

October 17, 2008

DOL Revises ERISA Interpretive Statements on Shareholder Rights and Economically Targeted Investments

On October 17, 2008, the U.S. Department of Labor published in the Federal Register interpretive bulletins updating and modifying its prior bulletins on the exercise of shareholder rights, including proxy voting, and on economically targeted investments by ERISA-governed employee benefit plans. The new bulletins in part incorporate into these formal interpretive statements the positions taken by DOL in advisory opinions issued to the U.S. Chamber of Commerce in 2007 and 2008. The prior bulletins – Interpretive Bulletins 94-1 and 94-2 – are superseded, effective immediately.

Shareholder Rights

New [Interpretive Bulletin §2509.08-2](#) appears to retain DOL's prior statement on the following topics:

- **Proxy voting.** DOL continues to take the view that proxy voting is integral to the fiduciary act of managing plan assets, and can only be exercised by (i) the plan trustee, (ii) a named fiduciary through instruction of the plan trustee, or (iii) the investment manager to which investment authority of the relevant asset has been delegated. The voting of proxies must be based solely on factors relating to the economic value of the investment and may not consider, e.g., the fiduciary's relationship with the plan sponsor. Named fiduciaries are obliged to monitor periodically the proxy voting decisions of the plan's investment managers, and for that purpose managers should maintain written records of its voting procedures, the actions taken in individual proxy voting situations, and, where appropriate, cost-benefit analyses of any situation where the manager refrained from voting on a determination that the cost of voting (including the cost of research) likely exceeded the expected economic benefits of voting.
- **Statements of investment policy.** DOL remains of the view that a proxy voting policy is an important part of a comprehensive statement of investment policy, and that the appointment of investment managers may be conditioned on acceptance of that policy, with which the manager would be obligated under ERISA to comply.

In the case of pooled funds where the proxy voting policies of investing plans are inconsistent, the manager is obliged to (i) disregard any policy that would contravene the prudence, exclusive benefit or other fiduciary standards of ERISA, and (ii) otherwise, to proportionally vote the proxies to the extent permitted. The pooled fund manager may also require acceptance of its own investment policy statement as to plan assets invested in the fund, to avoid such potential conflicts.

DOL revised its prior bulletin by modifying its statement on shareholder activism generally, and adding a discussion of socially directed proxy voting, investment policies and shareholder activism:

- **Shareholder activism.** DOL added to its guidance in its 1994 bulletin – that ERISA allows an investment policy to contemplate shareholder activism that, net of its costs, enhances the economic value of long-term or illiquid investments or in other appropriate circumstances, with a

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recitation of potentially appropriate issues – a statement that a fiduciary may not use the investment policy to “promote myriad policy preferences.”

- **Socially directed exercise of shareholder rights.** DOL stated that the use of plan assets by fiduciaries to further legislative, regulatory or public policy issues through the proxy resolutions or otherwise through the proxy process, unrelated to the enhancement of the economic value of the plan’s investment, would be an ERISA violation. DOL further cautioned that, because of the potential for abuse, fiduciaries should articulate in advance, and be prepared to demonstrate in enforcement actions, a clear basis for concluding that such activities are “more likely than not to enhance the economic value of the plan’s investment” No legal authority is offered for this “more likely than not” standard.

Economically Targeted Investments

New [Interpretive Bulletin §2509.08-1](#) significantly elaborates DOL’s prior bulletin on this issue. The guidance was revised to further emphasize DOL’s position that “fiduciaries may never subordinate the economic interests of the plan to unrelated objectives, and may not select investments on the basis of any factor outside the economic interest of the plan except in very limited circumstances” Those circumstances occur, according to DOL, when the responsible fiduciary has determined that two investment opportunities are “truly equal, taking into account a quantitative and qualitative analysis of the economic impact on the plan” with regard to, e.g., investment risk/return and portfolio diversification/liquidity; in that case, and only in that case, DOL believes that ERISA does not itself specifically provide a basis for making the investment choice and that fiduciaries can choose between the investment alternatives on a basis other than the economic interest of the plan. DOL added the following examples to illustrate its views:

- A plan may not replace an existing interest in a limited partnership that proposes to invest in a competitor of the plan sponsor unless the fiduciaries prudently determine that a replacement investment is economically equal or superior to the limited partnership interest and would not adversely affect the plan’s investment portfolio.
- A multiemployer plan covering employees in the construction industry that has appropriately invested in construction loans in the local community may not make a new, otherwise prudent loan, to further foster job creation, if the new loan would create a lack of diversification in the plan’s portfolio and thus would not be of equal economic value to the plan as other alternative investments.
- A plan may not invest in a local affordable housing bond that does not match the plan’s projected liquidity needs as well as otherwise available investments and does not provide incremental return sufficient to offset that incremental risk.
- A plan may not adopt an investment policy that favors only “green” companies; the fiduciaries must consider all investments that meet the plan’s “prudent financial criteria” and may eliminate investments in companies that are not “green” only if the “green” alternatives are economically equal or superior and would play the same role in the investment portfolio.
- A collective investment fund with a strategy of investing in commercial real estate constructed or renovated with union labor may give effect to the union labor criterion only after a determination (best justified if recorded in writing) that those investments are economically equal or superior to their alternatives.



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