fin. Econ. 2.1, 2.15 (2010) (“Activist institutions

iii. The Avon Letter and Proxy Voting

As the Department first stated in the Avon Letter, the fiduciary duty to manage plan assets that are shares of corporate stock encompasses responsibility over the voting of proxies appurtenant to those shares of stock. This responsibility is subject to ERISA's core fiduciary duties of loyalty and care. A fiduciary's exercise of voting rights (or other shareholder rights) must be performed solely for the plan's economic interests, which under no circumstances may be subordinated to non-pecuniary goals. Accordingly, the use of plan assets for purposes other than enhancing the value of the plan's investments—through proxy voting or otherwise—violates the fiduciary duties of loyalty and care under ERISA. The economic interests of participants and beneficiaries must be the basis of fiduciary decision-making.

The Avon Letter has been read by some outside of its factual context as creating a general presumption that ERISA fiduciaries responsible for managing plan assets that are shares of corporate stock should always vote the proxies appurtenant to those shares.⁴⁰ For fiduciaries with such an understanding, the letter presented them with an ambiguous duty that in practice was often very difficult to discharge without the assistance of third-party proxy advisory firms. The Department is now concerned that some fiduciaries and proxy advisory firms—in part relying on the Avon Letter—may be acting in ways that unwittingly allow plan assets to be used to support or pursue proxy proposals for environmental, social, or public policy agendas that have no connection to increasing the value of investments used for the payment of benefits or

frequently state that their goal is not to improve the value of individual investment positions, but rather to create positive externalities by signaling optimal governance practices market wide”).

⁴⁰ See *supra* note 12.

plan administrative expenses, and in fact may have unnecessarily increased plan expenses.⁴¹ In addition, informed by the changed circumstances over the past 30 years and the potential for continued fiduciary breaches that can result from a belief that such presumption applies as a legal matter, the Department believes that it is important to expressly reject the notion of such a presumption.

In proposing this regulation, the Department wishes to be clear: there is no fiduciary mandate under ERISA always to vote proxies appurtenant to shares of stock. The Department's longstanding position—that “the decision as to how proxies should be voted with regard to the issues that might affect the economic value of the underlying securities is a fiduciary act of plan asset management”⁴²—does not mean that ERISA requires fiduciaries to always vote such proxies.⁴³ Instead, ERISA mandates that fiduciaries manage voting rights prudently and for the “exclusive purpose” of securing economic benefits for plan participants and beneficiaries—which may or may not require a proxy vote to be cast.⁴⁴ In the Department's view there is no presumption that abstaining from voting proxies appurtenant to shares of stock is a per se

⁴¹ See, e.g., U.S. Dep't of Labor Office of Inspector General Report No. 09-11-001-12-121, *Proxy-Voting May Not be Solely for the Economic Benefit of Retirement Plans* (Mar. 31, 2011), www.oig.dol.gov/public/reports/oa/2011/09-11-001-12-121b.pdf, at 4 (“EBSA does not have adequate assurances that fiduciaries or third parties voted proxies solely for the economic benefit of plans.”).

⁴² Pension and Welfare Benefits Administration, Proxy Project Report (Mar. 2, 1989), at 2; see also Testimony of David Walker, Ass't Sec'y for Pension and Welfare Benefits, Tax Policy Aspects of Mergers and Acquisitions, before the H. Ways and Means Comm., Serial 101-10 (Feb. 2, 1989), at 525 (“[P]ension plan fiduciaries [have an obligation] to vote shares that could have an effect on the economic value of the stock in accordance with what is in interest of plan participants and beneficiaries, recognizing the plan as a separate legal entity designed for the purpose of providing retirement income.”).

⁴³ See also Comment Letter to SEC from Institutional Shareholder Services, Inc. (Nov. 7, 2018), www.sec.gov/comments/4-725/4725-4629940-176410.pdf, at 7 (“[I]nvestment advisers have no absolute duty to vote every proxy relating to their clients' portfolios”).

⁴⁴ The Supreme Court as recently as 2014 unanimously held in the context of ERISA retirement plans that benefits must be understood to refer to “*financial*” rather than “nonpecuniary” benefits. See *Fifth Third Bancorp v. Dudenhoeffer*, 573 U.S. 409, 421 (2014) (the “benefits” to be pursued by ERISA fiduciaries as their “exclusive purpose” do not include “nonpecuniary benefits”) (emphasis in original).

fiduciary breach. Rather, fiduciaries must vote proxies in a manner that is in the best interest of the plan. The proposed regulation is designed to reflect these principles while permitting fiduciaries to execute such duties in a cost-efficient manner.

iv. Recent SEC Actions Regarding Proxy Voting

As part of its ongoing proxy reform initiative, the SEC has issued guidance and adopted rule amendments that, to the extent applicable to ERISA fiduciaries, address some of the Department's concerns about ERISA fiduciaries properly discharging their duties with respect to proxy voting activities and appropriately selecting and overseeing proxy advisory firms. Although persons subject to SEC's jurisdiction would also be ERISA investment advice fiduciaries to the extent they meet the five-part test in the Department's regulation at 29 CFR 2510.3-21, the SEC's actions would not apply to ERISA fiduciaries that are outside of the SEC's jurisdiction. The Department believes that it would be appropriate to consider updating its regulations to ensure more consistent conduct by all plan fiduciaries.

On August 21, 2019, the SEC issued guidance regarding proxy voting responsibilities of investment advisers.⁴⁵ The guidance described a number of steps investment advisers could take where the investment adviser has assumed the authority to vote proxies on behalf of a client to demonstrate that it is making voting determinations in a client's best interest and in accordance with the investment adviser's proxy voting policies and procedures. Among other things, the investment adviser must conduct a reasonable investigation into matters on which the adviser votes and vote in the best interest of each client for whom the adviser performs proxy voting

⁴⁵ See Commission Guidance Regarding Proxy Voting Responsibilities of Investment Advisers, 84 FR 47420 (Sept. 10, 2019) (2019 SEC Guidance).

services, and should consider reasonable measures to determine that it is casting proxy votes on behalf of its clients consistently with the adviser's voting policies and procedures and in its client's best interest.⁴⁶

The SEC guidance also provides that before casting votes, investment advisers that retain proxy advisory firms to provide voting recommendations or voting services should consider additional steps to evaluate whether the voting determinations are consistent with the investment adviser's voting policies and procedures and in the client's best interest. The SEC guidance also provides that investment advisers should consider whether the proxy advisory firm has the capacity and competency to adequately analyze the matters for which the investment adviser is responsible for voting. The SEC guidance also explains that an investment adviser's decision regarding whether to retain a proxy advisory firm should also include a reasonable review of the proxy advisory firm's policies and procedures regarding how it identifies and addresses conflicts of interest.⁴⁷ Further, as part of the investment adviser's ongoing compliance program, the investment adviser must annually review and document the adequacy of its voting policies and procedures.⁴⁸

On July 22, 2020, the SEC adopted rule amendments that, among other things, require proxy advisory firms that are engaged in a solicitation to provide specified disclosures, adopt written policies and procedures designed to ensure that proxy voting advice is made available to securities issuers, and provide proxy advisory firm clients with a mechanism by which the clients can reasonably be expected to become aware of a securities issuer's views about the proxy

⁴⁶ 2019 SEC Guidance, 84 FR at 47423-47424.

⁴⁷ Id. at 47424-47425.

⁴⁸ Id.

voting advice so that the clients can take such views into account as they vote proxies.⁴⁹ At the same time, the SEC issued supplemental guidance to assist investment advisers in assessing how to consider the additional information that may become more readily available to them as a result of these amendments, including in circumstances where the investment adviser uses a proxy advisory firm's electronic vote management system that "pre-populates" the adviser's proxies with suggested voting recommendations and/or voting execution services.⁵⁰ The Department believes that activities of proxy advisory firms have similar relevance for fiduciaries under ERISA.

C. Provisions of the Rule

This proposed rule would amend the current "Investment duties" regulation 29 CFR 2550.404a-1 and address the prudence and exclusive purpose duties under sections 404(a)(1)(A) and 404(a)(1)(B) of ERISA in the context of proxy voting and other exercises of shareholder rights by the responsible ERISA plan fiduciaries.⁵¹

Paragraph (e)(1) of the proposed rule provides that the fiduciary duty to manage plan assets that are shares of stock includes the management of shareholder rights appurtenant to those plan assets, such as the right to vote proxies.

⁴⁹ SEC Release No. 34-89372 (July 22, 2020), *Exemptions from the Proxy Rules for Proxy Voting Advice* (2020 SEC Proxy Voting Advice Amendments).

⁵⁰ SEC Release No. IA-5547 (July 22, 2020), *Supplement to Commission Guidance Regarding Proxy Voting Responsibilities of Investment Advisers* (2020 SEC Supplemental Guidance).

⁵¹ As explained in paragraph (e)(2)(ii)(B) and paragraph (e)(4)(i) of the proposal, the responsibility for exercising shareholder rights lies exclusively with the plan trustee except to the extent that either (1) the trustee is subject to the directions of a named fiduciary pursuant to ERISA section 403(a)(1), or (2) 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).

Paragraph (e)(2)(i) provides that 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 pursuant to ERISA sections 403 and 404.

Paragraph (e)(2)(ii) sets forth specific standards that fiduciaries must meet when deciding whether to exercise shareholder rights and when exercising shareholder rights. Specifically, the paragraph states that plan fiduciaries must (1) act solely in accordance with the economic interest of the plan considering only factors that they prudently determine will affect the economic value of the plan's investment based on a determination of risk and return over an appropriate investment horizon consistent with the plan's investment objectives and the funding policy of the plan; (2) consider the likely impact on the investment performance of the plan based on such factors as the size of the plan's holdings in the issuer relative to the total investment assets of the plan, the plan's percentage ownership of the issuer, and the costs involved; (3) 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 sacrifice investment return or take on additional investment risk to promote goals unrelated to these financial interests of the plan's participants and beneficiaries or the purposes of the plan; (4) investigate material facts that form the basis for any particular proxy vote or other exercise of shareholder rights (e.g., the fiduciary may not adopt a practice of following the recommendations of a proxy advisory firm or other service provider without appropriate supervision and a determination that the service provider's proxy voting guidelines are consistent with the economic interests of the plan and its participants and beneficiaries); (5) maintain records on proxy voting activities and other exercises of

shareholder rights, including records that demonstrate the basis for particular proxy votes and exercises of shareholder rights; and (6) 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.

The proposed provisions confirm that when making their voting decisions, fiduciaries must perform reasonable investigations, understanding that certain proposals may require a more detailed or particularized voting analysis. Information that will better enable fiduciaries to determine whether or how to vote proxies on particular matters includes the cost of voting, including opportunity costs; the type of proposal (e.g., those relating to social or public policy agendas versus those dealing with issues that have a direct economic impact on the investment); voting recommendations of management;⁵² and an analysis of the particular shareholder proponents. In the Department's view, fiduciaries must be prepared to articulate the anticipated economic benefit of proxy-vote decisions in the event they decide to vote.

As stated above, the Department recognizes that fiduciaries may reasonably delegate their proxy voting authority to investment managers. In such cases, ERISA requires fiduciaries to monitor proxy voting decisions made by their investment managers to ensure such entities are voting, or refraining from voting, in a manner that maximizes investment returns and does not sacrifice economic benefits for non-pecuniary objectives, as described above. Therefore, it is the

⁵² Corporate directors owe their own fiduciary duties to their corporation, and can be subjected to shareholder lawsuits for breach of those duties. See, e.g., *Aronson v. Lewis*, 473 A.2d 805 (Del. 1984) (citing *Loft, Inc. v. Guth*, 2 A.2d 225 (Del. Ch. 1938), *aff'd*, 5 A.2d 503 (Del. 1939)) (“The existence and exercise of this power carries with it certain fundamental fiduciary obligations to the corporation and its shareholders.”).

view of the Department that, consistent with the duty to monitor, fiduciaries should require documentation of the rationale for proxy-voting decisions so that fiduciaries can periodically monitor proxy-voting decisions made by third parties. A plan fiduciary must also assess and monitor an investment manager's use of any proxy advisory firm, including any review by the manager of the advisory firm's policies and procedures for identifying and addressing conflicts of interest.⁵³

Similarly, any ERISA plan fiduciary that uses a proxy advisory firm is responsible for ensuring that the proxy advisory firm's practices with respect to its services to the ERISA plan are consistent with the prudence and loyalty obligations that govern the fiduciary's proxy voting actions.⁵⁴ In particular, fiduciaries must be aware that conflicts of interest can arise at proxy advisory firms that could affect vote recommendations. For example, in certain instances a proxy advisory firm may issue proxy voting recommendations while the company that is the subject of such recommendations is a client of the firm's consulting business.⁵⁵ When using a proxy advisory firm, ERISA fiduciaries must exercise prudence and diligence in selecting and

⁵³ Many investment managers are registered as investment advisers with the SEC. As such, they are required by an SEC rule to: (i) adopt and implement written policies and procedures reasonably designed to ensure they vote securities in a client's best interest, and which procedures must include how the adviser will address material conflicts of interest that may arise between the adviser's interests and those of its client; (ii) disclose to clients about how they may obtain information about how the adviser voted with respect to their securities; and (iii) describe to clients the adviser's proxy voting policies and procedures and, upon request, furnish a copy of the policies and procedures to the requesting client. See 17 CFR 275.206(4)-6; see also 2019 SEC Guidance, 84 FR at 47424 (addressing considerations that an investment adviser should take into account if it retains a proxy advisory firm to assist it in discharging its proxy voting duties).

⁵⁴ For example, research has shown that a significant number of asset managers automatically vote in accordance with the recommendations of proxy advisory firms. See, e.g., Paul Rose, *Robovoting and Proxy Vote Disclosure* (Nov. 2019), <https://corpgov.law.harvard.edu/2019/11/25/robovoting-and-proxy-vote-disclosure> (detailing the prevalence of such "robovoting" by firms that contract with proxy advisory firms and expressing concern regarding this lack of diligence).

⁵⁵ See, e.g., GAO Report 07-765, *Issues Relating to Firms That Advise Institutional Investors on Proxy Voting* (June 2007), at 4, 9-10. By contrast, section 201 of the Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, mandates the independence of auditors in part by prohibiting a public accounting firm that performs an audit from simultaneously offering non-audit services.

monitoring the firm, as both are fiduciary acts. Such diligence should include assessing whether the proxy advisory firm is able to competently analyze proxy issues, identify and address potential conflicts of interest, and adhere to the plan's proxy voting policy guidelines. Particular attention must be given to proxy advisory firms that provide both proxy advisory services to investors and consulting services to issuers on matters subject to proxy resolutions.⁵⁶ In addition, the Department's long-established position is that compliance with the duty to monitor necessitates proper documentation of the activities that are subject to monitoring.

