AMERICAN BENEFITS COUNCIL

October 5, 2020

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Office of Regulations and Interpretations
Employee Benefits Security Administration
Room N-5655
U.S. Department of Labor
200 Constitution Avenue N.W.
Washington, DC 20210

Re: RIN 1210-AB91, Fiduciary Duties Regarding Proxy Voting and Shareholder Rights

Dear Sir or Madam:

On behalf of the American Benefits Council ("the Council"), we are submitting these comments with respect to the above-referenced proposed regulation issued by the U.S. Department of Labor (DOL). Similar to the DOL proposed regulation related to environmental, social and governance (ESG) factors, this proposal would make changes to the DOL 1979 regulation that explains how a fiduciary will satisfy his or her obligations under ERISA Section 404(a)(1)(B) with regard to an investment or an investment course of action. This proposed regulation will impose significant, and in some cases troubling, new obligations on fiduciaries with respect to proxy voting and the exercise of other shareholder rights. While our members have varying levels of concern, the proposed regulation will affect plan sponsors, plan committees, trustees and investment managers – literally anyone who serves as a fiduciary of an ERISA-governed plan with responsibility for exercising proxy voting or other shareholder rights for plan assets.

As we stated in our comment letter on the ESG proposal, the Council agrees with DOL about the importance of plan fiduciaries acting in accordance with ERISA's prudence and loyalty responsibilities when they make investment decisions. Our members believe that when they act as fiduciaries and make decisions regarding plan assets, they must act solely in the interest of participants and beneficiaries and with the exclusive purpose of providing benefits and defraying reasonable expenses. This is true with respect to a fiduciary's management of shareholder rights, including the right to vote proxies. We also welcome the DOL clear message that ERISA does not require fiduciaries to discharge voting or other shareholder rights in every instance.

However, as detailed below, we are concerned that the proposal in its current form will have unintended negative consequences for plans and their investment managers, including unnecessarily increasing costs.

IMPORTANCE OF FULLY CONSIDERED REGULATORY PROCESS

As we pointed out in our letter on the DOL ESG proposal, the Council strongly believes that notice and comment rulemaking, enhanced by the discipline and additional consideration of costs and benefits that results from the requirement to conduct an economic impact analysis and formal OMB review, leads to a better outcome for participants, plan sponsors, DOL and the regulated community. This is especially true here, where the issues covered by the proposal are long standing and do not involve the need for immediate guidance to address a new statutory rule or an emergency. Well-reasoned and thoughtful regulations that reflect broad input from stakeholders also are more likely to stand the test of time, rather than being subject to shifts in the political winds.

We urge DOL not to rush to finalize the proxy voting regulation until it has considered all points of view, including from those stakeholders with strong views on all sides of this issue. We further urge DOL to collect sufficient information regarding the full array of costs and economic impacts to fully understand and consider these in the consideration of potential alternatives and the decisions embodied in the regulation.

We do not object to a review of proxy voting guidance, as a number of our member companies are concerned about the increasing influence and impact of proxy advisory firms in recent years and a review of those rules helps to address that concern.

As with our comment letter on the ESG proposal, this letter itself is an attempt to reflect a number of voices of our membership. Council members who support parts of this regulation reached out to us to state that they support DOL reinforcing the primacy of ERISA's duties of prudence and loyalty and the need for fiduciaries to act in the interest of plan participants when exercising shareholder rights. However, we also heard from other Council members who are concerned that the proposal's details will have an unintended and negative impact on plans, including raising costs, without sufficiently demonstrating that a fundamental problem in fiduciary oversight exists or that a regulation is truly needed. We also heard from some members who hold both of these views and who believe DOL should seek a middle road.

BINARY CHOICE REGARDING VOTING PROXIES SHOULD BE REMOVED

It has been the longstanding (and relatively noncontroversial) view of DOL that a fiduciary should vote proxies and exercise other shareholder rights where the fiduciary determines that the vote "may affect the economic value of the plan's investment," taking into account the costs associated with that vote (including investigation).[1] Under the proposal, however, a fiduciary must now consider the six different factors in the regulation and then would be *prohibited* from voting on 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."

