

DOL Guidance on Shareholder Rights (A Political Ritual)

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On December 28, 2016 (at the end of the Obama administration), the U.S. Department of Labor (DOL) issued Interpretive Bulletin 2016-1 (IB 2016-1) to document DOL views regarding shareholder rights such as voting of proxies and shareholder activism/ engagement. This Interpretive Bulletin also addresses maintenance of and compliance with investment policies in employee benefit plans.¹

IB 2016-1 withdrew Interpretive Bulletin 2008-2, issued at the end of the Bush administration, and reinstated views expressed in Interpretive Bulletin 94-2, which was issued during the Clinton administration, but withdrawn by the Bush administration. Most views expressed in the Obama, Bush and Clinton era Interpretive Bulletins have remained consistent over the years. Views on economically targeted investments ("ETI"), environmental, social and governance ("ESG") investing, and associated shareholder activism have, however, been less consistent.

Outlined below are views expressed consistently by Obama, Bush and Clinton era Interpretive Bulletins. Inconsistent views are highlighted in comment boxes. The analysis below is footnoted in order to link discussions regarding investment selection and shareholder action in the above-referenced Interpretive Bulletins with companion Interpretive Bulletins devoted to "economically targeted investments."²

- A. Voting is a Fiduciary Act.** The fiduciary act of managing plan assets that are shares of corporate stock includes the voting of proxies appurtenant to those shares of stock.
- B. Who Votes.** Voting of proxies lies exclusively with the plan trustee except to the extent (1) the trustee is subject to the direction of a named fiduciary, or (2) the power to manage, acquire or dispose of the relevant assets has been delegated to one or more investment managers pursuant to ERISA 403(a)(2).
- C. Investment Policy Statements.** The maintenance by an employee benefit plan of an investment policy statement ("IPS") is consistent with the fiduciary obligations set forth in ERISA section 404(a)(1)(A) and (B).

- D. An Investment Policy Is Not a Shield.** Actions taken in compliance with an investment policy are not protected actions if they are imprudent under the circumstances.
- E. Components of an Investment Policy.** An investment policy includes guidelines or general instructions concerning types or categories of investment management decisions, which may include proxy voting decisions. A named fiduciary's determination of the terms of an IPS is an exercise of fiduciary responsibility and, as such, may need to take into account factors such as the plan's funding policy and its liquidity needs, as well as issues of prudence, diversification and other fiduciary requirements of ERISA.

IB 2016-1 (Obama era): An investment policy may include policies concerning economically targeted investments, incorporate environmental, social or governance (ESG) factors, or integrate ESG-related tools, metrics and analysis to evaluate an investment's risk or return or to choose among equivalent investments.

- F. Monitoring of Investment Policy.** A named fiduciary must monitor investment managers' compliance with the governing investment policy. The governing investment policy can be the plan's investment policy or the investment manager's investment policy.
- G. Tie Breaker.** If two or more investments are economically indistinguishable and would fill a similar role with respect to diversification, liquidity, and risk/return, then factors outside the economic interest of the plan could be used to decide between these investments.
- H. No Subordination of Value of Retirement Benefits.** In voting proxies, the responsible fiduciary may not subordinate the interests of participants and beneficiaries in their retirement income to unrelated objectives.

IB 2016-1 (Obama era): ESG factors can be consistent with the economic interests of participants and their beneficiaries in their retirement income, as suggested by the growing number of institutional investors now engaging companies on ESG issues.³

- I. Shareholder Activism/Engagement.** An investment policy that contemplates activities intended to monitor or influence the management of corporations in which the plan owns stock is consistent with a fiduciary's obligations under ERISA. Such activism may be especially appropriate where plan investments in corporate stock are held as long-term investments or where a plan may not be able to easily dispose of such an investment.

IB 2008-2 (Bush era): Shareholder activism is appropriate where the responsible fiduciary concludes there is a reasonable expectation that such monitoring or communication with management will enhance the economic value of the plan's investment in the corporation after taking into account the costs involved.

IB 94-2 (Clinton era) and IB 2016-1 (Obama era): Shareholder activism is appropriate where the responsible fiduciary concludes that there is a reasonable expectation that such monitoring or communication with management *is likely* to enhance the value of the plan's investment in the corporation after taking into account the costs involved.