Consistent with these principles, paragraph (e)(2)(iii) of the proposal states that, where the authority to vote proxies or exercise shareholder rights has been delegated to an investment manager pursuant to ERISA section 403(a)(2) or a proxy voting firm or other person performs advisory services as to the voting of proxies, plan fiduciaries shall require such investment manager, proxy voting firm, or other advisor to document the rationale for proxy voting decisions or recommendations sufficient to demonstrate that the decision or recommendation was based on the expected economic benefit to the plan, and that the decision or recommendation was based solely on the interests of participants and beneficiaries in obtaining financial benefits under the plan. To facilitate transparency, the Department also reminds

⁵⁶ The SEC has issued guidance on the elements an investment adviser should consider in retaining or continuing to retain a proxy advisory firm, including the process an investment adviser should take to review and assess a proxy advisory firm's policies and procedures for identifying and addressing conflicts of interest. See 2019 SEC Guidance, 84 FR at 47425. The SEC issued supplementary guidance for investment advisers on how to consider additional information that may become more readily available to them as a result of the amendments to the proxy rule for proxy voting advice, including when an investment adviser utilizes a proxy advisor's electronic vote management system that "pre-populates" with suggested voting recommendations and/or for voting execution services. See 2020 SEC Supplemental Guidance. In the event fiduciaries believe the retention of a proxy advisory firm is appropriate, the Department likewise views the SEC's guidance as reasonable direction for the diligence that ERISA plan fiduciaries should perform when reviewing and assessing a proxy advisory firm. The Department notes, however, that the SEC standards do not necessarily capture all the actions that ERISA may require as a result of that review and assessment.

fiduciaries that proxy voting guidelines must be made available to plan participants, either as a separate document or by including them in the plan's existing investment policy statement.

When an investment manager's rationale on a vote for recurring issues is to follow a uniform internal policy, the manager should document the reasons for any vote that goes against the policy, which would generally only require a brief explanation directly in the proxy-voting record.

Paragraph (e)(3) sets forth certain proposed requirements and limitations pertaining to proxy voting. The proposed rule provides in paragraph (e)(3)(i) that a plan fiduciary must vote any proxy where the fiduciary prudently determines that the matter being voted upon would have an economic impact on the plan after considering those factors described in paragraph (e)(2)(ii) and taking into account the costs involved (including the cost of research, if necessary, to determine how to vote). As a corollary, paragraph (e)(3)(ii) provides that a plan fiduciary must *not* vote any proxy unless the fiduciary prudently determines that the matter being voted upon would have an economic impact on the plan after considering those factors described in paragraph (e)(2)(ii) and taking into account the costs involved.

These provisions are intended to reflect the fact that there will be circumstances when fiduciaries are required to vote a proxy and there will be circumstances when a fiduciary is required not to vote a proxy. In those circumstances when a fiduciary prudently determines that the fiduciary's duties to the plan require the fiduciary to vote, the fiduciary must exercise care, skill, prudence, diligence, and loyalty when making voting decisions on behalf of the plan.⁵⁷

⁵⁷ ERISA section 404(a)(1).

The Department recognizes that because the decision regarding whether a proxy vote will or will not affect the economic value of a plan's investments is critical in triggering a fiduciary's obligations under ERISA to vote or abstain from voting, fiduciaries may need to conduct an analytical process which could in some cases be resource-intensive (requiring, among other things, organizing proxy materials, diligently analyzing portfolio companies and the matters to be voted on, determining how the votes should be cast, and submitting proxy votes to be counted), and that these activities may often burden fiduciaries out of proportion to any potential benefit to the plan.⁵⁸ Given that widely diversified plans significantly dilute the effect of a single holding, and the mixed evidence regarding whether proxy voting affects firm value,⁵⁹ the Department is concerned that the costs for fiduciaries to prudently exercise proxy voting rights often will exceed any potential economic benefits to a plan.

To address this concern, the Department has proposed potential options for fiduciaries that are intended to reduce the need for fiduciaries to consider proxy votes that are unlikely to have an economic impact on the plan, thereby allowing plans to focus resources on matters most likely to have an economic impact. These various options (labeled "permitted practices" in the proposed rule) will thus help fiduciaries more cost-effectively comply with the obligations under paragraphs (e)(3)(i) and (ii). Under the proposed provisions, a fiduciary may adopt proxy voting policies that encompass one or more of the permitted practices, and the fiduciary may then apply those proxy voting policies to proxy votes. The development and adoption of such policies is

⁵⁸ The SEC described a number of functions performed by proxy voting advice businesses and observed that in the absence of such services, investment advisers and other clients of these businesses may require considerable resources to independently conduct the work necessary to analyze and make voting determinations. See 2020 SEC Proxy Voting Advice Amendments, at 140-141.

⁵⁹ See *supra* note 39.

subject to the fiduciary's duties of prudence and loyalty. However, paragraph (e)(3)(v) ensures that such proxy voting policies would not preclude a fiduciary from voting in any particular case in which a fiduciary subsequently determines that the proxy matter being voted upon would have an economic impact on the plan, or from refraining from voting based on a subsequent determination that the matter being voted upon would not have an economic impact.

Accordingly, the Department proposes to assist plan fiduciaries by providing in paragraph (e)(3)(iii) that it is permissible to adopt general proxy voting policies or parameters for exercising voting rights that are prudently designed to serve the plan's economic interest. Paragraphs (e)(3)(iii)(A), (B), and (C) provide examples of such policies.

In paragraph (e)(3)(iii)(A), the Department proposes that a fiduciary may adopt a policy of voting proxies in accordance with the voting recommendations of a corporation's management on proposals or types of proposals that the fiduciary has prudently determined are unlikely to have a significant impact on the value of the plan's investment, subject to any conditions determined by the fiduciary as requiring additional analysis because the matter being voted upon concerns a matter that may present heightened management conflicts of interest or is likely to have a significant economic impact on the value of the plan's investment. Under this permitted practice, a fiduciary may, consistent with its obligations set forth in ERISA section 404(a)(1)(A) and (B), maintain a proxy voting policy that relies on the fiduciary duties that officers and directors owe to a corporation based on state corporate laws.⁶⁰ On that basis, the proxy voting policy may state that the responsible plan fiduciary, if it so determines, ordinarily will follow the recommendations of a corporation's management. Furthermore, empirical observations indicate

⁶⁰ See *Aronson v. Lewis*, *supra* note 51.

that nearly all management proposals are approved with little opposition.⁶¹ Fiduciaries retain the right to override this practice or any voting policy if they subsequently determine that prudence dictates a different voting decision pursuant to paragraphs (e)(3)(i) and (ii).

The Department proposes in paragraph (e)(3)(iii)(B) that a fiduciary may determine in its proxy voting policy to focus its resources only on particular types of proposals that the fiduciary has prudently determined are likely to have a significant impact on the value of the plan's investment, such as proposals relating to corporate events (mergers and acquisitions transactions, dissolutions, conversions, or consolidations), corporate repurchases of shares (buy-backs), issuances of additional securities with dilutive effects on shareholders, or contested/ elections for directors.

Paragraph (e)(3)(iii)(C) proposes that a fiduciary may adopt a policy of refraining from voting on proposals or particular types of proposals when the plan's holding of the issuer relative to the plan's total investment assets is below quantitative thresholds that the fiduciary prudently determines, considering its percentage ownership of the issuer and other relevant factors, is sufficiently small that the matter being voted upon is unlikely to have a material impact on the investment performance of the plan's portfolio (or investment performance of assets under management in the case of an investment manager). The Department believes that establishing a specific quantitative upper limit for the threshold (i.e., a cap) under paragraph (e)(3)(iii)(C) may help fiduciaries by reducing the circumstances when borderline cases might result in plans performing individual cost/benefit analyses to decide whether to vote proxy proposals, a likely

⁶¹ See The Conference Board, *Proxy Voting Analytics (2015-2018)*, at 105, (2018), <https://law.rutgers.edu/sites/law/files/RR-1674-18-R.pdf>.

inefficient use of plan resources. The Department also believes that determining materiality based on a percentage of plan assets could be a straightforward way for fiduciaries to apply such a cap, and specifically solicits comments on whether in setting this upper limit, the Department should look to financial practices and existing regulations regarding quantitative measures of materiality. The Department solicits comments on whether a maximum cap should be defined and, if so, what factors should be considered in setting a cap. In particular, the Department solicits comments on whether a five-percent cap would be appropriate, or some other percent level of plan assets.⁶²

The proposed permitted practices provisions in paragraph (e)(3)(iii) include conditions that are intended to require a fiduciary to make prudence-based judgments about the policies. The specified types of proposals are not intended to be limiting, and a fiduciary could prudently determine other criteria for determining in advance the types of proposals on which to focus. These proposed provisions are also intended to be applied flexibly rather than in a binary “all or none” manner, and may be used either independently or in conjunction with each other.

A fiduciary should adopt proxy voting policies that are appropriate for a plan’s particular facts and circumstances. For example, a fiduciary declining to submit any proxy votes for holdings below a prudently determined quantitative materiality threshold may modify the policy in advance to allow proxy voting if needed for the portfolio holding to achieve a quorum for its shareholders’ meeting.⁶³ As another example, a fiduciary could determine not to spend plan

⁶² The proposal is not intended to suggest or express a view on whether in any particular case investing five percent of a plan’s portfolio in one holding would comply with ERISA’s diversification requirement, 29 U.S.C. 1104(a)(1)(C).

⁶³ The direct and indirect costs incurred by the corporation related to delaying the shareholders’ meeting, such as additional proxy solicitation, legal, and administrative costs, would be an economic detriment to the plan’s holding.

assets on proxy votes for nonbinding proposals, unless it is aware that such a proposal will somehow still have an economic impact on the value of the plan's investment. A fiduciary could also utilize the permitted practices to create a proxy voting policy that votes in accordance with management's recommendations for uncontested elections of directors and ratification of independent auditors and certain types of non-binding proposals, but primarily reserves its proxy voting resources for corporate events that are expected to have a significant economic impact on the value of the plan's holding, such as share buy-backs, dilutive issuances of securities, and contested elections for directors of the board. Plans could also fashion policies or exceptions from policies to account for circumstances where a plan's vote share is more likely to affect the outcome of a vote and the fiduciary believes changing the outcome would have an economic impact on the plan.

Paragraph (e)(3)(iv) would require plan fiduciaries to review any proxy voting policies adopted pursuant to paragraph (e)(3)(iii) at least once every two years. Paragraph (e)(3)(iv) is intended to permit fiduciaries to prudently determine a review cycle for their proxy voting policies, but establishes a maximum interval of no more than two years, which the Department believes is an appropriate limit to ensure a plan's proxy voting policies remain prudent given ongoing changes in financial markets and the investment world. The Department also understands that this provision is consistent with industry practices regarding periodic review and approval of investment policy statements.⁶⁴ The Department solicits comments on whether some other maximum interval would be appropriate to better ensure that plan policies adopted

⁶⁴ See also PBGC regulations at 29 CFR 4002.1(a)(4) (stating that PBGC Board must review the Corporation's Investment Policy Statement at least every two years and approve the Investment Policy Statement at least every four years).

pursuant to paragraph (e)(3)(iii) remain prudent without unnecessarily burdening plan fiduciaries.

Finally, the Department's proposed rule acknowledges in paragraph (e)(3)(v) that a fiduciary's fundamental priority is to act in the best interest of participants and beneficiaries. In the view of the Department, no policies adopted under paragraph (e)(3)(iii) would interfere with, or impose liability for, submitting a proxy vote when the fiduciary prudently determines that the matter being voted upon would have an economic impact on the plan after taking into account the costs involved. Rather, in situations where a fiduciary has prudently determined it is in the economic interest of the plan to vote, a fiduciary responsible for proxy voting must carry out this responsibility "solely" and "for the exclusive purpose of" the participants' and beneficiaries' interest in the economic value of the plan assets.

In addition to the solicitation of public comments on the particular proposed permitted practices, the Department requests comment on whether the proposed permitted practices should contain additional examples regarding when advance proxy voting directions may be exercised pursuant to specific parameters designed to serve the plan's economic interest and, if so, what situations those examples should cover. For example, the Department requests comment on whether the permitted practice in paragraph (e)(3)(iii)(B) should have additional specified types of proposals and, if so, which types of proposals. The Department also requests comment on whether the permitted practices in paragraphs (e)(3)(iii)(A) and (B) should be subject to quantitative limitations on plan holdings like those referenced in paragraph (e)(3)(iii)(C).

Paragraphs (e)(4)(i) and (ii) adopt provisions from the Department's prior IBs and state that the responsibility for exercising shareholder rights lies exclusively with the plan trustee,

except to the extent that either (1) the trustee is subject to the directions of a named fiduciary pursuant to ERISA section 403(a)(1), or (2) 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). Where the authority to manage plan assets has been delegated to an investment manager pursuant to section 403(a)(2) of ERISA, the investment manager has exclusive authority to vote proxies or exercise other shareholder rights appurtenant to such plan assets, except to the extent the plan or 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 regarding the exercise or management of some or all of such shareholder rights.

Paragraph (e)(4)(ii) provides proposed language concerning the obligations of an investment manager of a pooled investment vehicle that holds assets of more than one employee benefit plan that may be subject to an investment policy statement that conflicts with the policy of another plan. Compliance with ERISA section 404(a)(1)(D) requires the investment manager to reconcile, insofar as possible, the conflicting policies (assuming compliance with each policy would be consistent with ERISA section 404(a)(1)(D)). 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 plan's economic interest in the pooled investment vehicle. Such an investment manager may, however, develop an investment policy statement consistent with Title I of ERISA and this section, and require participating plans to accept the investment manager's investment policy, including any proxy voting policy, before they are allowed to invest. In such cases, a fiduciary must assess whether the investment

manager's investment policy statement and proxy voting policy are consistent with Title I of ERISA and this regulation before deciding to retain the investment manager.

Paragraph (g) provides for the effective date for the proposed rule. Under paragraph (g), the proposed rule would be effective on a date thirty days after the date of the publication of the final rule. The Department notes that on June 30, 2020 (85 FR 39113), it published in the Federal Register a proposed rule on Financial Factors in Selecting Plan Investments. Both this proposal and the Financial Factors in Selecting Plan Investments proposal are amendments to §2550.404a-1. Both proposals include a proposed paragraph (g), but the Financial Factors in Selecting Plan Investments proposal proposes an effective date of 60 days after publication of a final rule. Depending on the publication date of the respective final rules, the Department may need to revise paragraph (g) to separately effectuate the final rules. For example, if a final rule on Financial Factors in Selecting Plan Investments is published exactly 30 days before a final rule on Fiduciary Duties Regarding Proxy Voting and Shareholder Rights, and no changes were made to the proposed effective dates as part of the final rules, then no revision to paragraph (g) would be necessary. The Department requests comment on how to structure the effective date of this proposed rule, including whether it should be adjusted to ensure it matches the effective date of the rule on Financial Factors in Selecting Plan Investments, if finalized. The Department also requests comment on whether any transition or applicability date provisions should be added to for any of the provisions of the proposal.

Paragraph (h) provides that should a court of competent jurisdiction hold any provision of the rule invalid, such action will not affect any other provision. Including a severability clause provides clear guidance that the Department's intent is that any legal infirmity found with part of

the proposed rule should not affect any other part of the proposed rule. The Department notes that it included the exact same paragraph in the proposed rule on Financial Factors in Selecting Plan Investments.