In other words, every vote is presented as a stark binary choice under which a fiduciary's conduct is prescribed by whether the fiduciary determines – and determines "prudently" – that the vote will have an economic impact on the plan, considering factors which may point in opposite directions. Very similar to our concerns with the ESG proposal, we believe that DOL has assumed a precision in the analysis of proxy votes that does not reflect how investment professionals operate or what is feasible (or cost-effective) for them to do. As with all investment decision making, there is significant uncertainty about the economic impact of any particular proxy vote. The proposal seems to be suggesting something about the precision in how investment professionals evaluate proxy votes that is not the case. This also presents a burden for plan sponsors, who are charged with monitoring the investment professionals engaged by the plan.

The proposal includes a section that attempts to mitigate this by confirming that plans may adopt proxy voting policies under which voting authority shall be exercised pursuant to specific parameters reasonably designed to serve the plan's economic interest. But the existence of such policies is not a true safe harbor.[2] In fact, the proposal appears to require the fiduciary to deviate from the policies when the fiduciary determines that a matter being voted on will (or will not) have an economic impact on the plan.[3] The section of the proposal relating to proxy voting procedures provides no fiduciary or litigation relief for adopting such policies and therefore the same fiduciary

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[1] Interpretative Bulletin 08-02.

[2] The existence of a true safe harbor may be appropriate to consider. If DOL decides to create a safe harbor, it would need to be done through a reproposal so that DOL could receive adequate input from the regulated community.

[3] Proposed paragraph (e)(3)(v) provides: "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."

analysis, documentation and general voting considerations and processes will have to be pursued by plan fiduciaries in making a proxy voting determination.

Moreover, this "binary choice" requirement is inconsistent with other regulatory rules. DOL notes in the preamble that the Securities and Exchange Commission (SEC) has recently updated its guidance regarding proxy voting.[4] Most proxy votes with respect to ERISA plan assets are undertaken by investment managers that are also subject to SEC jurisdiction and thus it is important that DOL provide consistency, when possible. We address this issue in more detail below, but here we point out that SEC rules do not impose a requirement *not* to vote proxies, nor do they preclude an investment manager from voting if doing so likely is neutral from an economic perspective. Rather, the SEC rules state that an investment adviser that has assumed voting authority on behalf of a client generally will vote those proxies but "may" refrain from voting if it has determined that refraining is in the best interest of the client.[5]

Finally, we would point out that the mandate not to vote proxies, unless the fiduciary has prudently determined that the matter being voted upon would have an economic impact on the plan, may have *the opposite effect* than DOL intends. To the extent that the purpose and benefit of the proposal is to reduce the impact of shareholder proposals that have "little bearing on share value or other relation to plan interests,"[6] the proposal could result in plans simply refraining from voting on proposals where the plan represents a relatively small portion of the shares or believes the shareholder proposal will have no impact on its interests, thereby concentrating the power and enhancing the influence of those who do vote.

SPECIFICITY ON PRUDENCE AND LOYALTY REQUIREMENTS IS UNNECESSARY

Prior guidance on proxy voting has emphasized, rightly, that proxy voting is subject to the duties of loyalty and prudence. However, the proposal, namely paragraphs (e)(2)(ii)(A), (B), (C), (D), (E) and (F), would add striking specificity to these prudence and loyalty principles, which Congress intended to be flexible and dependent on the facts and circumstances.

In this regard, DOL has provided no evidence that prior guidance has truly led to confusion or that fiduciaries are routinely failing to meet their obligations of prudence and loyalty. DOL states, without any evidence, that "sub-regulatory guidance that DOL

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[4] See Commission Guidance Regarding Proxy Voting Responsibilities of Investment Advisers, 84 FR 47420 (Sept. 10, 2019); SEC Release No. 34-89372 (July 22, 2020), Exemptions from the Proxy Rules for Proxy Voting Advice; SEC Release No. IA-5547 (July 22, 2020), Supplement to Commission Guidance Regarding Proxy Voting Responsibilities of Investment Advisers.

