

has already made several other loans for construction projects in the same metropolitan area, and this loan could create a risk of large losses to the plan's portfolio due to lack of diversification. The fiduciaries may not choose this investment on the basis of the local job creation factor because, due to lack of diversification, the investment is not of equal economic value to the plan.

A plan is considering an investment in a bond to finance affordable housing for people in the local community. The bond provides a return at least as favorable to the plan as other bonds with the same risk rating. However, the bond's size and lengthy duration raises a potential risk regarding the plan's ability to meet its predicted liquidity needs. Other available bonds under consideration by the plan do not pose this same risk. The return on the bond, although equal to or greater than the alternatives, would not be sufficient to offset the additional risk for the plan created by the role that this bond would play in the plan's portfolio. The plan's fiduciaries may not make this investment based on factors outside the economic interest of the plan because it is not of equal or greater economic value to other investment alternatives.

A plan sponsor adopts an investment policy that favors plan investment in companies meeting certain environmental criteria (so-called "green" companies). In carrying out the policy, the plan's fiduciaries may not simply consider investments only in green companies. They must consider all investments that meet the plan's prudent financial criteria. The fiduciaries may apply the investment policy to eliminate a company from consideration only if they appropriately determine that other available investments provide equal or better returns at the same or lower risks, and would play the same role in the plan's portfolio.

A collective investment fund, which holds assets of several plans, is designed to invest in commercial real estate constructed or renovated with union labor. Fiduciaries of plans that invest in the fund must determine that the fund's overall risk and return characteristics are as favorable, or more favorable, to the plans as other available investment alternatives that would play a similar role in their plans' portfolios. The fund's managers may select investments constructed or improved with union labor, after an economic analysis indicates that these investment options are equal or superior to their alternatives. The managers will best be able to justify their investment choice by recording their analysis in writing. However, if real estate investments that satisfy both ERISA's fiduciary requirements and the union labor criterion are unavailable, the fund managers may have to select invest-

ments without regard to the union labor criterion.

[73 FR 61735, Oct. 17, 2008]

**§ 2509.08-2 Interpretive bulletin relating to the exercise of shareholder rights and written statements of investment policy, including proxy voting policies or guidelines.**

This interpretive bulletin sets forth the Department of Labor's (the Department) interpretation of sections 402, 403 and 404 of the Employee Retirement Income Security Act of 1974 (ERISA) as those sections apply to voting of proxies on securities held in employee benefit plan investment portfolios and the maintenance of and compliance with statements of investment policy, including proxy voting policy. In addition, this interpretive bulletin provides guidance on the appropriateness under ERISA of active monitoring of corporate management by plan fiduciaries. The guidance set forth in this interpretive bulletin modifies and supersedes the guidance set forth in interpretive bulletin 94-2 (29 CFR 2509.94-2).

(1) Proxy Voting

The fiduciary act of managing plan assets that are shares of corporate stock includes the management of voting rights appurtenant to those shares of stock.<sup>1</sup> As a result, the responsibility for voting or deciding not to vote proxies lies exclusively with the plan trustee except to the extent that either (1) the trustee is subject to the direction of a named fiduciary pursuant to ERISA Sec. 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 Sec. 403(a)(2). Where the authority to manage plan assets has been delegated to an investment manager pursuant to Sec. 403(a)(2), no person other than the investment manager has authority to make voting decisions for proxies appurtenant to such plan assets except to the extent that the 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 voting of proxies. In this regard, a named fiduciary, in delegating investment management authority to an investment manager, could reserve to itself the right to direct a trustee with respect to the voting of all proxies or reserve to itself the right to direct a trustee as to the voting

<sup>1</sup>See letter from the Department of Labor to Helmut Fandl, Chairman of the Retirement Board of Avon Products, Inc., dated February 23, 1988.

of only those proxies relating to specified assets or issues.

