



## Management Alert

# Department of Labor Issues Additional Guidance on Investing Benefit Plan Assets

The U.S. Department of Labor (DOL) recently issued two new Interpretive Bulletins relating to certain fiduciary implications of investments by employee benefit plans, the first having to do with economically targeted investments and the second relating to the exercise of shareholder rights. Investment committees and other fiduciaries responsible for plan investments may be personally liable for any losses incurred as a result of a breach of fiduciary duty, and should review their investment policies and investment advisory agreements, as applicable, to insure that they comply with the DOL guidelines.

### Economically Targeted Investments

Interpretive Bulletin (IB) §2509.08-1 reiterates the DOL's previously published guidance that fiduciaries may never subordinate the economic interests of the plan to unrelated objectives when making investment decisions. Other factors, such as the desire to favor or avoid investments in a certain geographic area (e.g., policies that prohibit investments in Sudan or Iran), or to favor investments in companies that support a particular public policy, may only be considered if two or more potential investments are of "equal economic value to a plan," taking into account those facts and circumstances that the fiduciary knows (or should know) are relevant.

The DOL restates its view that relevant facts and circumstances include risk/return characteristics of the investment, as well as the role the investment would play in the portion of the plan's aggregate investment portfolio that is within the scope of the fiduciary's responsibility in terms of liquidity and diversification. The DOL further suggests that a fiduciary who relies on non-economic factors should maintain written records demonstrating its quantitative and qualitative analyses in order to be able to prove that the alternatives were of equal value.

Although the Interpretive Bulletin does not directly address the sale of investments based upon non-economic factors, a plan's policy of divesting itself of the stock of companies based upon the companies' social policies may also violate the fiduciary requirements of ERISA.

It should be noted that the Interpretive Bulletin neither acknowledges nor addresses the sense of Congress resolution passed last year as part of the Sudan Accountability and Divestment Act. That resolution stated that policies prohibiting investments in Sudan or requiring divestiture of such investments should not be considered to be a violation of a fiduciary's duties under ERISA. Nonetheless, that Act did not amend ERISA or direct the DOL to issue regulations in this regard.

## Exercise of Shareholder Rights

IB §2509.08-2, relating to the exercise of shareholder rights, reaffirms the DOL's position on proxy voting and goes much farther, discussing statements of investment policy, shareholder activism and socially-directed policies and proxy voting.

### *Proxy Voting*

**Responsible Fiduciary.** IB §2509.08-2 reiterates that proxy voting is a fiduciary obligation that is generally appurtenant to the management of the underlying stock, unless the named fiduciary who appoints the investment manager reserves to itself or another named fiduciary the authority to make voting decisions. Moreover, the DOL states that if the investment management agreement provides that the manager is not required to vote proxies, but does not expressly preclude the manager from doing so, the manager still has the exclusive responsibility. In order to avoid misunderstandings, the investment management agreement should specifically state whether the manager has the authority to make voting decisions and any limitations on that authority.

The Interactive Bulletin further states that an investment manager would not be relieved of its fiduciary responsibilities by following directions of some other person or by delegating the responsibility. Thus, a manager who relies exclusively on a proxy voting service will still be responsible for the voting decisions.

**Basis for Voting Decisions.** Consistent with IB §2509.08-1 discussed above, the DOL states that only those factors that relate to the economic value of the plan's investment may be taken into account. In this regard, the DOL affirmatively states that if the fiduciary reasonably determines that the cost of voting—including the cost of research, expenditures related to proxy voting services, the analysis of the likely net effect of a particular issue on the economic value of the investment, etc.—outweighs the economic benefit of voting, or if the exercise of voting rights will produce a negative impact (such as the imposition of unwarranted trading restrictions), then the fiduciary should not vote. While this clarification is useful, in particular with respect to foreign securities, the DOL further states, however, that in deciding whether to purchase shares of a foreign corporation, *the fiduciary should consider whether any additional difficulty and expense in voting such shares is reflected in the market price.*

### *Statements of Investment Policy*

**Policy Contents and Proxy Voting Guidelines.** The DOL reaffirms its position that maintenance of a statement of investment policy is consistent with the fiduciary obligations set forth in ERISA, and further states that a statement of proxy voting policy would be an "important part of any comprehensive statement of investment policy." It would be inappropriate for the proxy voting policy to subordinate the economic interests of the plan to unrelated objectives (such as voting "green").

**Policy Statements and Investment Managers.** The DOL goes on to assert that if the named fiduciary, in appointing an investment manager, requires the manager to comply with the terms of the investment policy and the policy sets forth proxy voting guidelines, then the guidelines and policy become a part of the "documents and instruments governing the plan" and the manager would be obligated to comply unless it was not prudent to do so. Having said that, the DOL acknowledges that a manager of a pooled investment vehicle could encounter a conflict in the event that the various plan investors had guidelines that differed from the pooled investment vehicles' guidelines. With respect to proxy voting, the DOL states that, if the manager concludes that each plan's voting policies are consistent with ERISA, then the manager would generally be

required to vote the proxies in proportion to each plan's interest in the pooled vehicle. Recognizing that this may not be practical or desirable, the DOL agrees that a pooled vehicle manager could require the participating investors to accept the managers' investment policy statement, including proxy voting guidelines, as a condition to investing.

### *Shareholder Activism*

Consistent with its statement regarding economically targeted investments and proxy voting, the DOL states that shareholder activism is only appropriate if it will enhance the economic value of the plan's investment, taking into account the costs involved. The DOL acknowledges that it could be appropriate in certain circumstances, such as where the investment is held for the long-term, where a plan may not be able to easily dispose of the investment, or where a particular issue is reasonably likely to affect the economic value of the investment.

### *Socially-Directed Policies And Proxy Voting*

The DOL strongly states that a plan fiduciary risks violating ERISA's exclusive purpose rule if it exercises its fiduciary authority in an attempt to further legislative, regulatory or public policy issues through the proxy process. Use of pension plan assets to further policy or political issues through proxy resolutions that have no connection to enhancing economic value of the investment violate the prudence and the exclusive purpose requirements.

These rules apply only to plans that are subject to ERISA. Qualified plans, such as owner-only Keogh plans, that are not subject to ERISA, IRA's, governmental plans and certain church plans are not subject to these rules; however, they are subject to general fiduciary rules and the DOL's views are often looked to by way of analogy.

*If you have any questions about these Interpretive Bulletins, or any other employee benefit plan investment matter, please contact your Seyfarth Shaw attorney or any attorney on our website ([www.seyfarth.com](http://www.seyfarth.com)).*



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