[5] See 84 Fed. Reg. at 47426.

[6] 85 Fed. Reg. at 55229.

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." DOL then concludes that the proposal "could increase the investment return on plan assets by specifying when plan fiduciaries should or should not exercise their shareholder rights to vote proxies."

As stated earlier, we appreciate confirmation that ERISA does not require fiduciaries to discharge voting or other shareholder rights in every instance. But Council members, which include both large plan sponsors who routinely engage investment managers to manage plan assets and vote proxies, as well as the investment managers themselves, report no confusion about when they should or should not vote proxies. Nor have our members told us they are expending *unnecessary* costs or resources based on current guidance. There are costs incurred, of course, in prudently managing plan assets, but we do not see any reason to believe those costs will be reduced by the proposal.

Most plan assets are managed by large professional asset managers that have sophisticated proxy voting committees. These proxy voting committees both utilize the services of proxy advice firms and make independent judgments for all of their clients, including ERISA plans. Our plan sponsor members are not confused about their responsibility to oversee their investment managers with respect to proxy voting. In fact, our members told us that the only thing the proposal will do is require them to review, and possibly renegotiate, every investment management agreement that they have entered into. It will also require additional documentation and review with respect to their investment managers and introduce additional obligations in monitoring investment managers over time. This work will invariably be an unnecessary cost burden to plan sponsors and/or plan participants.

The only data DOL cites to justify the need for this regulation has nothing to do with confusion about the duty to vote proxies, but rather the increase in shareholder proposals. DOL states that it "is likely that many of these proposals have little bearing on share value or other relation to plan interests." DOL, however, cites no evidence that ERISA plan fiduciaries are voting proxies in anything other than the interests of the plan and its participants.

We affirm the notion that plan fiduciaries should vote proxies solely in the interest of the plan and its participants. But the proposal, with its detailed requirements to "demonstrate the basis for particular proxy votes and exercise of shareholder rights," will create costly record keeping requirements for our members.

DOL seeks comments on whether the proposal would be regulatory or deregulatory. Because of the significant burden this proposal will impose on plan fiduciaries and investment managers, unless it is significantly simplified, *the proposal is clearly regulatory, **not** deregulatory*.

MANDATE TO REVIEW PROXY VOTING POLICIES EVERY TWO YEARS UNNECESSARY

Under the proposal, any proxy voting policies adopted by plan fiduciaries must be reviewed at least once every two years. This requirement is overly prescriptive and unnecessary.

In the preamble, DOL states its belief that the two-year rule "is an appropriate limit to ensure a plan's proxy voting policies remain prudent given ongoing changes in financial markets and the investment world." DOL alleges that "this provision is consistent with industry practices regarding periodic review and approval of investment policy statements." But in support of this statement, DOL cites to no evidence of this "industry practice" and points solely to regulations adopted by the Pension Benefit Guaranty Corporation (PBGC) involving the review of the PBGC's own *investment policy statement* (which of course governs many more issues than proxy voting).[7]

Plan fiduciaries, whether plan sponsors or investment managers, adopt many policies and procedures that govern their conduct. Fiduciary plan committees commonly have an investment policy statement and they may have a committee charter or governance document. More generally, plan fiduciaries must periodically monitor a variety of fiduciary and nonfiduciary service providers. Nothing in ERISA requires that a fiduciary operate under any sort of arbitrary timing requirement with respect to its monitoring duties. Rather, ERISA requires that the fiduciary adapt to "the circumstances then prevailing." In fact, large investment managers may review their proxy voting policies more regularly than every two years. But there will be circumstances where the proxy voting policies simply do not need to be reviewed this frequently, consistent with ERISA's prudence requirements.

Further, we are concerned that this regulation could be interpreted by plan fiduciaries as a requirement to review *all* the plan's policies and procedures every two years. To the extent this occurs, DOL has vastly underestimated the costs of this proposal.

We recommend that the proposed regulation be revised to simply require that any proxy voting policies should be periodically reviewed. The rule should allow fiduciaries

[7] See Footnote 64 of the proposed regulation.

to determine the appropriate periodicity of such review, taking into account all of the factors relating to the established practices of the plan.