- J. Topics for Shareholder Activism/Engagement.** Appropriate topics include (i) independence and expertise of candidates for the corporation's board of directors, (ii) assuring that the board has sufficient information to carry out its responsibility to monitor management, (iii) appropriateness of executive compensation, (iv) corporate policy regarding mergers and acquisitions, (v) extent of debt financing and capitalization, (vi) nature of long-term business plans, (vii) corporate investment in training to develop its work force, and (viii) other workplace practices.

IB 2016-1 (Obama era): Adds the following potential topics for shareholder activism/engagement:

- (i) Governance structures and practices, particularly those involving board compensation.
- (ii) Transparency and accountability in corporate decision-making.
- (iii) Responsiveness to shareholders.
- (iv) Climate change preparedness and sustainability.
- (v) Governance and compliance policies, and practices for avoiding criminal liability and ensuring employees comply with applicable laws and regulations.
- (vi) Diversity and equal employment opportunity for the work force.
- (vii) Policies and practices to address environmental or social factors that have an impact on shareholder value.

K. DOL Enforcement.

IB 2008-2 (Bush era): Contains the following warnings:

- (i) Plan fiduciaries risk violating the exclusive purpose rule when they exercise their fiduciary authority in an attempt to further legislative, regulatory or public policy issues through the proxy process. In such cases the Department would expect fiduciaries to be able to demonstrate in enforcement actions their compliance with the requirements of ERISA sections 404(a)(1)(A) (exclusive purpose) and (B) (prudent man standard).⁴
- (ii) Fiduciaries must be prepared to articulate a clear basis for concluding that the proxy vote, the investment policy, or the activity is *more likely than not* to enhance the economic value of the plan's investment before expending plan assets.

IB 2016-1 (Obama era): Concern that IB 2008-2 (Bush era) is out of step with important domestic and international trends in investment management and has the potential to dissuade ERISA fiduciaries from exercising shareholder rights.^{5, 6}

In summary, Obama era guidance is consistent with Clinton era guidance and can be viewed as consistent with Bush era guidance, except as follows: (i) Obama era guidance is based on the concept that ETI and ESG factors can positively impact the economic interests of the plan and its participants, and (ii) Obama era guidance supports shareholder activism/engagement if it is "likely to enhance" shareholder value, while Bush era guidance required that such activism/engagement be "more likely than not" to enhance shareholder value.

Obama era guidance supports employee benefit plan investment fiduciaries who incorporate ETI and ESG factors into their investment-related activities. History tells us, however, that Obama era guidance, like predecessor guidance, remains subject to change. In any event, for investment fiduciaries, recently issued Interpretive Bulletin 2016-1 is a reminder to monitor implementation of shareholder rights and statements of investment policy.

For footnotes see next page

¹ IB 2016-1 documents legal standards imposed by Sections 402, 403 and 404 of Part 4 of Title I of the Employee Retirement Income Security Act of 1974 ("ERISA"). It does not address prohibited transaction issues.

² See, IB 94-1 (companion to Clinton era IB 94-2), IB 2008-1 (companion to Bush era IB 2008-2), and IB 2015-1 (companion to Obama era IB 2016-1).

³ IB 2015-1 (issued during Obama era in conjunction with IB 2016-1) states that environmental, social and governance issues may have a direct relationship to the economic value of the plan's investment.

⁴ Consistent with item G, above, IB 2008-1 (issued during Bush era in conjunction with IB 2008-2) permits a fiduciary to take into account factors outside the economic interest of the plan to decide between two or more investments that are economically indistinguishable. This Interpretive Bulletin provides, however, that under these circumstances, fiduciaries will "rarely be able to demonstrate compliance with ERISA absent a written record demonstrating that a contemporaneous economic analysis showed that the investment alternatives were of equal value."

⁵ IB 94-1 (issued during Clinton era in conjunction with IB 94-2) provided that "fiduciary standards applicable to ETIs are no different than the standards applicable to plan investments generally."

⁶ IB 2015-1 (issued during Obama era in conjunction with IB 2016-1) states that fiduciaries need not treat commercially reasonable investments as inherently suspect or in need of special scrutiny merely because they take into consideration environmental, social or other such factors, and that the DOL does not construe consideration of ETIs or ESG criteria as presumptively requiring additional documentation or evaluation beyond that required by fiduciary standards applicable to plan investment generally.

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