D. Request for Public Comments

The Department invites comments from interested persons on all facets of the proposed rule. Commenters are free to express their views not only on the specific provisions of the proposed regulation as set forth in this document, but on other issues germane to the subject matter of the proposal. Comments should be submitted in accordance with the instructions at the beginning of this document. Comments on the proposal must be submitted on or before [INSERT DATE 30 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]. The Department believes that this period of time will afford interested persons an adequate amount of time to analyze the proposed rule and submit comments.

E. Regulatory Impact Analysis

Executive Orders

The Department has examined the effects of this rule as required by Executive Order 12866,⁶⁵ Executive Order 13563,⁶⁶ Executive Order 13771,⁶⁷ the Congressional Review Act,⁶⁸

⁶⁵ Regulatory Planning and Review, 58 FR 51735 (Oct. 4, 1993).

⁶⁶ Improving Regulation and Regulatory Review, 76 FR 3821 (Jan. 18, 2011).

⁶⁷ Reducing Regulation and Controlling Regulatory Costs, 82 FR 9339 (Jan. 30, 2017).

⁶⁸ 5 U.S.C. 804(2) (1996).

the Paperwork Reduction Act of 1995,⁶⁹ the Regulatory Flexibility Act,⁷⁰ Section 202 of the Unfunded Mandates Reform Act of 1995,⁷¹ and Executive Order 13132.⁷²

Executive Orders 12866 and 13563 direct agencies to assess the costs and benefits of available regulatory alternatives and, if regulation is necessary, to select regulatory approaches that maximize net benefits (including potential economic, environmental, public health and safety effects; distributive impacts; and equity). Executive Order 13563 emphasizes the importance of quantifying both costs and benefits, of reducing costs, of harmonizing rules, and of promoting flexibility.

Under Executive Order 12866, “significant” regulatory actions are subject to review by the Office of Management and Budget (OMB). Section 3(f) of the Executive order defines a “significant regulatory action” as an action that is likely to result in a rule (1) having an annual effect on the economy of \$100 million or more in any one year, or adversely and materially affecting a sector of the economy, productivity, competition, jobs, the environment, public health or safety, or state, local or tribal governments or communities (also referred to as “economically significant”); (2) creating a serious inconsistency or otherwise interfering with an action taken or planned by another agency; (3) materially altering the budgetary impacts of entitlement grants, user fees, or loan programs or the rights and obligations of recipients thereof; or (4) raising novel legal or policy issues arising out of legal mandates, the President's priorities, or the principles set forth in the Executive order. OMB has determined that this rule is economically significant

⁶⁹ 44 U.S.C. 3506(c)(2)(A) (1995).

⁷⁰ 5 U.S.C. 601 et seq. (1980).

⁷¹ 2 U.S.C. 1501 et seq. (1995).

⁷² Federalism, 64 FR 43255 (Aug. 10, 1999).

within the meaning of section 3(f)(1) of the Executive Order 12866. Therefore, the Department has provided an assessment of the potential costs, benefits, and transfers associated with this proposed rule. OMB has reviewed the proposal pursuant to the Executive order. Pursuant to the Congressional Review Act, OMB has designated this proposed rule as a “major rule,” as defined by 5 U.S.C. 804(2).

1. *Introduction*

ERISA plan assets comprise a substantial stake of the shares of public companies. In 2017, plan assets contained stock holdings of \$2.1 trillion, including 28 percent of defined benefit plan assets and 15 percent of defined contribution plan assets.⁷³ However, ERISA pension holdings represent a decreasing share of all corporate equity. ERISA defined benefit and defined contribution plans held just 5.5 percent of total corporate equity in 2019, down from a high of 22 percent in 1985.⁷⁴

Prior to its annual meeting, a publicly traded company sets a record date and sends out a list of proposals on which shareholders will vote. A shareholder must hold shares as of the record date in order to vote at a shareholder meeting. There are two types of proposals: management proposals and shareholder proposals. Management proposals—including director elections, audit firm ratification proposals, and proposals regarding the company’s executive compensation program (also known as “say-on-pay” proposals)—account for 98 percent of proposals and are largely mandated by law or exchange listing requirements. Over the period

⁷³ Department estimates are based on Form 5500 annual reports filed by plans with 100 or more participants. These estimates include only stocks held directly or through Direct Filing Entities, not through mutual funds.

⁷⁴ Department calculations based on U.S. Federal Reserve statistics.

2011 to 2017, shareholder proposals accounted for about 2 percent of proposals but often were more controversial and thus received more attention than management proposals.⁷⁵ Shareholder votes on some proposals, such as director elections, are binding. Votes on many other proposals, including shareholder proposals and say-on-pay proposals, are not binding and serve only as shareholder recommendations for the company's board.⁷⁶

As shareholders, ERISA-covered plans have the right to vote on proposals. Some of these proposals may have an economic impact on a plan's investment, while others may not. The responsible plan fiduciary generally must decide whether (and how) to vote the plan's shares on each proposal. As noted earlier in the preamble, the determination of whether or not the vote will affect the economic value of a plan's investment portfolio is critical in triggering a fiduciary's obligations under ERISA to vote or abstain from voting. For example, if a shareholder vote approves an economically beneficial transaction, the value of the plan's investment could increase.⁷⁷ Fiduciaries may need to conduct an analytical process that could in some cases be resource-intensive (requiring, among other things, organizing proxy materials, diligently analyzing portfolio companies and the matters to be voted on, determining how the votes should be cast, and submitting proxy votes to be counted), and these activities may often impose burdens on fiduciaries that are disproportional to any potential economic benefit to the plan. To address this concern, the Department proposes several potential options for fiduciaries to consider that are intended to reduce the need for them to consider proxy votes thereby freeing

⁷⁵ Morris Mitler, Dorothy Donohue & Sean Collins, *Proxy Voting by Registered Investment Companies, 2017*, ICI Research Perspective (July 2019), at 4 (hereinafter "ICI Proxy Voting Report").

⁷⁶ *Id.* at 6; see also 15 U.S.C. 78n-1.

⁷⁷ See Art Durnev & E. Han Kim, *To Steal or Not to Steal: Firm Attributes, Legal Environment, and Valuation*, 60 *Journal of Finance* 1461-1493 (2005); see also Gerald F. Davis & E. Han Kim, *Business Ties and Proxy Voting by Mutual Funds*, 85 *Journal of Financial Economics* 552-570 (2007).

resources for fiduciaries to focus on activities most likely to have an economic impact on the plan's investment. This proposed rule preserves fiduciaries' role in casting such votes, and includes provisions to ensure that fiduciaries make proxy voting decisions for the exclusive purpose of securing net economic benefits for plans and their participants as ERISA requires.

1.1. Need for Regulation

The cost of determining whether or how a responsible fiduciary should vote a plan's shares on a proposal is generally borne by the plan. If the proposal has no or negligible implications for the value of the plan's investment, it would be better for the plan to simply refrain from voting than to incur even small costs making this determination. Even if the proposal has substantial implications for the company, the cost of voting still may be higher than the potential benefit to the plan, especially if each fiduciary separately must collect and analyze the information necessary to reach an appropriate conclusion. The cost may be lower if the fiduciary can rely on an impartial, expert third-party adviser who specializes in such matters and provides similar services to many shareholders. Likewise, the cost may be lower if the fiduciary can rely on recommendations from the company's management on proposals where the interests of the plan and management are aligned.⁷⁸

⁷⁸ In 2010, TIAA-CREF senior vice president Jonathan Feigelson noted: "Though we dedicate a significant amount of resources to corporate governance research and the voting of proxies, we still would have difficulty processing the 80,000 plus unique agenda items voted by our staff annually without utilizing [proxy advisory firm] research." See letter to Elizabeth Murphy, Secretary, Securities and Exchange Commission, *Re: Concept Release on the U.S. Proxy System*, File No. S7-14-10 (Nov. 8, 2010), www.sec.gov/comments/s7-14-10/s71410-263.pdf. In 2017, the average mutual fund voted on 1,500 separate proposals. See ICI Proxy Voting Report, at 5. Furthermore, institutional investors' incentives to remain informed and hold specific voting positions varies according to how much the fund benefits from voting. The more the fund is invested in a company, the more likely it is to perform independent research on the proposal. See Peter Iliev & Michelle Lowry, *Are Mutual Funds Active Voters?*, 28 *Review of Financial Studies* 446–85 (2014).

The Department has two main concerns. First, the Department is concerned that responsible plan fiduciaries, in their efforts to decide whether or how to vote plan shares—and where applicable, to vote them—and exercise other shareholder rights, may impose costs on plans that exceed the consequent economic benefits to them. Some stakeholders believe that fiduciaries must always vote proxies, subject to limited exceptions, in order to fulfill their obligations under ERISA.⁷⁹

Second, the Department has reason to believe that responsible fiduciaries may sometimes rely on third-party advice without taking sufficient steps to ensure that the advice is impartial and rigorous. Such action would fall short of ERISA's standards of fiduciary care and loyalty in the exercise of plans' shareholder rights. Both of these concerns point to the risk that a plan's proxy voting activity sometimes will impair rather than benefit participants' economic interests. The Department's objective in issuing this proposed rule is to ensure that plan fiduciaries only incur costs to vote proxies and exercise other shareholder rights that are economically justified. The Department further seeks to ensure that plans' shareholder rights are exercised by responsible fiduciaries consistent with ERISA's fiduciary requirements.

Large ERISA plans and certain financial intermediaries holding ERISA-covered assets file annual reports with the Department that include some information on certain fees paid directly to specific service providers. The reported information sheds little light on the costs attendant to voting proxies or exercising other shareholder rights. The information omits very small direct payments, direct payments by small plans, and essentially all indirect payments. The last omission may be particularly important because plans may delegate asset management,

⁷⁹ See *supra* note 12.

including proxy voting, to third-party asset managers, who then may hire proxy advisory firms. In that case, plans' reports would bundle proxy voting costs, including any proxy advisory fees, into asset management fees. A preliminary examination of all ERISA plan and intermediary fee reports identifies just 18 direct payments to one of the two leading proxy advisory firms, and none to the other. Measured against the reporting plans' total assets, the 18 reported payments averaged 0.2 basis points. The reports additionally identify 46 payments to a second service provider known to provide proxy advice, which averaged 0.2 basis points, and 363 payments to a third, which averaged 6.3 basis points. It is unclear whether all of these payments relate to proxy voting, as the service providers may provide other services as well. Many reported payments to the third service provider in particular appear likely to be for other types of services in addition to, or rather than, proxy voting services, because a majority of the plans reporting such payments also reported having no direct stock holdings. This may help explain why reported payments to the third provider are higher than payments to the first two service providers.

While these reported costs might generally seem small, actual total proxy voting costs could be substantially higher for some or many plans, and even small costs may not be justified. As noted above, not all plan payments to proxy advisory firms are reported. Nearly all of the reported payments came from multiemployer plans. A large majority of multiemployer plans and nearly all single-employer plans reported no payment to any known proxy advisory firm. The magnitude of unreported costs is unknown. Other costs that are not reported separately are likely included as part of the fees paid to third-party asset managers who hire proxy advisory firms and/or do their own research on proposals. In addition, even small voting costs may somewhat impair participants' financial interest in their benefits if the votes pertain to issues that have little or no bearing on share value or are otherwise immaterial to the plan's financial

interest. As stated earlier, research regarding whether proxy voting has reliable positive effects on shareholder value generally has yielded mixed results.⁸⁰ The Department invites comments on whether, to what extent, and under what circumstances plans' proxy votes are likely or unlikely to increase the value of their shares or otherwise advance their participants' economic interest.

The Department's concerns about plans' voting costs sometimes exceeding attendant benefits has been amplified by the recent increase in the number of environmental and social shareholder proposals introduced. It is likely that many of these proposals have little bearing on share value or other relation to plan interests.⁸¹ From 2011 through 2017, shareholders submitted 462 environmental proposals and 841 social shareholder proposals, and resubmitted at least once 41 percent of environmental and 51 percent of social proposals.⁸² These proposals increasingly call for disclosure, risk assessment, and oversight, rather than for specific policies or actions, such as phasing out products or activities.⁸³ Support for environmental and social proposals grew between 2004 and 2018.⁸⁴ Few received majority support, but the number of environmental proposals winning majority support ticked up sharply in 2018.⁸⁵ By one count, the number of such proposals submitted or resubmitted grew from approximately 130 in 2000 to

⁸⁰ See *supra* note 39.

⁸¹ See John G. Matsusaka, Oguzhan Ozbas, & Irene Yi, *Can Shareholder Proposals Hurt Shareholders? Evidence from SEC No-Action Letter Decisions*, USC CLASS Research Paper No. CLASS17-4 (2019), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2881408, at 25; Joseph P. Kalt, L. Adel Turki, Kenneth W. Grant, Todd D. Kendall & David Molin, *Political, Social, and Environmental Shareholder Resolutions: Do They Create or Destroy Shareholder Value?*, National Association of Manufacturers (June 2018), www.shopfloor.org/wp-content/uploads/2018/06/nam_shareholder_resolutions_survey.pdf.

⁸² Procedural Requirements and Resubmission Thresholds Under Exchange Act Rule 14a-8, 84 FR 66458, 66491 (Dec. 4, 2019) (2019 SEC Rule 14a-8 Proposal).

⁸³ 2019 ISS Proxy Voting Trends.

⁸⁴ 2019 SEC Rule 14a-8 Proposal, 84 FR at 66484; see also 2019 ISS Proxy Voting Trends.

⁸⁵ 2019 SEC Rule 14a-8 Proposal, 84 FR at 66486.

more than 240 by 2016, before falling to approximately 180 in 2018.⁸⁶ The Department is aware, however, that in 2019, the SEC proposed a rule amendment that could have the effect of reducing the overall number of shareholder proposals that appear on issuer proxy statements.⁸⁷

Beyond voting costs, the Department is also concerned that plans may incur substantially larger costs to exercise shareholder rights more vigorously, such as by sponsoring or campaigning for shareholder proposals. Such activities may deliver little or no benefit to plans because they concern issues that have little bearing on share value or other plan interests.

The Department invites comments on the degree to which plans are incurring costs to vote on proposals or exercise other shareholder rights and how they have balanced those costs against any perceived duty or requirement to vote proxies. The Department requests comments on the relative size of the regulatory and deregulatory provisions that would be associated with this rule.

A number of stakeholders have questioned whether third-party proxy advice is impartial, sufficiently rigorous, and consistent with ERISA's fiduciary duties, as would be necessary to reliably advance ERISA investors' interests. Some question whether proxy advisory firms' practices are sufficiently transparent for investors to be able to determine whether their interests are being advanced. Some stakeholders also question whether the market for proxy advice is too concentrated and insufficiently competitive, which could impair investors' access to quality,

⁸⁶ 2019 ISS Proxy Voting Trends.

⁸⁷ 2019 SEC Rule 14a-8 Proposal.

affordable advice.⁸⁸ Proxy advice that is not rigorous or not aligned with a plan's interest could lead to a responsible plan fiduciary voting shares when voting costs exceed any benefit, or when voting would otherwise run counter to the plan's interest.