If the plan document or investment management agreement provides that the investment manager is not required to vote proxies, but does not expressly preclude the investment manager from voting proxies, the investment manager would have exclusive responsibility for proxy voting decisions. Moreover, an investment manager would not be relieved of its own fiduciary responsibilities by following directions of some other person regarding the voting of proxies, or by delegating such responsibility to another person. If, however, the plan document or the investment management contract expressly precludes the investment manager from voting proxies, the responsibility for voting proxies would lie exclusively with the trustee. The trustee, however, consistent with the requirements of ERISA Sec. 403(a)(1), may be subject to the directions of a named fiduciary if the plan so provides.

The fiduciary duties described at ERISA Sec. 404(a)(1)(A) and (B), require that, in voting proxies, regardless of whether the vote is made pursuant to a statement of investment policy, 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. Votes shall only be cast in accordance with a plan's economic interests. 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, or if the exercise of voting results in the imposition of unwarranted trading or other restrictions, the fiduciary has an obligation to refrain from voting.<sup>2</sup> In making this determination, objectives, considerations, and economic effects unrelated to the plan's economic interests cannot be considered. The fiduciary's duties under ERISA Sec. 404(a)(1)(A) and (B) also require that the named fiduciary appointing an investment manager periodically monitor the activities of the investment manager with respect to the management of plan assets, including decisions made and actions taken by the investment manager with regard to proxy voting decisions. The named fiduciary must carry out this responsibility solely in the participants' and beneficiaries' interest in the economic value of the plan assets and without regard to the fiduciary's relationship to the plan sponsor.

It is the view of the Department that compliance with the duty to monitor necessitates proper documentation of the activi-

ties that are subject to monitoring. Thus, the investment manager or other responsible fiduciary would be required to maintain accurate records as to proxy voting decisions, including, where appropriate, cost-benefit analyses.<sup>3</sup> Moreover, if the named fiduciary is to be able to carry out its responsibilities under ERISA Sec. 404(a) in determining whether the investment manager is fulfilling its fiduciary obligations in investing plan assets in a manner that justifies the continuation of the management appointment, the proxy voting records must enable the named fiduciary to review not only the investment manager's voting procedure with respect to plan-owned stock, but also to review the actions taken in individual proxy voting situations.

The fiduciary obligations of prudence and loyalty to plan participants and beneficiaries require the responsible fiduciary to vote proxies on issues that may affect the economic value of the plan's investment. However, fiduciaries also need to take into account costs when deciding whether and how to exercise their shareholder rights, including the voting of shares. Such costs include, but are not limited to, expenditures related to developing proxy resolutions, proxy voting services and the analysis of the likely net effect of a particular issue on the economic value of the plan's investment. Fiduciaries must take all of these factors into account in determining whether the exercise of such rights (*e.g.*, the voting of a proxy), independently or in conjunction with other shareholders, is expected to have an effect on the economic value of the plan's investment that will outweigh the cost of exercising such rights. With respect to proxies appurtenant to shares of foreign corporations, a fiduciary, in deciding whether to purchase shares of a foreign corporation, should consider whether any additional difficulty and expense in voting such shares is reflected in their market price.

#### (2) Statements of Investment Policy

The maintenance by an employee benefit plan of a statement of investment policy designed to further the purposes of the plan and its funding policy is consistent with the fiduciary obligations set forth in ERISA section 404(a)(1)(A) and (B). Because the fiduciary act of managing plan assets that are shares of corporate stock includes the voting, where appropriate, of proxies appurtenant to those shares of stock, a statement of proxy voting policy would be an important part of any comprehensive statement of investment policy. For purposes of this document, the term "statement of investment

<sup>2</sup>See Advisory Opinion No. 2007-07A (December 21, 2007).

<sup>3</sup>See letter from the Department of Labor to Robert A.G. Monks, Institutional Shareholder Services, Inc., January 23, 1990.

policy” means a written statement that provides the fiduciaries who are responsible for plan investments with guidelines or general instructions concerning various types or categories of investment management decisions, which may include proxy voting decisions. A statement of investment policy is distinguished from directions as to the purchase or sale of a specific investment at a specific time or as to voting specific plan proxies.