THE PROPOSAL IMPOSES ADDITIONAL COSTS ON ERISA PLANS

As noted earlier, the vast majority of ERISA plan assets are managed by large, sophisticated investment firms. These investment management firms manage assets for a variety of clients, both ERISA and non-ERISA. Further, these firms generally adopt policies and procedures with respect to exercising shareholder rights that do not depend on whether the plan is an ERISA plan. After all, if the investment manager believes a particular vote will have a positive impact on the client's economic interest, there is no reason to treat ERISA plans differently.

This is not to suggest that investment managers should not be cognizant of their ERISA duties when they manage plan assets. And the Council's plan sponsor members require in their investment management agreements that the investment manager meet ERISA's requirements, including the duty to vote proxies consistent with the duty of loyalty. Provided that the investment manager is acting solely in the client's interest, it would be exceedingly rare for an investment manager to need to vote a proxy differently (or not vote at all) with respect to an ERISA plan. For this reason, we understand that plans are generally not charged a fee or premium for the service of voting proxies simply because the plan is an ERISA plan.

Thus, to the extent that the proposal requires additional procedures for ERISA plans that are not required under SEC rules, the proposal will result in new costs that will need to be passed to the plan. One example of this difference we noted earlier: The proposal requires a binary decision as to whether to vote proxies and *prohibits* voting unless the fiduciary has prudently determined that doing so will have an economic impact on the plan's investment. This means that, even when the marginal cost of voting the shares of ERISA plans is *de minimis*, there will be circumstances where the investment manager must distinguish ERISA plans.

Despite efforts by DOL to provide some tools to mitigate costs, there remain hidden costs in the proposal that are not accounted for by DOL. As another example, the DOL proposal requires the plan sponsor to require the investment manager or proxy advisory firm to document the rationale for proxy voting decisions or recommendations sufficient to demonstrate that they are based on the economic benefit to the plan and solely in the interests of participants in obtaining financial benefits under the plan. This new requirement will require investment management agreements to be revised and will require periodic reporting that does not apply to other clients – actions that will likely lead to increased fees. In contrast, the SEC's rules simply require documentation of the adequacy of policies and procedures.

In this regard, we believe that plan sponsors and investment managers would benefit from more specificity and/or examples of the types of documents or documentation that DOL contemplates in referring to "records that demonstrate the basis for particular proxy votes and exercises of shareholder rights."

Of course, fiduciaries are required to discharge their duties in all aspects of investment management in a prudent way. This means expending time and resources to develop and apply processes and standards for the discharge of their duties that are reasonable under the circumstances, including the exercise of shareholder rights. Clearly, some cost is necessary. And to the extent that increased costs result from fiduciaries providing increased oversight in response to meeting ERISA's fundamental prudence and loyalty standards, which we agree are core to our system, we acknowledge and accept that cost.

However, we would note that the DOL estimate of costs focuses largely on the costs for those entities that actually vote proxies. But for the Council's plan sponsor members, this proposal would require them to review, and likely renegotiate, their agreements with investment managers (and then monitor compliance with any new requirements over time), costs DOL did not consider, likely leading to additional fees for the services. DOL suggests that the cost for large plan sponsors is nonexistent[8] and that the total cost for a small plan will be $94.68.[9] We disagree.

We would draw the DOL attention in particular to the proposal's burden on small plan sponsors. Most small plan sponsors must pay an adviser for the creation of an investment policy statement. The proposal would essentially require the creation and adoption of another document, which the small plan sponsor must pay for, and the charge will be much more than $94.68. We ask DOL to be cognizant of the need to reduce, not increase, the cost of plan establishment and maintenance by small employers.

Finally, we question the DOL assumption that there is "cost savings" because of the provisions in the rule that allow the adoption of proxy voting policies. Proxy voting policies already largely exist; the DOL proposal would impose additional costs because they will all need to be reviewed, both on an initial basis and on an ongoing basis due to the new requirement to review them every two years.

[8] The economic analysis states: "DOL 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." 85 Fed. Reg. at 55237. We agree, which is why we believe the additional burdens of this proposal are unnecessary.