The Department notes that the SEC recently amended its rules governing proxy solicitations to help ensure that investors who use proxy voting advice receive more accurate, transparent, and complete information on which to make their voting decisions.⁸⁹ In its economic analysis of its proposal, the SEC stated that proxy advisory firms can capture economies of scale for several of the services they provide, including voting advice.⁹⁰

The SEC noted that the proxy voting advice industry in the United States consists of three major firms,⁹¹ and is highly concentrated among the two leading proxy advisory firms, Institutional Shareholder Services, Inc. (ISS) and Glass, Lewis & Co., LLC (Glass Lewis). Clients of proxy advisory firms include investment advisers, banks, and insurers that may be voting ERISA plan shares.

In proposing its amendments, the SEC described concerns regarding proxy advisory firms, including the adequacy of disclosure of any actual or potential conflicts of interest, the accuracy and material completeness of the information underlying proxy advice, and the inability

⁸⁸ See, e.g., *Proxy Season 2018: Examining Developments & Looking Forward*, presented by the Center for Capital Markets Competitiveness and NASDAQ, https://www.centerforcapitalmarkets.com/wp-content/uploads/2018/10/ProxySeasonSurvey_v3_Digital.pdf.

⁸⁹ 2019 SEC Proxy Voting Advice Amendments, at 1.

⁹⁰ *Id.* at 141, 201.

⁹¹ *Id.* at 150. In the proposal, the SEC identified two additional firms which claimed a large number of pension and profit sharing clients as providing proxy advice, but the SEC subsequently stated in the final amendments that, based on commenters, these two additional firms did not advise investment advisers and institutional investors on their voting determinations and would therefore not be affected by the amendments. *Id.* at 150 n. 502. The SEC indicated that was because they vote on behalf of their clients rather than providing them with research reports and voting recommendations. *Id.* at 30.

of proxy advice clients to receive information and views from the registrant, potentially contrary to that presented in the advice, in a manner that is consistently timely and efficient.⁹² Moreover, with respect to a small fraction of proposals, some commenters have asserted that proxy advisory firms have made factual and/or analytic errors in additional definitive proxy materials.⁹³ Such shortcomings make it more difficult for a responsible ERISA fiduciary to rely on a proxy advisory firm's recommendations. A fiduciary who does so rely could risk violating ERISA's fiduciary requirements.

Critics additionally complain that proxy advisory firms sometimes inappropriately provide the same recommendations to investors with different duties or obligations. Uniform voting policies for clients with different investment strategies and objectives have also been noted as a problem. Such a concern recently led the SEC to state that "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."⁹⁴

The Department has tried to convey in its prior sub-regulatory guidance that fiduciaries need not vote all proxies. A fiduciary's duty is to vote those proxies that are prudently determined to have an economic impact on the plan after the costs of research and voting are taken into account. Nevertheless, a misunderstanding that fiduciaries must research and vote all

⁹² Amendments to Exemptions from the Proxy Rules for Proxy Voting Advice, 84 FR 66518, 66525 (Dec. 4, 2019). Id. at 66525.

⁹³ Id. at 66545-46.

⁹⁴ 2019 SEC Guidance, 84 FR at 47423.

proxies continues to persist, causing some plans to expend their assets unnecessarily on matters not economically relevant to the plan. Accordingly, this proposed rule is necessary to interpret ERISA and expressly state that fiduciaries must not vote in circumstances where plan assets would be expended on shareholder engagement activities that do not have an economic impact on the plan, whether by themselves or after the costs of engagement are taken into account. The Department believes that addressing these issues in the form of a notice and comment regulation will help safeguard the interests of participants and beneficiaries in their plan benefits.

1.2. Affected Entities

This proposal would affect ERISA-covered pension, health, and other welfare plans that hold shares of corporate stock. It would affect plans with respect to stocks they hold directly, as well as with respect to stocks they hold through ERISA-covered intermediaries, such as common trusts, master trusts, pooled separate accounts, and 103-12 investment entities. The proposal would not affect plans with respect to stock held through registered investment companies, because the proposal does not apply to such funds' internal management of such underlying investments.

ERISA-covered plans with 100 or more participants (large plans) annually report data on their stock holdings on Form 5500 Schedule H (see Table 1). Approximately 29,000 defined contribution plans and 5,500 defined benefit plans, with approximately 86 million participants, hold either common stocks or employer stocks, totaling approximately \$2.1 trillion. Common stocks constitute about 20 percent of total assets of those plans holding common stock but not employer securities. Out of the 29,000 plans that hold common stock, but not employer securities, about 24,000 plans hold common stock through an ERISA-covered intermediary and

approximately 3,700 plans hold common stock directly. A smaller number of plans hold stock both directly and indirectly.⁹⁵ In addition to the large pension plans, approximately 619,000 small pension plans hold assets and may invest in stock.⁹⁶ Additionally 597 health and other welfare plans file the schedule H and report holding either common stocks or employer stocks. The Department solicits comments regarding the number of plans that exercise shareholder rights and thus would be affected by this proposal.

Table 1. Number of Pension Plans Holding Common Stocks or Employer Stocks by Type of Plan, 2017 ^a

Common Stock	Defined Benefit	Defined Contribution	Total Plans
Direct Holdings	1,460	2,241	3,701
Indirect Holdings	3,035	20,701	23,736
Direct and Indirect Holdings	982	664	1,646
Total	5,476	23,606	29,082
Employer Securities	-	6,457	6,457
Common Stock and Employer Securities	-	634	634
Total Plans Holding Stocks	5,476	29,430	34,906

^a DOL calculations from the 2017 Form 5500 Pension Research Files.

While this proposal would directly affect ERISA-covered plans that possess the relevant shareholder rights, the activities covered under the proposal would be carried out by responsible fiduciaries on plans' behalf. Many plans hire asset managers to carry out fiduciary asset management functions, including proxy voting. In 2017, large ERISA plans reportedly used

⁹⁵ DOL estimates from the 2017 Form 5500 Pension Research Files.

⁹⁶ The Form 5500 does not require these plans to categorize the assets as common stock, so the Department does not know if they hold stock.

approximately 18,000 different service providers, some of whom provide services related to the exercise of plans' shareholder rights. Such service providers include trustees, trust companies, banks, investment advisers, and investment managers.⁹⁷

In addition, this proposal would indirectly affect proxy advisory firms. ERISA plans' demand for proxy advice might decline if fiduciaries refrain from voting shares under the provisions of this proposal or under proxy voting policies adopted pursuant to paragraph (e)(3)(iii). Plan fiduciaries may want customized recommendations about which particular proxy proposals would have an economic impact on their particular plan and how they should cast their vote. Plans' preferences for proxy advice services could shift to prioritize services offering more rigorous and impartial recommendations. These effects may be more muted, however, if the SEC rule amendments enhance the transparency, accuracy, and completeness of the information provided to clients of proxy voting firms in connection with proxy voting decisions.

1.3. Benefits

This proposed rule would benefit plans by providing improved guidance regarding how ERISA's fiduciary duties apply to proxy voting. As discussed above, sub-regulatory guidance that the Department has issued over the years may have led to a misunderstanding among some that fiduciaries are required to vote on all proxies presented to them. This misunderstanding may lead some plans to expend plan assets unnecessarily to research and vote on proxy proposals not likely to have a material impact on the value of the plan's investments. The proposed rule is intended to eliminate that confusion and ensure ERISA fiduciaries execute shareholder rights in

⁹⁷ DOL estimates from the 2017 Form 5500 Schedule C.

an appropriate and cost-efficient manner. The proposal clarifies the duties of fiduciaries in regard to proxy voting and the monitoring of proxy advisory firms. Plan fiduciaries would be better able to conserve plan assets by having clear direction and permitted practices to refrain from researching and voting on proposals that they prudently determine have no economic impact on the value of the plan's investment. When votes are cast on behalf of plans, they would more frequently advance plans' economic interests. Cost savings and other benefits to plans would flow to plan participants and beneficiaries and plan sponsors.

The proposed rule would replace existing guidance on fiduciary responsibilities for exercising shareholders' rights. The proposed rule provides more certainty than sub-regulatory guidance and is subject to public notice and comment. And unlike guidance, a substantive regulation sets forth binding requirements.

The proposed regulation could increase the investment return on plan assets by specifying when plan fiduciaries should or should not exercise their shareholder rights to vote proxies. The proposal also requires fiduciaries to maintain records on proxy voting activities and other exercises of shareholder rights, including records demonstrating the basis for particular proxy votes and other exercises of shareholder rights. Plan fiduciaries are responsible for maximizing the economic benefits to the plan, including in their management of proxy voting rights, which may require voting proxies or declining to vote them. If the cost of obtaining information that informs the vote exceeds the likely economic benefits to the plan of voting, then fiduciaries should not vote. This course of action will save resources and increase societal benefits.

Another benefit of the rule is it allows plan fiduciaries and asset managers to focus on where they can add value the most. The rule allows plan fiduciaries to determine if diverting

resources away from proxy voting and into researching new investment opportunities presents a better use of time and resources to increase value. They can then act on this decision and bring added value to the plan and its participants and beneficiaries. To the extent that the proposed regulation increases the investment return on plan assets, it would broaden participants' and beneficiaries' retirement security, thereby strengthening a central purpose of ERISA. For the plans and participants that would be affected by the proposed rule, the benefits they would experience from higher investment returns, compounded over many years, could be considerable. The Department seeks information that could be used to quantify the increase in investment returns.

The societal resources freed for other uses due to voting fewer proxies (minus potential upfront transition costs) would represent benefits of the rule; in other words, the increased returns would be associated with investments generating higher pre-fee returns, which means the higher returns qualify as benefits of the rule. However, to the extent that there are any externalities, public goods, or other market failures, those might generate costs to society on an ongoing basis. For example, a fiduciary may vote for a proposal on a corporate merger or acquisition transaction to maximize shareholder value even though implementation of the proposal would bring about impacts in an affected geographic area that would be adverse for local businesses or residents. Finally, some portion of the increased returns would be associated with transactions in which there is an opposite party experiencing a decreased return of equal magnitude. This portion of the rule's impact would, from a society-wide perspective, be appropriately categorized as a transfer, and is discussed further below (though it should be noted that, if there is evidence of wealth differing across the transaction parties, it would have implications for marginal utility of the assets).

The proposal's provisions establish certain "permitted practices" that allow plans to prudently adopt proxy voting policies to guide their proxy voting decisions. These permitted practices would assist plan fiduciaries in carrying out their duties under paragraphs (e)(3)(i) and (ii) in a cost-effective manner that preserves plan resources. The Department anticipates that plans would derive savings from the proposal's "permitted practices" provisions. The proposed permitted practices are designed to provide clear examples of proxy voting policies that a fiduciary may determine are prudent. The expenditure of plan resources is generally warranted only when proposals have a meaningful bearing on share value or when plan fiduciaries have determined that the interests of the plan are unlikely to be aligned with the positions of a company's management. In general, such proposals include those that are substantially related to the company's business activities or that relate to corporate events (mergers and acquisitions transactions, dissolutions, conversions, or consolidations), corporate repurchases of shares (buy-backs), issuances of additional securities with dilutive effects on shareholders, and contested elections for directors, where plans' exposure to the stock is sufficiently large to justify the expenditure.

The proposal also emphasizes that plan resources may not be expended in circumstances where the fiduciary prudently determines that a proxy vote would not affect the economic value of the plan's investment. The Department also believes that the expenditure of plan resources to decide whether and how to vote on other proposals that are unlikely to have an impact on a plan's economic value may be unwarranted and, given the particular facts and circumstances, could constitute a fiduciary breach. The Department invites comments on this view, including any examples of proposals that could fall under the proposed permitted practices but for which

such expenditures to vote would be justified and consistent with ERISA's fiduciary requirements.

The Department also invites comments on whether the proposed rule, if finalized, would enable plans to retain proxy advisory firms at lower cost or with more attractive fee arrangements, since a much narrower range of responsibilities might be encompassed, and on whether the proposed rule would lead to new, narrower advisory engagements or new services.

1.4. Costs

The proposal includes requirements that a responsible fiduciary must satisfy when exercising a plan's shareholder rights appurtenant to specific security holdings or monitoring third parties providing proxy advice. It requires a responsible fiduciary to determine that the exercise of shareholder rights advances the plan's economic interest, investigate the basis for voting on proposals, and maintain records showing the basis of their decisions. The proposal also requires a fiduciary to require an investment manager and proxy adviser to document their decisions and recommendations.

The Department believes that the incremental costs of these provisions will be small on a per plan basis because the Department anticipates that most, if not all plans, will adopt policies that utilize the permitted practices and the activities described in the proposal already are reflected in common practice and are best practices. If plan fiduciaries choose not to use any of the permitted practices, the costs of the proposed rule, including determining whether each proxy vote will have an economic impact, may be significantly greater. While the Department believes responsible plan fiduciaries would spend some time familiarizing themselves with the rule, it

expects that these costs would be minimal. The Department requests comments and data it could use to quantify such costs.

The Department's IB 2008-02 guidance addressed "the exercise of shareholder rights" explaining that "the duty to monitor necessitates proper documentation."⁹⁸ Its 2008 guidance on economically targeted investing likewise explained that a written record of the basis for economically targeted investment decisions may be necessary to demonstrate compliance with ERISA.⁹⁹ The Department acknowledges, however, that such practices are not universal. In the course of its enforcement activity, the Department sometimes encounters instances where documentation is absent or does not meet the requirements of this proposal. Accordingly, the Department invites comments addressing to what degree existing practices already satisfy these proposed requirements and what the cost would be to fully satisfy them. The Department additionally believes that the availability of economies of scale limit the costs of this proposal. The Department understands that under the proposal, most of the relevant fiduciary duties will reside with, and most of the required activities will be performed by, third-party asset managers, as is already common practice. Such asset managers are often large and provide the relevant fiduciary services for a large number of plans. The Department invites comments on the assignment of the responsibilities under this proposal and the degree to which economies of scale might limit the proposal's costs. Costs for maintaining the required documentation are discussed in the Paperwork Reduction Act section of this document.

⁹⁸ 29 CFR 2509.08-2 (2010).

⁹⁹ 29 CFR 2509.08-1 (2010).

As noted earlier, this proposal's permitted practices and other provisions would eliminate or reduce plans' costs for voting on many proposals, because plans would not vote on proposals the responsible plan fiduciary has determined are not economically relevant to the plan. The Department generally does not expect this proposal to change the costs associated with plans' remaining voting activity. Provisions requiring responsible fiduciaries to monitor and document voting policies and activities would generally be satisfied by current best practices that satisfy earlier Department guidance. Neither does the Department expect plans to incur substantial costs from proxy advisory firms' potential efforts to help fiduciaries meet this proposal's requirements. If they do not already meet the standards detailed in the proposed regulation, plans that currently exercise shareholder rights, including proxy voting activities, would now incur the costs associated with deciding whether to exercise shareholder rights pursuant to this proposal.

