

EBSA Response to Draft Report

U.S. Department of Labor

Assistant Secretary for
Employee Benefits Security Administration
Washington, D.C. 20210

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MEMORANDUM FOR: ELLIOT P. LEWIS
Assistant Inspector General for Audit

FROM: PHYLLIS C. BORZI *Phyllis C. Borzi*
Assistant Secretary for Employee Benefits Security

SUBJECT: EBSA Response to OIG Performance Audit
Draft Audit Report Number 09-11-001-12-121

Thank you for the opportunity to comment on the recommendations in your above referenced Performance Audit Report on ERISA regulation of proxy voting by employee benefit plan investors and EBSA's related enforcement activities.

The Employee Benefits Security Administration (EBSA) is responsible for the administration and enforcement of the civil and criminal provisions of Title I of the Employee Retirement Income Security Act of 1974 (ERISA) and related criminal statutes. EBSA oversees approximately 718,000 private retirement plans, 2.6 million health plans, and similar numbers of other welfare benefit plans, such as those providing life or disability insurance. The employee benefit plans under our jurisdiction hold approximately \$6.5 trillion in assets and cover approximately 150 million participants and beneficiaries.

Your audit focused on EBSA's proxy voting guidance described in Interpretive Bulletin 29 CFR 2509.08-2, and your objective was to determine whether EBSA has assurances that proxies were voted solely for the economic benefit of plan participants and beneficiaries.

The Department has long recognized the importance of the role of employee benefit plan investors in corporate governance and proxy voting. EBSA has periodically conducted enforcement studies and issued guidance on ERISA's requirements, including recently updating and reissuing an interpretative bulletin that applies ERISA's fiduciary rules to proxy voting decisions. More recently, we published a proposal to amend our regulation defining persons who become fiduciaries by reason of providing investment advice for a fee. This proposal specifies that making recommendations as to the management of securities is a fiduciary act.

The Interpretive Bulletin makes it clear that 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 and that fiduciaries must carry out their duties relating to voting proxies prudently and solely in accordance with the economic interest of the plan. Nothing in our guidance was meant to discourage fiduciaries from exercising full shareholder rights when it is in the plan's economic interest to do so. For example, plan fiduciary shareholders must vote proxies on proposals to change a company's state of incorporation because of the possible affect on shareholder rights to participate in corporate decision-making, which could, in turn, affect the value of the plan's investment. Similarly, plan fiduciaries should independently evaluate proposals regarding

executive compensation and “golden parachute” arrangements because of the reasonable expectation that such proposals will economically impact the value of the company.

Guidelines for the Department's investigators specifically include steps for reviewing a plan's proxy voting practices. Such reviews, however, have uncovered few, if any, violations. In this regard, we believe the guidance EBSA has provided over the years has become well understood.

OIG's RECOMMENDATIONS

Recommendation 1: Propose amending ERISA to give the Secretary of Labor the authority to assess monetary penalties against fiduciaries for failure to comply with proxy-voting requirements.

The Department strongly believes that ERISA should be amended to provide more effective remedies and expanded civil penalties for fiduciary breaches. Thus, while we would support expanding ERISA civil penalties for all fiduciary breaches, including proxy voting violations, we do not believe it makes sense to propose the type of narrow amendment you recommend. Based upon our enforcement experience, we do not believe proxy voting is the area most in need of expanded remedies for plans, and their participants and beneficiaries, or of more effective deterrents for fiduciary misconduct. In many contexts, plan fiduciaries can breach their obligations, cause a direct and demonstrable loss to plan participants, and yet face no potential liability for the losses under ERISA. The OIG's recommendation fails to explain why it would be appropriate to seek a remedy for proxy voting violations, while neglecting categories of violations that clearly injure plan participants, but have no remedy.

We note that ERISA § 502(l) provides for a civil penalty (1) against a fiduciary who breaches a fiduciary duty under, or commits a violation of, Part 4 of Title I of ERISA or (2) against any other person who knowingly participates in such a breach or violation. This penalty is equal to 20 percent of the amount recovered under any settlement agreed upon by the Secretary or ordered by a court to be paid in a judicial proceeding instituted by the Secretary. In general, the Secretary cannot obtain a recovery amount, in the first place, unless she can prove that a breach caused losses to the plan. In this regard, it is typically difficult to make such a showing in the context of proxy votes. . . Most often, the plan's ownership interest is insufficient to have an impact on the proxy vote. Even where that is not the case, numerous economic variables may have an impact on the short- and long-term value of stock.

Recommendation 2. Revise proxy voting requirements in 29 CFR 2509.08-2 (the Interpretative Bulletin) to require documented support for fiduciary monitoring and the economic benefit for proxy-voting decisions.

ERISA does not specifically require that every fiduciary decision or act, including proxy voting decisions, be documented. Rather, the recordkeeping requirements described in the Interpretative Bulletin are derived from the general fiduciary duties of prudence and loyalty under section 404 of ERISA. In our view, the Interpretative Bulletin takes an appropriate facts and circumstances approach as to documentation of proxy voting decisions. According to the Interpretative Bulletin, compliance with the duty to monitor necessitates proper documentation

sufficient to enable the named fiduciary to review not only the investment manager's voting procedures with respect to plan-owned stock, but also to review the actions taken in individual proxy voting situations. The Interpretive Bulletin recognizes that the extent of the documentation needed to satisfy the monitoring obligation will depend on individual circumstances, including the subject of the proxy voting and its potential economic impact on the plan's investment. For example, as to fiduciary monitoring, various types of plan documentation of its ongoing operations may be sufficient to show appropriate monitoring of proxy voting decisions. Similarly, the rationale for a manager's vote may be to follow a uniform internal policy for recurring issues, and simply to document the reasons for any vote which goes against the policy.

Under section 505 of ERISA, EBSA has the authority to prescribe regulations necessary or appropriate to carry out the provisions of Title I of ERISA. In light of our enforcement and regulatory experience with proxy voting decisions, we do not believe we have a public record at this time that would justify the administrative burden and expenses that would be imposed on plans by a more expansive recordkeeping requirement than that described in the Interpretive Bulletin. Nor do we have a basis for uniquely singling out fiduciary proxy voting activities for a special documentation rule that does not apply to other fiduciary actions.

Recommendation 3. Include fiduciary proxy vote monitoring in enforcement investigations to ensure that the economic benefit for proxy-voting decisions are appropriately documented.

EBSA currently investigates the monitoring of proxy voting decisions. EBSA conducted three proxy-voting projects between 1988 and 1996. As a result of these projects, the Department included a review of proxy voting in its investment management and ESOP investigative guides. EBSA investigations include a review of proxy voting when it is appropriate to do so. However, when such reviews have taken place, few, if any, violations relating to the voting of proxies have been uncovered. None of these cases resulted in violations with identifiable monetary damages as a result of a fiduciary's proxy voting decision. EBSA has found procedural violations in connection with proxy voting in the past, and obtained corrective action for these violations.

In addition, investigations may include a review of all monitoring of service providers by plan trustees or named fiduciaries. EBSA's current investigative procedures concerning monitoring are consistent with our statements in Recommendation 2 regarding documented support for fiduciary monitoring.

We appreciate the opportunity to provide our comments to the draft report and hope that they will be helpful to you in developing a final document.