In plans where investment management responsibility is delegated to one or more investment managers appointed by the named fiduciary pursuant to ERISA Sec. 402(c)(3), inherent in the authority to appoint an investment manager, the named fiduciary responsible for appointment of investment managers has the authority to condition the appointment on acceptance of a statement of investment policy. Thus, such a named fiduciary may expressly require, as a condition of the investment management agreement, that an investment manager comply with the terms of a statement of investment policy that sets forth guidelines concerning investments and investment courses of action that the investment manager is authorized or is not authorized to make. Such investment policy may include a policy or guidelines on the voting of proxies on shares of stock for which the investment manager is responsible. Such guidelines must be consistent with the fiduciary obligations set forth in ERISA Sec. 404(a)(1)(A) and (B) and this Interpretive Bulletin, and may not subordinate the economic interests of the plan participants to unrelated objectives. In the absence of such an express requirement to comply with an investment policy, the authority to manage the plan assets placed under the control of the investment manager would lie exclusively with the investment manager. Although a trustee may be subject to the direction of a named fiduciary pursuant to ERISA Sec. 403(a)(1), an investment manager who has authority to make investment decisions, including proxy voting decisions, would never be relieved of its fiduciary responsibility if it followed the direction as to specific investment decisions from the named fiduciary or any other person.

Statements of investment policy issued by a named fiduciary authorized to appoint investment managers would be part of the “documents and instruments governing the plan” within the meaning of ERISA Sec. 404(a)(1)(D). An investment manager to whom such investment policy applies would be required to comply with such policy, pursuant to ERISA Sec. 404(a)(1)(D) insofar as the policy directives or guidelines are consistent with titles I and IV of ERISA. Therefore, if, for example, compliance with the guidelines in a given instance would be imprudent, then the investment manager’s failure to follow the guidelines would not vio-

late ERISA Sec. 404(a)(1)(D). Moreover, ERISA Sec. 404(a)(1)(D) does not shield the investment manager from liability for imprudent actions taken in compliance with a statement of investment policy.

The plan document or trust agreement may expressly provide a statement of investment policy to guide the trustee or may authorize a named fiduciary to issue a statement of investment policy applicable to a trustee. Where a plan trustee is subject to an investment policy, the trustee’s duty to comply with such investment policy would also be analyzed under ERISA Sec. 404(a)(1)(D). Thus, the trustee would be required to comply with the statement of investment policy unless, for example, it would be imprudent to do so in a given instance.

Maintenance of a statement of investment policy by a named fiduciary does not relieve the named fiduciary of its obligations under ERISA Sec. 404(a) with respect to the appointment and monitoring of an investment manager or trustee. In this regard, the named fiduciary appointing an investment manager must periodically monitor the investment manager’s activities with respect to management of the plan assets. Moreover, compliance with ERISA Sec. 404(a)(1)(B) would require maintenance of proper documentation of the activities of the investment manager and of the named fiduciary of the plan in monitoring the activities of the investment manager. In addition, in the view of the Department, a named fiduciary’s determination of the terms of a statement of investment policy is an exercise of fiduciary responsibility and, as such, statements 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.

An investment manager of a pooled investment vehicle that holds assets of more than one employee benefit plan may be subject to a proxy voting policy of one plan that conflicts with the proxy voting policy of another plan. If the investment manager determines that compliance with one of the conflicting voting policies would violate ERISA Sec. 404(a)(1), for example, by being imprudent or not solely in the economic interest of plan participants, the investment manager would be required to ignore the policy and vote in accordance with ERISA’s obligations. If, however, the investment manager reasonably concludes that application of each plan’s voting policy is consistent with ERISA’s obligations, such as when the policies reflect different but reasonable judgments or when the plans have different economic interests, ERISA Sec. 404(a)(1)(D) would generally require the manager, to the extent permitted by applicable law, to vote the proxies in proportion to each plan’s interest in the pooled investment vehicle. An