It is possible that proxy advisory firms would take steps to avoid or mitigate conflicts of interest, strengthen factual and analytic rigor, better match their research and recommendations with ERISA plans' interests, or increase transparency. The Department notes, however, that proxy advisory firms are likely to take at least some of these steps in response to recent SEC policy initiatives and spread their related costs across all of their clients, not just ERISA plans.¹⁰⁰ At the same time, the proposed rule may reduce plans' demand for proxy advice. However, this

¹⁰⁰ The SEC's rule amendments require proxy advisory firms engaged in a solicitation to provide conflicts of interest disclosure, to adopt and publicly disclose policies and procedures designed to ensure that the company subject of the proxy voting advice has such advice made available to it at or prior to the time the advice is disseminated, and to provide a mechanism by which its clients can become aware of any written statements by the company in response to the proxy advice. The SEC also modified its proxy solicitation antifraud rule to specifically include material information about the proxy advisor's methodology, sources of information, or conflicts of interest, as examples of when the failure to disclose could, depending upon the particular facts and circumstances, be considered misleading. See 2020 SEC Proxy Voting Advice Amendments, at 242-246.

reduction in demand is beneficial to plans as they previously were purchasing more advice than they would have chosen to, due to their misinterpretation that they were required to vote all proxies. This reduced demand will lower the market price and the amount of advice purchased. Consequently, any compliance costs passed on from proxy advisory firms to ERISA plans are likely to be at least partially offset by plans' cost savings from purchasing a smaller amount of advice. It should be noted that proxy advisory firms will see a reduction in revenues as a result of the decreased demand for their services. In addition, proxy advisory firms' efforts to satisfy any SEC requirements might ease responsible fiduciaries' efforts to comply with this proposal. For example, it may be easier to monitor proxy advisory firms if those firms provide additional disclosure about their conflicts of interest and their policies and procedures to address such conflicts.

1.5. Transfers

Proxy advisory firms that respond best to this proposal will likely gain a relative competitive advantage. Firms that limit or eliminate conflicts of interest and modify their services to better align with the guidance of these proposed regulations could gain market share relative to firms that do not. Firms that are willing to tailor their voting guidelines, strategies, and costs according to each plan's investment guidelines could gain market share relative to firms that do not.

Moreover, as noted previously, if some portion of rule-induced increases in returns would be associated with transactions in which the opposite party experiences decreased returns of equal magnitude, then this portion of the proposed rule's impact would, from a society-wide perspective, be appropriately categorized as a transfer.

1.6. Regulatory Alternatives

The Department considered a purely principles-based approach that would not have included the permitted practices in paragraph (e)(3)(iii). However, for the reasons described above, the Department believes that clearly articulating examples of permitted proxy voting policies would be helpful to plan fiduciaries and ultimately beneficial to plan participants and beneficiaries. A purely principles-based approach could result in a responsible fiduciary, for each individual proxy proposal, having to determine whether to vote. This determination process could consume significant plan resources, even where the potential economic benefit to the plan is small or difficult to determine. A responsible fiduciary might arrive at his or her own policies for simply not voting, or voting in a specific manner on certain types of proposals, based on the plan's limited exposure to a stock or the economic immateriality of the matter being voted upon. However, under a principles-based approach fiduciaries would likely be cautious about adopting such policies, and might believe it prudent to be able to demonstrate in each case why a decision was made not to vote, and therefore err on the side of devoting excessive resources to voting decisions. The Department invites comment on the inclusion of permitted practices and their usefulness in aiding a fiduciary's determination of whether to vote.

The Department also considered including a specific numeric cap for the materiality permitted practice in paragraph (e)(3)(iii)(C), but opted not to do so until it has the opportunity to review the comments solicited earlier in this preamble on this question. The Department similarly invites comments here on those issues for purposes of this regulatory impact analysis.

The Department also invites comments generally on its choice of permitted practices, including whether any should not be retained and whether any other practices should be added.

1.7. Uncertainty

The Department's economic assessment of this proposal's effects is subject to uncertainty. The Department invites comments that can more fully inform its assessment.

Cost Savings—As noted earlier, the Department currently lacks complete data on plans' exercise of their shareholder rights appurtenant to their stock holdings, including proxy voting activities, and on the attendant costs and benefits. The Department invites comments that illuminate these activities, including their costs and benefits, as well as comments regarding how this proposal would change these activities.

In light of the uncertainty regarding the proxy voting activities of ERISA plans, and the attendant costs and benefits of this proposal, the Department presents an illustration below of an analytical approach to evaluating the possible impacts of this notice of proposed rulemaking (NPRM). Details on the estimated impacts of this proposed rule are presented in a supplemental illustrative analysis in Appendix A. This illustration is a part of the Department's solicitation of comments on an appropriate methodology and assumptions for evaluating the costs and savings that could result from the rule. The analytical model assumes that proxies are primarily voted by asset managers or other service providers. The Department also assumes that the proposed rule may require some plans or service providers to expend more effort researching whether a proxy vote will have a relevant economic impact on the plan and how the plan should vote in cases in which the proposal has such an economic impact. Service providers, plans, or both, may also need to provide more documentation of their decisions than they already produce. Additionally, plans may take advantage of the permitted practices described in the proposal that allow them to conserve plan assets, because they may not need to conduct as extensive an amount of research

or expend as much time on documenting decisions. In this illustration, the Department estimates that each service provider will vote 9.3 times, on average, per stock.¹⁰¹ If there are 1,988 service providers impacted by the rule's requirements,¹⁰² and 8,020 stocks voted annually per service provider, then the Department estimates that those entities take a cumulative total of 148,276,968 annual stock votes.¹⁰³ As discussed previously, some stocks may fall within the permitted practice provisions of the rule and would be less burdensome to research and document. The Department assumes that 5.6 percent of all proxy votes could fall outside the permitted practices and would still need to be researched, voted, and documented under the proposal.¹⁰⁴ For votes falling within the permitted practices, on average the Department estimates that responsible plan fiduciaries would take 30 minutes to conduct research and 10 minutes to document each vote at a total cost of \$435,042,756.¹⁰⁵ For votes falling outside the permitted practices, the Department estimates two hours of research and 20 minutes to document each vote at a total cost of \$100,175,208. Under this illustrative analysis, the total costs of a hypothetical alternative to the proposed rule, for increases in research and documentation costs, excluding cost savings that could occur if the permitted practices are used, could reach \$535,217,964. The cost savings from the permitted practices are discussed later. However, the Department fully expects that most of these potential costs will not be realized, because plans will use the permitted practices to avoid

¹⁰¹ Investment Company Institute. "Proxy Voting by Registered Investment Companies, 2017." Vol 25, No. 5. July 2019. See endnote 15. <https://www.ici.org/pdf/per25-05.pdf>.

¹⁰² Estimate based on the number of clients for the three largest proxy advisory firms.

¹⁰³ Based on 4,684 domestic stocks and 3,336 foreign stocks, 1,988 service providers, and an estimate of 9.3 votes per stock for each service provider.

¹⁰⁴ Investment Company Institute. "Proxy Voting by Registered Investment Companies, 2017." Vol 25, No. 5. July 2019. See Figures 2 and 3. <https://www.ici.org/pdf/per25-05.pdf>. We developed this assumption by looking at the ICI data from 2011 to 2017 on the percentage of total proxy proposals that related to mergers, acquisitions, dissolution, conversions, consolidation, corporate repurchase of shares, issuance of additional securities, and contested elections for directors.

¹⁰⁵ Research labor rate of \$116.96/hr and documentation rate of \$110.39/hr.

incurring them. The Department requests comments on the assumptions and underlying data used to reach this illustrative estimate.

As discussed elsewhere in this preamble, while the Department believes that the common practices of most plans related to proxy voting are generally consistent with the standards in the proposal, we lack data for the share of plans that do not currently meet such standards. To illustrate the potential burden for firms whose practices are inconsistent with the proposed standards, DOL assumes that research costs will increase by 5% and that documentation costs will increase by 1%. The Department requests data that could be used to estimate the share of plans that do not currently meet such standards.

To illustrate potential cost savings from responsible plan fiduciaries using the permitted practices, the Department notes that responsible plan fiduciaries do not have to vote proxies that fall within the permitted practices, which could save at least some of the costs associated with research and documentation. The Department intends that the permitted practices will impact a large share of all proxy votes and the burden associated with these votes when using the permitted practices will likely be very low. By way of illustration, if under permitted practices 10 percent of proxy votes are no longer voted and responsible plan fiduciaries therefore did not incur research and documentation costs, the total cost savings could exceed \$1 billion.¹⁰⁶

¹⁰⁶ \$800m in cost savings due to a reduction in research costs (10 percent permitted practice cost savings x 0.5 hours x 139,973,458 votes x \$116.96 per hour = \$818,582,278) and \$250m in cost savings due to a reduction in documentation costs (10 percent permitted practice cost savings x 0.167 hours x 139,973,458 votes x \$110.39 per hour = \$257,516,169). Instead of thinking about this as a reduction in actual votes, it can also be viewed as a 10 percent reduction in costs if votes are still cast pursuant to the permitted practices that allow voting but reduce burden, such as paragraph (e)(3)(iii)(A) of the proposal, which would allow fiduciaries to adopt a policy to vote proxies in accordance with the voting recommendations of corporate management.

Demand for New Services — The Department also invites comments regarding whether this proposal, if finalized, would create a demand for new services, and if so, what alternate services or relationships with service providers might result and how overall plan expenses could be impacted.

Other Securities — This proposal generally would govern plans' exercise of shareholder rights appurtenant to their stock holdings of individual companies, but not to their holdings of other securities. The Department cannot determine whether some plans nonetheless would modify their practices with respect to other securities because of this proposal. As noted earlier, ERISA pensions held just 5.5 percent of total corporate equity in 2019, down from a high of 22 percent in 1985. Mutual funds, in contrast, held 22 percent of all corporate equity in 2019, up from 6 percent in 1985.¹⁰⁷ As ERISA-covered pensions have shifted from defined benefit to defined contribution plans, both the proportion of pension assets invested in mutual funds and the proportion of all mutual fund shares owned by pensions have increased dramatically. In 2019, ERISA-covered pensions held 25 percent of all mutual fund shares, up from 8 percent in 1985. ERISA would apply to any proxy votes for mutual fund shares and shares of other funds registered with the SEC for which the plan fiduciary is responsible. ERISA does not govern the management of the portfolio internal to a fund registered with the SEC, including such fund's exercise of its shareholder rights appurtenant to the portfolio of stocks it holds, though ERISA would apply to similar funds organized as collective investment trusts. The Department invites comments as to whether or how this proposal might influence plans' exercise of shareholder rights for SEC-registered funds, or their selection of such funds as plan investments, as well as

¹⁰⁷ Department calculations based on U.S. Federal Reserve statistics.

comments on the costs and benefits associated with any such influence, such as impacts on the ability to achieve a quorum at shareholder meetings of such funds.

Operation of Permitted Practices—The permitted practices provisions in paragraph (e)(3)(iii) would deliver benefits by relieving plans from much of the cost of deciding whether and how to vote proxies. Responsible fiduciaries might be inclined to use the permitted practices as expansively as possible, to conserve plan assets or even in some cases in an effort to reduce possible exposure to fiduciary liability when exercising shareholder rights. However, a responsible fiduciary may use them less expansively if for practical reasons it is operationally more efficient to do so, or if the fiduciary identifies an opportunity to advance the plan’s economic interest by voting on a proposal that falls within the permitted practices. Accordingly, the Department invites comments on the optimal operation of the permitted practices provisions.

Fiduciaries would still be required to vote shares in situations not encompassed by proxy voting policies adopted pursuant to the permitted practices provisions of paragraph (e)(3)(iii) if they prudently determine that the matter being voted upon would have an economic impact on the plan. For instance, the Department believes that voting the shares of plan holdings that comprise a small portion of total plan assets rarely advances plans’ economic interests, but invites comments on whether or under what circumstances such voting might do so. For example, might this sometimes be the case for large plans and asset managers for whom even a small threshold of total plan assets would represent a large financial stake in dollar terms that might justify the cost of deciding whether and how to vote? As an illustration, a five-percent threshold for a pension plan with more than \$1 billion in assets would be more than \$50 million. In 2017, there were 1,391 plans with more than \$1 billion in assets each. These plans together

represented just 0.2 percent of all pension plans, but held \$5.3 trillion in assets, representing more than one-half of ERISA-covered pension assets.

More generally, the Department solicits comments on whether the permitted practices included in this proposal might produce unintended costs by discouraging responsible fiduciaries from voting shares when voting may be economically beneficial.

Non-ERISA Investors—Many asset managers serve both ERISA plans and other investors. The Department invites comments as to whether any such asset managers currently follow uniform proxy policies for both, and vote shares uniformly for both. The Department believes such uniform voting for ERISA and non-ERISA clients may sometimes jeopardize responsible fiduciaries' satisfaction of their duties under ERISA. However, as noted earlier in the preamble, this concern may be mitigated in the case of investment managers subject to the SEC's jurisdiction by the fact that federal securities law requires investment advisers to make the determination in their client's best interest and not to place the investment adviser's own interests ahead of their client's.¹⁰⁸ Where an SEC registered investment adviser has assumed the authority to vote on behalf of its client, the SEC would require the investment adviser, among

¹⁰⁸ See Commission Interpretation Regarding Standard of Conduct for Investment Advisers, 84 FR 33669, 33673 (July 12, 2019) (discussing an adviser's obligation to make a reasonable inquiry into its client's financial situation, level of financial sophistication, investment experience and financial goals and have a reasonable belief that the advice it provides is in the best interest of the client based on the client's objectives); Commission Guidance Regarding Proxy Voting Responsibilities of Investment Advisers, Release No. IA-5325 (Aug. 21, 2019) (82 FR 47420 (Sep. 10, 2019)(clarifying investment advisers' duties when voting shareholder proxies). See also Rule 206(4)-6 under the Investment Advisers Act of 1940, 17 CFR 275.206(4)-6 (Under rule 206(4)-6, it is a fraudulent, deceptive, or manipulative act, practice or course of business within the meaning of section 206(4) of the Investment Advisers Act for an investment adviser to exercise voting authority with respect to client securities, unless the adviser (i) has adopted and implemented written policies and procedures that are reasonably designed to ensure that the adviser votes proxies in the best interest of its clients, which procedures must include how the investment adviser addresses material conflicts that may arise between the adviser's interests and interests of their clients; (ii) discloses to clients how they may obtain information from the investment adviser about how the adviser voted with respect to their securities; and (iii) describes to clients the investment adviser's proxy voting policies and procedures and, upon request, furnishes a copy of the policies and procedures to the requesting client.

other things, must have a reasonable understanding of the client's objectives and must make voting determinations that are in their best interest.

Under this proposed rule, responsible fiduciaries might increase their demands for asset managers to implement separate policies customized for particular ERISA plans or for ERISA plans generally, such as policies that align with the proposed permitted practices in paragraph (e)(3)(iii). The Department invites comments on the degree to which such customized policies by asset managers could benefit ERISA plans or increase plan costs.

Asset Allocation—This proposal could exert influence on a plan's asset allocation. For example, the quantitative threshold provision in paragraph (e)(3)(iii)(C) would permit responsible fiduciaries, after prudently considering the relevant factors, to adopt proxy voting policies allowing them to refrain from voting shares when the plan's holding in a single issuer is sufficiently small relative to the plan's total investment that the outcome of the vote is unlikely to have a material impact on the investment performance of the plan's portfolio. This provision might produce additional economic benefits by promoting fuller and more optimal diversification where it may otherwise have been lacking. That is, the quantitative threshold could prompt a fiduciary to diversify what otherwise would have been a concentration of more than the specified threshold amount of a plan's portfolio in a single stock. The Department invites comments on this possibility.