[9] 85 Fed. Reg. at 55237.

CLARIFICATIONS REGARDING SCOPE (PASS-THROUGH VOTING, MUTUAL FUNDS, TIMEFRAME)

We have a few comments regarding the scope of the proposal.

Mutual Funds

The proposed regulation applies to "plan assets that are shares of stock." Much of the preamble suggests that DOL intends the proposal to apply to the shares of operating companies. But regulated investment companies (also called mutual funds) also issue shares and they will occasionally seek the vote of shareholders, such as for changes in fund policies. As we would have expected, DOL confirmed that managers of mutual funds are not affected by the rule because they are not considered fiduciaries under the plan asset rules. However, it is not clear if the proposal would apply to plan fiduciaries in the exercise of shareholder rights with respect to the mutual fund itself, in those cases where the fund seeks a vote of its shareholders. The regulatory impact statement states that the 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," and also states that "[p]lans that hold their assets in registered investment companies, such as mutual funds, will be unaffected by the proposed rule." We would ask DOL to clarify the extent to which the proposal applies to proxy voting shares of mutual funds.

Pass-Through Voting

Many defined contribution plan documents provide that the plan will pass through voting rights to participants. This is particularly common for employer securities and brokerage windows, but plans may also pass through voting rights for other plan investments, such as mutual funds. We believe that the proposal would not apply in that case. The decision to pass through voting to participants is a settlor decision and plan participants are not considered to be fiduciaries when exercising such rights.[10] Please confirm that the proposal does not apply to plans that pass through voting rights to participants.

Timeframe for Consideration

As with the ESG proposal, this proxy voting proposal requires the plan fiduciary to focus on the economic interest of the plan. We would ask DOL to confirm that the fiduciary may take into consideration the long-term nature of the plans' investment horizon. For example, although some proxy votes may not have an impact immediately, the plan fiduciary may have prudently determined that consistently voting for

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[10] *See* ERISA Section 404(c)(1)(A)(i).

particular shareholder proposals will have a long-term positive impact on the plans' investments. As one such example, for a long-term challenge such as climate change, companies need to begin putting policies and procedures in place now, as well as hiring appropriate talent to help enact those policies, in order for a company's business model to become more resilient to the changes that will take place in the coming decades. Proxy voting can and should reflect the fiduciary's considered judgment regarding long-term investment challenges and opportunities.

THE PROPOSED EFFECTIVE DATE IS TOO SOON

DOL is proposing to make the new rules effective 30 days after publication of the final rule. As we have detailed in our letter, we believe that this proposal is not simply a restatement of prior DOL guidance. To the contrary, it will likely require revisiting investment management agreements (IMAs), in addition to significant changes to the procedures of investment managers. It would be impossible for most plan sponsors, who work with internal and external counsel, to come up with new language for an IMA, have the IMA approved by the appropriate committee and then have the IMA executed by the investment managers, all within 30 days.

We would also point out that DOL is proposing to make subtle, but important, changes to the rules for investment managers of pooled investment vehicles, compared to Interpretative Bulletin 08-02. For example, under the proposal, the manager of a pooled vehicle would be required in some instances not to vote proxies in proportion to a plan's economic interest in the pooled investment vehicle. To the extent that the investment manager, in order to protect all of its clients, decides to adopt a revised investment policy statement that it will require participating plans to accept, the process of drafting that policy and obtaining consent from investing plans cannot be accomplished in 30 days.

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While we have expressed concern about the prescriptive nature of the proposed rule, we want to emphasize again that we do not object to DOL reiterating the duties of prudence and loyalty. We also do not object to DOL providing reasonable guidance for fiduciaries with respect to processes and procedures, or to the DOL goal of ensuring that fiduciaries are aware of and monitor proxy advisory firms and their possible conflicts.

We also support the use of a notice-and-comment process to address these issues, but we caution that DOL should take adequate time to consider comments and not rush to finalize the regulation on an artificial schedule.

Sincerely,

Jan Jacobson
Senior Counsel, Retirement Policy