investment manager may also require participating investors to accept the investment manager's own investment policy statement, including any statement of proxy voting policy, before they are allowed to invest, which may help to avoid such potential conflicts. As with investment policies originating from named fiduciaries, a policy initiated by an investment manager and adopted by the participating plans would be regarded as an instrument governing the participating plans, and the investment manager's compliance with such a policy would be governed by ERISA Sec. 404(a)(1)(D).

### (3) Shareholder Activism

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 where the responsible fiduciary concludes that there is a reasonable expectation that such monitoring or communication with management, by the plan alone or together with other shareholders, will enhance the economic value of the plan's investment in the corporation, after taking into account the costs involved. Such a reasonable expectation may exist in various circumstances, for example, where plan investments in corporate stock are held as long-term investments or where a plan may not be able to easily dispose such an investment. Active monitoring and communication activities would generally concern such issues as the independence and expertise of candidates for the corporation's board of directors and assuring that the board has sufficient information to carry out its responsibility to monitor management. Other issues may include such matters as consideration of the appropriateness of executive compensation, the corporation's policy regarding mergers and acquisitions, the extent of debt financing and capitalization, the nature of long-term business plans, the corporation's investment in training to develop its work force, other workplace practices and financial and non-financial measures of corporate performance that are reasonably likely to affect the economic value of the plan. Active monitoring and communication may be carried out through a variety of methods including by means of correspondence and meetings with corporate management as well as by exercising the legal rights of a shareholder. In creating an investment policy, a fiduciary shall consider only factors that relate to the economic interest of participants and their beneficiaries in plan assets, and shall not use an investment policy to promote myriad public policy preferences.<sup>4</sup>

<sup>4</sup>See Advisory Opinion No. 2008-05A (June 27, 2008) and letter from Department of Labor

(4) Socially-Directed Proxy Voting, Investment Policies and Shareholder Activism.

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 section 404(a)(1)(A) and (B). The mere fact that plans are shareholders in the corporations in which they invest does not itself provide a rationale for a fiduciary to spend plan assets to pursue, support, or oppose such proxy proposals. Because of the heightened potential for abuse in such cases, the fiduciaries must be prepared to articulate a clear basis for concluding that the proxy vote, the investment policy, or the activity intended to monitor or influence the management of the corporation is more likely than not to enhance the economic value of the plan's investment before expending plan assets.

The use of pension plan assets by plan fiduciaries to further policy or political issues through proxy resolutions that have no connection to enhancing the economic value of the plan's investment in a corporation would, in the view of the Department, violate the prudence and exclusive purpose requirements of section 404(a)(1)(A) and (B). For example, the likelihood that the adoption of a proxy resolution or proposal requiring corporate directors and officers to disclose their personal political contributions would enhance the economic value of a plan's investment in the corporation appears sufficiently remote that the expenditure of plan assets to further such a resolution or proposal clearly raises compliance issues under section 404(a)(1)(A) and (B).<sup>5</sup>

[73 FR 61732, Oct. 17, 2008]

### § 2509.75-2 Interpretive bulletin relating to prohibited transactions.

On February 6, 1975, the Department of Labor issued an interpretive bulletin, ERISA IB 75-2, with respect to whether a party in interest has engaged in a prohibited transaction with an employee benefit plan where the party in interest has engaged in a transaction with a corporation or partnership (within the meaning of section 7701 of the Internal Revenue Code of 1954) in which the plan has invested.

On November 13, 1986 the Department published a final regulation dealing with the definition of "plan assets". See § 2510.3-101 of

to Jonathan P. Hiatt, General Counsel, AFL-CIO (May 3, 2005).

<sup>5</sup>See Advisory Opinion No. 2007-07A (December 21, 2007).