Vote Categories — Proxy votes can be tallied in four ways: for, against/withhold, abstain, and not voted. The vast majority of outstanding shares are held in "street name" by intermediaries, such as broker-dealers. Broker-dealers may have discretionary authority to vote proxies without receiving voting instructions from the owner of the shares for routine

and noncontroversial matters, such as the ratification of a company's independent auditors. For matters in which a broker-dealer does not have discretionary authority to vote, a broker non-vote is required. For matters that require approval of a majority of shares present and voting, abstentions (which are cast neither for nor against a proposal) and broker non-votes are not counted in the final tally. For matters that require approval of a majority of the shares issued and outstanding, abstentions or broker-non votes are treated as votes against the proposal. If an investor is unsure about a matter or unsure whether her interests and management's interests are aligned, the investor arguably should abstain. The Department requests comments on how often this alignment of interests might occur, and on whether additional direction on voting, such as on the distinction between not voting and abstaining, would be beneficial to fiduciaries.

1.8. Conclusion

The proposed rule would benefit ERISA-covered plans, as it provides guidance regarding how ERISA's fiduciary duties apply to proxy voting and in particular when fiduciaries should refrain from voting. Plan fiduciaries will be able to conserve plan assets as they refrain from researching and voting on proposals that are unlikely to economically impact the plan, and thereby increase the return on plan assets. The Department believes that the benefits of the proposal would justify its costs, but also invites comments on this question.

2. Paperwork Reduction Act

As part of its continuing effort to reduce paperwork and respondent burden, the Department conducts a preclearance consultation program to allow the general public and federal

agencies to comment on proposed and continuing collections of information in accordance with the Paperwork Reduction Act of 1995 (PRA).¹⁰⁹ This helps to ensure that the public understands the Department's collection instructions, respondents can provide the requested data in the desired format, reporting burden (time and financial resources) is minimized, collection instruments are clearly understood, and the Department can properly assess the impact of collection requirements on respondents.

Currently, the Department is soliciting comments concerning the proposed information collection request (ICR) included in the Fiduciary Duties Regarding Proxy Voting and Shareholder Rights ICR. To obtain a copy of the ICR, contact the PRA addressee shown below or go to www.RegInfo.gov.

The Department has submitted a copy of the proposed rule to the Office of Management and Budget (OMB) in accordance with 44 U.S.C. 3507(d) for review of its information collections. The Department and OMB are particularly interested in comments that:

- Evaluate whether the collection of information is necessary for the proper performance of the functions of the agency, including whether the information will have practical utility;
- Evaluate the accuracy of the agency's estimate of the burden of the collection of information, including the validity of the methodology and assumptions used;
- Enhance the quality, utility, and clarity of the information to be collected; and
- Minimize the burden of the collection of information on those who are to respond, including through the use of appropriate automated, electronic, mechanical, or other

¹⁰⁹ 44 U.S.C. 3506(c)(2)(A) (1995).

technological collection techniques or other forms of information technology (e.g., permitting electronic submission of responses).

Comments should be sent to the Office of Information and Regulatory Affairs, Office of Management and Budget, Room 10235, New Executive Office Building, Washington, D.C., 20503 and marked “Attention: Desk Officer for the Employee Benefits Security Administration.” Comments can also be submitted by fax at (202) 395–5806 (this is not a toll-free number), or by email: OIRA_submission@omb.eop.gov. OMB requests that comments are received within 30 days of publication of the proposed rule to ensure their consideration.

PRA Addresses: Address requests for copies of the ICR to G. Christopher Cosby, Office of Policy and Research, U.S. Department of Labor, Employee Benefits Security Administration, 200 Constitution Avenue NW, Room N–5718, Washington, D.C., 20210. The PRA Addressee may be reached by telephone at (202) 693–8410 or by fax at (202) 219–5333. These are not toll-free numbers. ICRs also are available at www.RegInfo.gov (www.RegInfo.gov/public/do/PRAMain).

It has long been the view of the Department that the duty to monitor necessitates proper documentation of the activities that are subject to monitoring.¹¹⁰ Accordingly, the Department’s proposal requires that plan fiduciaries maintain records on proxy voting activities and other exercises of shareholder rights, including records that demonstrate the basis for particular proxy votes and exercises of shareholder rights. This requirement applies to all pension plans with investments, including those that have shareholder rights and proxy votes that may need to be

¹¹⁰ 29 CFR 2509.08-2 (2010).

exercised. Fiduciaries' proxy voting decisions may only involve consideration of those factors economically relevant to the plan.

Plan fiduciaries that have followed prior guidance, or good business practices, are already performing much if not all of the recordkeeping actions the proposal would require. While the incremental burden of the proposal is generally small, perhaps even *de minimis*, the full burden of the requirements will be included below to allow for full evaluation of the requirements in the information collection.

According to the most recent Form 5500 data there are 709,527 pension plans (90,604 large plans and 618,923 small plans) and 8,475 health or welfare plans (5,626 large plans filing a schedule H, and 2,849 small plans filing a schedule I).¹¹¹ While the Schedule H collects information on a plan's stock holdings, Schedule I lacks the specificity to determine if small plans hold stocks. As shown in Table 1, 34,906 pension plans hold stocks and would have shareholder rights they may need to exercise. Additionally, 597 health and other welfare plans file the schedule H and report holding either common stocks or employer stocks. The Department lacks information on the number of small plans that hold stock. Small plans are significantly less likely to hold stock than larger plans. For purposes of estimating the burden, five percent of small plans are presumed to hold stock resulting in 30,946 small plans needing to comply with the information collection. Therefore, a total of 66,649 plans will need to comply with this information collection.

¹¹¹ EBSA estimates using 2017 Form 5500 filing data.

2.1 Maintain Documentation

The proposed rule requires that the named plan fiduciary must maintain records on proxy voting activities and other exercises of shareholder rights, including records that demonstrate the basis for particular proxy votes and exercises of shareholder rights. Where the authority to vote proxies or exercise shareholder rights has been delegated to an investment manager pursuant to ERISA section 403(a)(2), or a proxy voting firm or another person performs advisory services as to the voting of proxies, plan fiduciaries must require such investment manager, proxy voting firm or other person to document the rationale for proxy voting decisions or recommendations. This is required of all plans with investments and includes plans that may exercise shareholder rights.

Much of the information needed to fulfill this requirement is generated in the normal course of business. Plans may need additional time to maintain the proper documentation, but this burden is likely to be reduced by the adoption of policies by plan fiduciaries that incorporate one or more of the proposed rule's permitted practices. The Department estimates that plan fiduciaries or investment managers will require a half hour annually and a half hour of help from clerical staff to maintain or document the required information. This is likely an overestimate, because many, if not most, plans use investment managers. These investment managers provide similar services for many plans. This results in an annual cost burden estimate of \$6,291,078.¹¹²

¹¹² The burden is estimated as follows: 66,449 plans * 0.5 hours = 33,224.6 hours for both a plan fiduciary and clerical staff. A labor rate of \$134.21 is used for a plan fiduciary and a labor rate of \$55.14 for clerical staff (33,224.6 * \$134.21 = \$4,459,074 and 33,224.6 * \$55.14 = \$1,832,004).

As a note, included in the uncertainty section of the regulatory impact analysis above is a model that seeks to quantify the costs and cost savings of the rule. It provides an alternative estimate of the documentation costs. Depending on comments received on the model, the Department could revise the burden associated with this ICR to reflect the estimates derived by using the model.

These paperwork burden estimates are summarized as follows:

Type of Review: New collection.

Agency: Employee Benefits Security Administration, Department of Labor.

Title: Fiduciary Duties Regarding Proxy Voting and Shareholder Rights

OMB Control Number: 1210–NEW.

Affected Public: Businesses or other for-profits.

Estimated Number of Respondents: 66,499

Estimated Number of Annual Responses: 66,499

Frequency of Response: Occasionally

Estimated Total Annual Burden Hours: N/A

Estimated Total Annual Burden Cost: \$6,291,078

3. *Regulatory Flexibility Act*

The Regulatory Flexibility Act (RFA)¹¹³ imposes certain requirements with respect to federal rules that are subject to the notice and comment requirements of section 553(b) of the Administrative Procedure Act¹¹⁴ and are likely to have a significant economic impact on a substantial number of small entities. The Department has determined that this proposal is likely to have a significant economic impact on a substantial number of small entities, and therefore presents this initial regulatory flexibility analysis of the proposed rule pursuant to section 603 of the RFA.

For purposes of analysis under the RFA, the Employee Benefits Security Administration (EBSA) considers employee benefit plans with fewer than 100 participants to be small entities.¹¹⁵ The basis of this definition is found in section 104(a)(2) of ERISA, which permits the Secretary of Labor to prescribe simplified annual reports for plans that cover fewer than 100 participants. Under section 104(a)(3) of ERISA, the Secretary may also provide for exemptions or simplified annual reporting and disclosure for welfare benefit plans. Pursuant to the authority of section 104(a)(3), the Department has previously issued (see 29 CFR 2520.104–20, 2520.104–21, 2520.104–41, 2520.104–46, and 2520.104b–10) simplified reporting provisions and limited exemptions from reporting and disclosure requirements for small plans, including unfunded or insured welfare plans, that cover fewer than 100 participants and satisfy certain requirements. While some large employers have small plans, small plans are generally maintained by small employers. Thus, the Department believes that assessing the impact of this proposed rule on small plans is an appropriate substitute for evaluating the effect on small entities. The definition

¹¹³ 5 U.S.C. 601 et seq. (1980).

¹¹⁴ 5 U.S.C. 551 et seq. (1946).

¹¹⁵ The Department consulted with the Small Business Administration Office of Advocacy in making this determination, as required by 5 U.S.C. 603(c) and 13 CFR 121.903(c) in a memo dated June 4, 2020.

of small entity considered appropriate for this purpose differs, however, from a definition of small business based on size standards promulgated by the Small Business Administration¹¹⁶ pursuant to the Small Business Act.¹¹⁷ Therefore, EBSA requests comments on the appropriateness of the size standard used in evaluating the impact of this proposed rule on small entities.

3.1. Need for and Objectives of the Rule

As detailed above, the Department is concerned that responsible plan fiduciaries, in their efforts to decide whether or how to vote plan shares—and where applicable, to vote them—and exercise other shareholder rights, may sometimes impose on plans costs that exceed the consequent economic benefits to the plans. Moreover, the Department has reason to believe that responsible fiduciaries may sometimes rely on third-party advice without taking sufficient steps to ensure that the advice is impartial and rigorous, potentially violating ERISA’s standards of fiduciary care and loyalty in their exercise of plans’ shareholder rights. Both of these concerns point to the risk that a plan’s proxy voting activity will sometimes impair rather than advance participants’ economic interest in their benefits. This proposed rule aims to ensure that the costs plans incur to vote proxies and exercise other shareholder rights are economically justified, and that responsible fiduciaries’ use of third-party advice supports rather than jeopardizes their adherence to ERISA’s fiduciary requirements.

Small plans may be especially likely to rely on third-party service providers, such as asset managers, to act as responsible fiduciaries or otherwise assist with the exercise of plans’

¹¹⁶ 13 CFR 121.201 (2011).

¹¹⁷ 15 U.S.C. 631 et seq. (2011).

shareholder rights. Many small plan sponsors are likely to lack the expertise to perform this function themselves. Small plans additionally stand to benefit most from the economies of scale that specialized service providers, such as asset managers and proxy advisory firms, can provide. Consequently, small plans may be especially vulnerable to any deficiencies in the services such entities provide, and to costs incurred to select and monitor service providers so as to minimize such deficiencies.

3.2. Affected Small Entities

The proposal would affect ERISA-covered pension, health, and welfare plans that hold stock either through common stock or employer securities. This includes plans that indirectly hold stocks through Direct Filing Entities (DFE) such as common trusts, master trusts, pooled separate accounts, and 103-12 investment entities. Plans that only hold their assets in registered investment companies, such as mutual funds, will be unaffected by the proposed rule.

There is minimal data available about small plans' stock holdings. The primary source of information on assets held by pension plans is the Form 5500. Schedule H, which reports data on stock holdings, is filed almost exclusively by large plans. While the majority of participants and assets are in large plans, most plans are small plans (plans with fewer than 100 participants). It is likely that many small defined benefit plans hold stock. Many small defined contribution plans hold stock only through mutual funds, and consequently would not be affected by this proposal. In 2017, there were 39,000 small defined benefit plans and 580,000 small defined contribution plans. The Department lacks information on the number of small plans that hold stock; however, believes small plans are significantly less likely to hold stock than larger plans.

For purposes of estimating the burden, five percent of small plans are presumed to hold stock resulting in approximately 30,950 small plans needing to comply with the proposed regulation.

Small service providers like asset managers could also be impacted by this rule. To the extent that service providers, and not plans, are the ones that primarily vote proxies, as discussed in section 3.3, below, they would incur costs, which they would likely pass on to their plan clients. An approach discussed in the alternative section suggests that 1,988 service providers could be providing services to plans. According to data from the 2012 Economic Census, 97 percent of firms reporting an NAICS code for portfolio management meet the SBA's definition of a small business. Accordingly, the Department estimates that approximately 1,930 small service providers would be affected by the proposed regulation. Thus, together with the approximately 30,950 small plans described above that we estimate would need to comply with the proposed regulation, overall, the Department estimates that approximately 32,880 small entities would be affected. The Department requests comments on the number of small entities the rule will affect.

3.3. Impact of the Rule

This proposed rule would benefit small plans, by providing guidance regarding how ERISA's fiduciary duties apply to proxy voting and the monitoring of proxy advisory firms, and in particular when fiduciaries should refrain from voting. Plan fiduciaries would be able to better conserve plan assets by having clear direction to refrain from researching and voting on proposals that they prudently determine have no economic impact on the plan. The proposal also would benefit plans by improving the frequency with which voting resources are expended on

matters that have an economic impact on the plan. Cost savings and other benefits to small plans would flow to plan participants and beneficiaries in the form of more secure retirement income.

As discussed under the Cost section above, while the Department assumes that small affected entities would spend some time familiarizing themselves with the rule, it expects that these familiarization costs would be minimal, because the activities that would be required by the proposed rule are reflected in common practice. The Department estimates it would take an hour for an in-house attorney to review the rule, at an hourly labor cost of \$138.41. The Department requests comments or data to inform the Department's estimate of the costs associated with familiarization.

Fiduciaries of plans must ensure that all investments are prudently monitored. The proposed rule provides that fiduciaries responsible for the exercise of shareholder rights must maintain records in order to demonstrate compliance with ERISA's fiduciary provisions. The Department assumes that, because the documentation of fiduciary decision-making is a common practice, responsible fiduciaries are likely already recording and maintaining documentation related to their own and investment managers' actions, including their exercise of shareholder rights.

For plans that are not currently in full compliance, the rule will have a small impact to maintain records or document decisions related to voting proxies or exercising other shareholder rights. Much of the information required to comply with this requirement is generated by affected entities in the normal course of business; however, additional time may be required to maintain the proper documentation. The Department estimates that compliance with this proposed regulation would require 30 minutes of a plan fiduciary's time and 30 minutes of a

clerical worker's time. The Department assumes an hourly rate of \$134.21 for a plan fiduciary and an hourly rate of \$55.14 for a clerical worker, resulting in an estimated per-entity annual cost of \$94.68.¹¹⁸ Under these assumptions, the Department believes that these requirements will not significantly increase costs for small plans. For service providers, the Department developed a model that illustrates the impact of the proposed rule by assuming that service providers, like asset managers, provide the required research and documentation that would be required to vote by proxy. The model is included for illustrative purposes as some of the assumption used are speculative. The following analysis should be viewed with the understanding of the high degree of uncertainty and the assumptions used. The model's costs estimates suggest an average cost per service provider of approximately \$50,400 (for more information on the assumptions, see the Uncertainty section in the regulatory impact analysis). The Department does not have data on how the number of proxy votes a service provider would need to prepare differs by service provider size. Based on data supplied by SBA from the 2012 Census, the Department estimates that the estimated average cost of \$50,400 would account for 0.8 percent of average annual revenue for all service providers.¹¹⁹ Considering fixed costs and economies of scale, the costs of complying with the proposed regulation would likely account for a higher proportion of revenue for small service providers. If it were assumed that the costs of complying with the proposed regulation would be the same, regardless of firm size, the Department assumes it would account

¹¹⁸ $0.5 \text{ hours} * \$134.21 + 0.5 \text{ hours} * \$55.14 = \$94.68$.

¹¹⁹ Based on data supplied by SBA from the 2012 Census, the Department calculated the average revenue of entities for relevant NAICS codes as \$6.4 million. In its calculation, the Department included the following industries; portfolio management (NAICS 523920); investment advice (523930); and trust, fiduciary, and custody activities (NAICS 523991).

for 4.1 percent of revenues on average for small entities.¹²⁰ The estimated proportions of costs are broken down by firm size for small firms in the Revenue Test column in the table below.

These estimates likely overestimate the costs for small service providers. The cost estimate assumes that these service providers are researching and documenting proxy votes for over 8,000 stocks. While the Department does not have data on how the number of proxy votes prepared by service providers would vary by firm size, the Department believes that small entities are less likely to oversee investments over the investment universe considered here. Accordingly, the Department assumes smaller entities would need to research and document fewer proxy votes, resulting in reduced demand on time resources and overall lower cost.

Additionally, the data presented in the table below considers all firms for the respective industries. A majority of firms in these industries will not be providing services that are affected by these proposed rules. The table illustrates the impact on affected firms and the dispersion of firms by revenue. For example, the Department believes that the smallest firms are not likely to be providing proxy-voting services to ERISA plans. Therefore, the Department believes that what appears to be the most serious cost impact for firms with less than \$100,000 in receipts would not occur.

The Department believes it is reasonable to assume that costs for small entities account for between 0.8 percent and 4.1 percent of revenues. A weighted average of these two

¹²⁰ Based on data supplied by SBA from the 2012 Census, the Department calculated the average revenue of small entities for relevant NAICS codes as \$1.2 million. In its calculation, the Department included the following industries; portfolio management (NAICS 523920); investment advice (523930); and trust, fiduciary, and custody activities (NAICS 523991). In accordance with SBA guidelines, entities with receipts less than \$41.5 million were considered small.

approaches by firm size, results in an estimate that costs account for an average of 2.4 percent of revenues for small entities. The estimated proportions of costs are broken down by firm size for small firms in the Adjusted Revenue Test column in the table below. The Department requests comments on the model and its assumptions, particularly with regard to business size.

Portfolio Management (NAICS 523920), Investment Advice (NAICS 523930), and Trust, Fiduciary, and Custody Activities (NAICS 523991) - \$41.5 Million Size Standard					
<i>Firm Size (by Receipts)</i>	<i>Average Annual Revenue</i>	<i>Annualized Cost per Firm</i>	<i>Percent of Small Firms</i>	<i>Revenue Test</i>	<i>Adjusted Revenue Test**</i>
All Firms	\$ 6,345,828	\$ 50,390	N/A	<1%	<1%
Small Firms	\$ 1,220,890	\$ 50,390	100%	4%	2%
<\$100,000	\$ 46,505	\$ 50,390	22%	108%	55%
\$100,000 - \$499,999	\$ 251,618	\$ 50,390	41%	20%	10%
\$500,000 - \$999,999	\$ 696,025	\$ 50,390	14%	7%	4%
\$1M - \$2.49M	\$ 1,531,804	\$ 50,390	12%	3%	2%
\$2.5M - \$4.99M	\$ 3,390,789	\$ 50,390	5%	1%	1%
\$5M - \$7.49M	\$ 5,779,106	\$ 50,390	2%	<1%	<1%
\$7.5M - \$9.99M	\$ 7,854,990	\$ 50,390	1%	<1%	<1%
\$10M - \$14.99M	\$ 10,752,200	\$ 50,390	1%	<1%	<1%
\$15M - \$19.99M	\$ 14,201,734	\$ 50,390	<1%	<1%	<1%
\$20M - \$24.99M	\$ 18,062,969	\$ 50,390	<1%	<1%	<1%
\$25M - \$29.99M	\$ 17,501,113	\$ 50,390	<1%	<1%	<1%
\$30M - \$34.99M	\$ 22,451,441	\$ 50,390	<1%	<1%	<1%
\$35M - \$39.99M	\$ 28,100,088	\$ 50,390	<1%	<1%	<1%
\$40M - \$ 41.5M	\$ 30,715,982	\$ 50,390	<1%	<1%	<1%
* Annualized compliance costs as a percentage of revenue.					
**The Adjusted Revenue Test considers a weighted averages of the low estimate—assuming the proportion of costs for all firms is equal to the proportion of costs for the average of 0.8%—and the high estimate of assuming all firms incur a cost of \$50,390 by firm size.					

It is likely that service providers will pass most, if not all, of these costs onto their clients, which is estimated to be about \$1,500 per plan holding stock. This initial regulatory flexibility analysis (IRFA) only considers the incremental cost the proposed regulation would impose on small entities. It, however, does not take into account the cost savings small entities would realize from the proposed regulation's permitted practices. As discussed in Appendix A, below,

the Department intends that the permitted practices will impact a large share of all proxy votes, and the burden associated with these votes when using the permitted practices will likely be very low. Therefore, taking the permitted practices into account, the net burden on small entities would be smaller than the Department illustrates in the table above, and in some cases, small entities could even realize cost savings.

3.4. Alternatives

As discussed above, the Department's longstanding position is that the fiduciary duties of prudence and loyalty under ERISA sections 404(a)(1)(A) and 404(a)(1)(B) apply to the exercise of shareholder rights, including proxy voting, proxy voting policies and guidelines, and the selection and monitoring of proxy advisory firms. These duties apply to all affected entities – large and small.

The Department carefully considered the proposed rule's impact on small entities in deliberating alternatives for the proposal. For example, the Department considered a purely principles-based approach that would not have included the permitted practices in paragraph (e)(3)(iii) of the proposal. However, the Department was concerned that small entities would not sufficiently benefit for this approach. The Department believes that clearly articulating examples of permitted proxy voting policies would be helpful to small plan fiduciaries and ultimately beneficial to small plan participants and beneficiaries because it will reduce the frequency with which voting resources are expended on matters that do not have an economic impact on small plans compared to a purely principles-based approach paired with the permitted practices. The Department thus concluded that a purely principles-based approach would not have preserved

plan assets or enhanced the retirement income security of participants and beneficiaries of small plans as much as the Department's chosen alternative.

Moreover, a purely principles-based approach could result in a responsible fiduciary, having to determine whether to vote each individual proxy proposal. This determination process could consume significant plan resources, even where the potential economic benefit to the plan is small or difficult to determine. A responsible fiduciary might arrive at his or her own policies for simply not voting, or voting in a specific manner on certain types of proposals, based on the plan's limited exposure to a stock or the economic immateriality of the matter being voted upon. However, under a principles-based approach fiduciaries would likely be cautious about adopting such policies, and might believe it prudent to be able to demonstrate in each case why a decision was made not to vote, and therefore err on the side of devoting excessive resources to voting decisions. By creating such uncertainty and caution in adopting such policies, this result would provide limited benefits on small entities and lead to unnecessary expenditure of plan assets. The Department invites comments on the impact of the inclusion of permitted practices on small entities and their usefulness in aiding a small plan fiduciary's determination of whether to vote.

The Department also considered including a specific numeric cap for the materiality permitted practice in paragraph (e)(3)(iii)(C), but opted not to do so until it has the opportunity to review the comments solicited earlier in this preamble on this question. The Department similarly invites comments regarding the impact on those issues on small entities for purposes of this IRFA. The Department also invites comments generally on its choice of permitted practices, including whether any should not be retained and whether any other practices should be added or additional alternatives considered to address specific circumstances affecting small entities.

3.5. Duplicate, Overlapping, or Relevant Federal Rules

The proposed rule would not conflict with any relevant federal rules. As discussed above, the proposal would merely clarify the application of ERISA's fiduciary duties to conform to significant changes in shareholder voting practices. The Department is monitoring other federal agencies whose statutory and regulatory requirements overlap with ERISA. In particular, the Department is monitoring SEC rules and guidance to avoid creating duplicate or overlapping requirements with respect to proxy voting.

4. Unfunded Mandates Reform Act

Title II of the Unfunded Mandates Reform Act of 1995¹²¹ requires each Federal agency to prepare a written statement assessing the effects of any federal mandate in a proposed or final agency rule that may result in an expenditure of \$100 million or more (adjusted annually for inflation with the base year 1995) in any one year by state, local, and tribal governments, in the aggregate, or by the private sector. For purposes of the Unfunded Mandates Reform Act, as well as Executive Order 12875, this proposal would not include any federal mandate that the Department expects would result in such expenditures by state, local, or tribal governments, or the private sector. This proposed rule would not result in an expenditure of \$100 million or more in any one year, because the Department is simply restating and modernizing fiduciary practices related to voting rights and aligning its regulations to the extent possible with guidance issued by the SEC.

¹²¹ 2 U.S.C. 1501 et seq. (1995).

5. Federalism Statement

Executive Order 13132 outlines fundamental principles of federalism and requires Federal agencies to adhere to specific criteria when formulating and implementing policies that have “substantial direct effects” on the states, the relationship between the National Government and states, or on the distribution of power and responsibilities among the various levels of government. Federal agencies promulgating regulations that have federalism implications must consult with state and local officials and describe the extent of their consultation and the nature of the concerns of state and local officials in the preamble to the rule.

In the Department’s view, these proposed regulations do not have federalism implications because they do not have direct effects on the states, the relationship between the National Government and the states, or the distribution of power and responsibilities among various levels of government. The proposed regulations describe requirements and permitted practices related to the exercise of shareholder rights under ERISA. While ERISA generally preempts state laws that relate to ERISA plans, and preemption typically requires an examination of the individual law involved, it appears highly unlikely that the provisions in this proposed regulation would have preemptive effect on general state corporate laws. The Department welcomes input from affected states regarding this assessment.

6. Appendix A

In light of the uncertainty regarding the proxy voting activities of ERISA plans, and the attendant costs and benefits of this proposal, the Department is presenting an illustration below of an analytical approach to evaluating the possible impacts of this NPRM. This is part of the

Department's solicitation of comments on an appropriate methodology and assumptions for evaluating the costs and savings that could result from the rule. The analytical model assumes that proxies are primarily voted by asset managers or other service providers. The Department also assumes that the proposed rule may require some plans or service providers to expend more effort researching whether a proxy vote will have a relevant economic impact on the plan and how the plan should vote in cases in which the proposal has such an economic impact. Service providers, plans, or both, may also need to provide more documentation of their decisions than they already produce. Additionally, plans may take advantage of the permitted practices described in the proposal that allow them to conserve plan assets, because they may not need to conduct as extensive an amount of research or expend as much time on documenting decisions. The analysis used in the illustration is based on a number of assumptions and estimates. Some of those assumptions and estimates are based on available data, but the Department does not have supporting data for some key assumptions and estimates. Specifically, the model portrays the following as described below and shown in tables 2-4 which are also found below.

An estimated 1,988 service providers may be impacted by the rule's requirements, shown in column A. This estimate is obtained by looking at the number of clients of three of the largest proxy advisory firms.¹²² While service providers that are affected by this rule may not use the services of these proxy advisory firms, it is also likely that not all of these firms provide services to ERISA-covered plans.

¹²² SEC Proxy Proposed Rule: Amendments to Exemptions from the Proxy Rules for Proxy Voting Advice Table 1 Page 84. The estimate includes those categories of clients viewed most-likely to be impacted by the rule: banking or thrift institutions, investment companies, pooled investment vehicles, pension and profit sharing plans, other investment advisers, and insurance companies.

To obtain the number of proxy votes that need to be evaluated, the estimate of the number of domestic stock (4,684) was obtained by looking at the number of shareholder meetings held, and ¹²³ the estimate for the number of foreign stock (3,336) was obtained by the number of stock in a foreign stock index.¹²⁴ These estimates were used to arrive at an estimate of 8,020 total stocks voted annually. Each stock can have multiple related proxy votes. Therefore, the Department estimates that there are 9.3 votes per stock.¹²⁵ These assumptions lead to an estimate of 148,276,968 proxy votes that could be impacted by this rule as shown in column C of Table 2.¹²⁶

As discussed previously, some stocks may fall within the permitted practice provisions of the rule. The illustration assumes that proposals that are within the permitted practices would be less burdensome to research and document even if the permitted practices provisions did not exist. The Department estimates that 5.6 percent of all proxy votes will fall outside the permitted practices; therefore, they still would be required to be researched, voted, and documented under the proposal.¹²⁷ The following assumptions were made to estimate the burden of such researching, voting, and fulfilling documentation requirements. For votes falling within the

¹²³ One service provider said that in 2019 they processed 4,216 shareholder meetings. Also, in 2019 this service provider held about 90 percent of the market for processing proxy votes. These statistics would lead to about 4,684 shareholder meetings (4,216/0.9). https://www.broadridge.com/_assets/pdf/broadridge-proxy-season-stats-final.pdf and (<https://www.sec.gov/spotlight/investor-advisory-committee-2012/recommendation-of-the-investor-as-owner-subcommittee-on-the-us-proxy-system-090519.pdf>).

¹²⁴ FTSE All-World ex US Index Fact Sheet, July 31, 2020. <https://www.ftserussell.com/analytics/factsheets/home/search>.

¹²⁵ Investment Company Institute. "Proxy Voting by Registered Investment Companies, 2017." Vol 25, No. 5. July 2019. See endnote 15. <https://www.ici.org/pdf/per25-05.pdf>.

¹²⁶ $1,988 * (4,684 + 3,336) * 9.3$

¹²⁷ Investment Company Institute. "Proxy Voting by Registered Investment Companies, 2017." Vol 25, No. 5. July 2019. See Figures 2 and 3. <https://www.ici.org/pdf/per25-05.pdf>. We developed this assumption by looking at the ICI data from 2011 to 2017 on the percentage of total proxy proposals that related to mergers, acquisitions, dissolutions, conversions consolidations, corporate repurchase of shares, issuance of additional securities, and contested elections for directors.

permitted practices, on average the Department estimates that 30 minutes would be needed for responsible plan fiduciaries to conduct research and 10 minutes would be required to document each vote. For votes falling outside the permitted practices, the Department estimates that on average two hours would be needed for responsible plan fiduciaries to conduct research and 20 minutes would be required to document each vote. Using these assumptions, and other assumptions about the proposal's impact discussed below, the Department estimated the total hours required for responsible plan fiduciaries to research and document proxy votes.

The costs of the research and documentation requirements were calculated by multiplying the total research hours by a labor rate of \$116.96 and the total documentation hours by a labor rate of \$110.39.¹²⁸ Column H shows the total costs of the rule for increases in research and documenting costs, but excludes cost savings that could occur if the permitted practices are used. The cost savings from the permitted practices are discussed later. It should be noted that although the Department calculated costs in column H, most of these costs will not be realized, because plans will use the permitted practices to avoid incurring them.

As discussed elsewhere in this preamble, while the Department believes that the common practices of most plans related to proxy voting are generally consistent with the standards in the proposal, we do not know with any level of precision the percent of plans that are not currently meeting such standards. For purposes of illustrating possible impacts of this rule, the

¹²⁸ These labor rates are a composite labor rate. For, research, it is for a financial manager and a financial professional with a quarter of the time provided by a financial manager and three-quarters of the time provided by a financial professional. For the documentation labor rate, it is for a financial manager and a clerical professional with each providing half the time. The wage rate for a financial manager (11-3031), financial professional (13-2011), and a clerical professional (43-6014) is respectively \$165.63, \$100.74, and \$55.14. <https://www.dol.gov/sites/dolgov/files/EBSA/laws-and-regulations/rules-and-regulations/technical-appendices/labor-cost-inputs-used-in-ebsa-opr-ria-and-pra-burden-calculations-june-2019.pdf>

Department assumes that five percent of total research costs will be new as some responsible plan fiduciaries will improve their research conducted to determine whether they should or should not vote proxies and then how to vote. The Department modeled one percent of the total research costs as new, because some responsible plan fiduciaries will need to increase the quality of their documentation for some affected votes. The hours shown in columns D and E reflect that only some of the votes will necessitate new burden. To illustrate, the 3,499,336 hours in the first row of column D is obtained by the following: 1,988 service providers * 8,020 stocks * 9.3 proxy votes per stock * (1-0.056 for share of votes effected by permitted practices) * 0.5 hours of new research * 5 percent increase in research costs.¹²⁹

An illustration of potential cost savings that could be derived from responsible plan fiduciaries using the permitted practices was arrived at using the same model. As depicted in table 3, responsible plan fiduciaries do not have to vote proxies that fall within the permitted practices, which could save at least some of the costs associated with research and documentation. Columns A, B, and C of table 3 are obtained in the same manner as columns A, B, and C of table 2. Columns D and E are obtained in the same manner as in table 2 except replacing the assumption that five percent of the costs are new with an assumption about the number of proxy votes that will not be voted due to the permitted practices. For this illustration, the Department assumed that 10 percent of the proxy votes will not be voted and responsible plan fiduciaries will not incur research and documentation costs. Instead of thinking about this as a reduction in actual votes, it can also be viewed as a 10 percent reduction in costs if votes are still cast pursuant to the permitted practices that allow voting but reduce burden, such as

¹²⁹ In the second row of Table 2, a one percent increase is reflected, rather than a five percent increase.

paragraph (e)(3)(iii)(A) of the proposal, which would allow fiduciaries to adopt vote proxies in accordance with the voting recommendations of corporate management. The Department intends that the permitted practices will impact a large share of all proxy votes and the burden associated with these votes when using the permitted practices will likely be very low. Column H of table 3 is an illustration of the potential cost reduction from the use of the permitted practices.

TABLE 2--Illustration of Possible *New Costs Due to Rule of Voting Proxies*

	# Firms Providing Proxy Voting for ERISA Plans	Number of Stock to Vote	Number of Proxy Votes	New Due to Rule: Hours to Research	New Due to Rule: Hours to Document	Cost Equivalent New Due to Rule: Research	Cost Equivalent New Due to Rule: Documentation	Total New Cost of Policy Alternative Without Permitted Practices	Total New Cost to Plans Incurring Cost if using Permitted Practices
	(A)	(B)	(C)	(D)	(E)	(F)	(G)	(H)	(I)
Providers: PP	1,988	8,020	139,973,458	3,499,336	233,289	\$409,291,139	\$25,751,617	\$435,042,756	
Providers: non-PP	1,988	8,020	8,303,510	830,351	27,678	\$97,119,931	\$3,055,277	\$100,175,208	\$100,175,208
Total	1,988		148,276,968	4,329,687	260,967	\$506,411,070	\$28,806,893	\$535,217,964	\$100,175,208

TABLE 3--Illustration of Possible *Cost Savings from Permitted Practices of Voting Proxies*

	# Firms Providing Proxy Voting for ERISA Plans	Number of Stock to Vote	Number of Proxy Votes	New Due to Rule: Hours to Research Saved	New Due to Rule: Hours to Document Saved	Cost Savings Due to Rule: Research	Cost Savings Due to Rule: Document	Total Cost Savings Due to Permitted Practices
	(A)	(B)	(C)	(D)	(E)	(F)	(G)	(H)
Provider: PP	1,988	8,020	139,973,458	6,998,673	2,332,891	\$818,582,278	\$257,516,169	\$1,076,098,447
Total	1,988		139,973,458	6,998,673	2,332,891	\$818,582,278	\$257,516,169	\$1,076,098,447

TABLE 4--*Cost Savings from Rule*

Total Costs of Policy Alternative without Permitted Practices	Cost Savings Due to Permitted Practices	Net Cost Savings
(A)	(B)	(B-A)
\$535,217,964	\$1,076,098,447	\$540,880,483

Statutory Authority

This regulation is proposed pursuant to the authority in section 505 of ERISA (Pub. L. 93-406, 88 Stat. 894; 29 U.S.C. 1135) and section 102 of Reorganization Plan No. 4 of 1978 (43 FR 47713, October 17, 1978), effective December 31, 1978 (44 FR 1065, January 3, 1979), 3 CFR 1978 Comp. 332, and under Secretary of Labor's Order No. 1-2011, 77 FR 1088 (Jan. 9, 2012).

List of Subjects in 29 CFR Parts 2509 and 2550

Employee benefit plans, Employee Retirement Income Security Act, Exemptions, Fiduciaries, investments, Pensions, Prohibited transactions, Reporting and recordkeeping requirements, Securities.

For the reasons set forth in the preamble, the Department is proposing to amend parts 2509 and 2550 of subchapters A and F of chapter XXV of title 29 of the Code of Federal Regulations as follows:

SUBCHAPTER A—GENERAL

PART 2509—INTERPRETIVE BULLETINS RELATING TO THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974

1. The authority citation for part 2509 continues to read as follows:

Authority: 29 U.S.C. 1135. Secretary of Labor's Order 1-2003, 68 FR 5374 (Feb. 3, 2003). Sections 2509.75-10 and 2509.75-2 issued under 29 U.S.C. 1052, 1053, 1054. Sec.

2509.75-5 also issued under 29 U.S.C. 1002. Sec. 2509.95-1 also issued under sec. 625, Pub. L. 109-280, 120 Stat. 780.

§ 2509.2016-01 [Removed]

2. Remove § 2509.2016-01.

**SUBCHAPTER F—FIDUCIARY RESPONSIBILITY UNDER THE EMPLOYEE
RETIREMENT INCOME SECURITY ACT OF 1974**

PART 2550—RULES AND REGULATIONS FOR FIDUCIARY RESPONSIBILITY

3. The authority citation for part 2550 continues to read as follows:

Authority: 29 U.S.C. 1135 and Secretary of Labor's Order No. 1-2011, 77 FR 1088 (January 9, 2012). Sec. 102, Reorganization Plan No. 4 of 1978, 5 U.S.C. App. at 727 (2012). Sec. 2550.401c-1 also issued under 29 U.S.C. 1101. Sec. 2550.404a-1 also issued under sec. 657, Pub. L. 107-16, 115 Stat 38. Sec. 2550.404a-2 also issued under sec. 657 of Pub. L. 107-16, 115 Stat. 38. Sections 2550.404c-1 and 2550.404c-5 also issued under 29 U.S.C. 1104. Sec. 2550.408b-1 also issued under 29 U.S.C. 1108(b)(1). Sec. 2550.408b-19 also issued under sec. 611, Pub. L. 109-280, 120 Stat. 780, 972. Sec. 2550.412-1 also issued under 29 U.S.C. 1112.

4. Section 2550.404a-1, as proposed to be revised at 85 FR 39113 (June 30, 2020), is further amended by adding paragraph (e), revising paragraph (g), and republishing paragraph (h) to read as follows:

§ 2550.404a-1 Investment duties.

* * * * *

(e) *Proxy voting and exercise of shareholder rights.* (1) The 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.

(2)(i) 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 pursuant to ERISA sections 403 and 404.

(ii) In order to fulfill the fiduciary obligations under paragraph (e)(2)(i) of this section, when deciding whether to exercise shareholder rights and when exercising shareholder rights, a plan fiduciary must:

(A) Act solely in accordance with the economic interest of the plan and its participants and beneficiaries considering only factors that they prudently determine will affect the economic value of the plan's investment based on a determination of risk and return over an appropriate investment horizon consistent with the plan's investment objectives and the funding policy of the plan;

(B) Consider the likely impact on the investment performance of the plan based on such factors as the size of the plan's holdings in the issuer relative to the total investment assets of the plan, the plan's percentage ownership of the issuer, and the costs involved;

(C) 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 sacrifice investment return or take on additional investment risk to promote goals unrelated to those financial interests of the plan's participants and beneficiaries or the purposes of the plan;

(D) Investigate material facts that form the basis for any particular proxy vote or other exercise of shareholder rights. The fiduciary may not adopt a practice of following the recommendations of a proxy advisory firm or other service provider without appropriate supervision and a determination that the service provider's proxy voting guidelines are consistent with the economic interests of the plan and its participants and beneficiaries as defined in paragraph (e)(2)(ii)(A) of this section;

(E) Maintain records on proxy voting activities and other exercises of shareholder rights, including records that demonstrate the basis for particular proxy votes and exercises of shareholder rights; and

(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.

(iii) Where the authority to vote proxies or exercise shareholder rights has been delegated to an investment manager pursuant to ERISA section 403(a)(2), or a proxy voting firm or other person performs advisory services as to the voting of proxies, a responsible plan fiduciary shall require such investment manager or proxy advisory firm to document the

rationale for proxy voting decisions or recommendations sufficient to demonstrate that the decision or recommendation was based on the expected economic benefit to the plan, and that the decision or recommendation was based solely on the interests of participants and beneficiaries in obtaining financial benefits under the plan.

(3)(i) A plan fiduciary must vote any proxy where the fiduciary prudently determines that the matter being voted upon would have an economic impact on the plan after considering those factors described in paragraph (e)(2)(ii) of this section and taking into account the costs involved (including the cost of research, if necessary, to determine how to vote).

(ii) A plan fiduciary must not vote any proxy unless the fiduciary prudently determines that the matter being voted upon would have an economic impact on the plan after considering those factors described in paragraph (e)(2)(ii) of this section and taking into account the costs involved (including the cost of research, if necessary, to determine how to vote).

(iii) In deciding whether to vote a proxy pursuant to paragraphs (e)(3)(i) and (ii) of this section, plans may adopt proxy voting policies that voting authority shall be exercised pursuant to specific parameters reasonably designed to serve the plan's economic interest. Such policies may include, for example:

(A) A policy of voting proxies in accordance with the voting recommendations of management of the issuer on proposals or particular types of proposals that the fiduciary has prudently determined are unlikely to have a significant impact on the value of the plan's investment, subject to any conditions determined by the fiduciary as requiring additional analysis because the matter being voted upon may present heightened management conflicts of interest or is likely to have a significant economic impact on the value of the plan's investment;

(B) A policy that voting resources will focus only on particular types of proposals that the fiduciary has prudently determined are substantially related to the corporation's business activities or likely to have a significant impact on the value of the plan's investment, such as proposals relating to corporate events (mergers and acquisitions transactions, dissolutions, conversions, or consolidations), corporate repurchases of shares (buy-backs), issuances of additional securities with dilutive effects on shareholders, or contested elections for directors; and

(C) 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 that the fiduciary prudently determines, considering its percentage ownership of the issuer and other relevant factors, is sufficiently small that the outcome of the vote is unlikely to have a material impact on the investment performance of the plan's portfolio (or investment performance of assets under management in the case of an investment manager).

(iv) Plan fiduciaries shall review proxy voting policies adopted pursuant to paragraph (e)(3)(iii) of this section at least once every two years.

(v) No policies adopted under paragraph (e)(3)(iii) of this section shall preclude, or impose liability for, submitting a proxy vote when the fiduciary prudently determines that the matter being voted upon would have an economic impact on the plan after taking into account the costs involved, or for refraining from voting when the fiduciary prudently determines that the matter being voted upon would not have an economic impact on the plan after taking into account the costs involved.

(4)(i)(A) The responsibility for exercising shareholder rights lies exclusively with the plan trustee except to the extent that either:

(1) The trustee is subject to the directions of a named fiduciary pursuant to ERISA section 403(a)(1); or

(2) 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).

(B) Where the authority to manage plan assets has been delegated to an investment manager pursuant to section 403(a)(2), the investment manager has exclusive authority to vote proxies or exercise other shareholder rights appurtenant to such plan assets in accordance with this section, 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 regarding the exercise or management of some or all of such shareholder rights.

(ii) An investment manager of a pooled investment vehicle that holds assets of more than one employee benefit plan may be subject to an investment policy statement that conflicts with the policy of another plan. Compliance with ERISA section 404(a)(1)(D) requires the investment manager to reconcile, insofar as possible, the conflicting policies (assuming compliance with each policy would be consistent with ERISA section 404(a)(1)(D)). 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 plan's economic interest in the pooled investment vehicle. Such an investment manager may, however,

develop an investment policy statement consistent with Title I of ERISA and this section, and require participating plans to accept the investment manager's investment policy, including any proxy voting policy, before they are allowed to invest. In such cases, a fiduciary must assess whether the investment manager's investment policy statement and proxy voting policy are consistent with Title I of ERISA and this section before deciding to retain the investment manager.

* * * * *

(g) *Effective date.* This section shall be effective on [30 days after date of publication of final rule].

(h) *Severability.* Should a court of competent jurisdiction hold any provision(s) of this subpart to be invalid, such action will not affect any other provision of this subpart.

Signed at Washington, DC.

Jeanne Klinefelter Wilson,
Acting Assistant Secretary, Employee Benefits Security Administration,
Department of Labor.

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