

# U.S. Department of Labor

Office of Inspector General—Office of Audit

## EMPLOYEE BENEFITS SECURITY ADMINISTRATION



## PROXY-VOTING MAY NOT BE SOLELY FOR THE ECONOMIC BENEFIT OF RETIREMENT PLANS

Date Issued:  
Report Number:

March 31, 2011  
09-11-001-12-121

## **BRIEFLY...**

Highlights of Report Number 09-11-001-12-121, to the Assistant Secretary for Employee Benefits Security.

### **WHY READ THE REPORT**

The private retirement system in the United States involves about \$6 trillion of investments, including approximately \$2.3 trillion of corporate stock for about 120 million Americans. Owning this corporate stock includes the right to vote on corporate issues. How a plan votes on corporate issues during company stockholders meetings can affect the retirement security of plan participants and beneficiaries.

Since many retirement plans invest in corporate stock, proxy-voting is integral to the fiduciary act of managing retirement plan investments, and the plan trustee can exercise the votes itself or through (i) a named fiduciary through instruction of the plan trustee, or (ii) the investment manager to which investment authority of the relevant asset has been delegated. The Employee Benefits Administration (EBSA) requires fiduciaries to vote solely for the plan's economic interests and requires named fiduciaries periodically to monitor proxy-voting decisions made by third parties.

In 2004, the General Accountability Office (GAO) issued an audit report entitled "Pension Plans: Additional Transparency and Other Actions Needed in Connection with Proxy-voting." GAO found that ERISA presented legal challenges for bringing cases such that it was often difficult to obtain evidence that the fiduciary was influenced in his or her voting by something other than the sole interests of plan participants. Additionally, GAO found DOL had no statutory authority to impose a penalty without first assessing damages and securing a monetary recovery. In part, because of these challenges, GAO pointed out that DOL had devoted few resources to enforcing proxy-voting by plans.

### **WHY OIG CONDUCTED THE AUDIT**

We conducted the audit to determine to what extent EBSA had assurances that proxies were voted solely for the economic benefit of plan participants and beneficiaries.

### **READ THE FULL REPORT**

To view the report, including the scope, methodology, and full agency response, go to:

<http://www.oig.dol.gov/public/reports/oa/2011/09-11-001-12-121.pdf>

**March 31, 2011**

## **Proxy-voting May Not be Solely for the Economic Benefit of Retirement Plans**

### **WHAT OIG FOUND**

EBSA does not have adequate assurances that fiduciaries or third parties voted proxies solely for the economic benefit of plans. EBSA's proxy-voting requirements do not specifically require fiduciaries or investment managers to document (1) the monitoring of proxy-voting activities or (2) economic rationale for proxy-voting decisions. For the calendar year 2009, we found that fiduciaries did not document that they monitored proxy-voting decisions for 90 percent of plans we reviewed, and proxy voters were unable to provide documentation to substantiate the economic benefit of proxy-voting decisions for 2,455 of 3,194 (77 percent) proposals, representing votes on 574 million shares of stock with values totaling \$11.6 billion.

We also noted EBSA has devoted few resources to enforcing proxy-voting requirements. While EBSA did conduct three proxy-voting projects between 1988 and 1996, EBSA did not routinely review proxy-voting decisions. EBSA lacks the statutory authority to assess penalties in cases that did not result in financial losses to plans and it is difficult to attribute monetary losses to proxy-voting decisions. EBSA also stated court cases have shown that fiduciaries may not need to document the rationale for their fiduciary decisions.

Without additional transparency and enhanced enforcement activities, concerns about the fiduciary use of plan assets to support or pursue proxy proposals for personal, social, legislative, regulatory, or public policy agendas, which have no clear connection to increasing the value of investments used for the payment of benefits or plan administrative expenses, may not be properly addressed.

### **WHAT OIG RECOMMENDED**

We made three recommendations to the Assistant Secretary for the Employee Benefits Security: (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, (2) revise proxy-voting requirements in 29 CFR 2509.08-2 to require documented support for fiduciary monitoring and the economic benefit for proxy-voting decisions, and (3) include fiduciary proxy-vote monitoring in enforcement investigations to ensure that the economic benefit for proxy-voting decisions are appropriately documented.

The Assistant Secretary for Employee Benefits Security did not agree to implement our recommendations. While EBSA supported expanding ERISA civil penalties for all fiduciary breaches, it did not believe proxy-voting activities warranted specific legislative changes, specific documentation requirements, or increased enforcement activities.

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**U.S. Department of Labor**

Office of Inspector General  
Washington, D.C. 20210



March 31, 2011

**Assistant Inspector General's Report**

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Assistant Secretary for  
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U.S. Department of Labor  
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Washington, D.C. 20210

The private retirement system in the United States involves about \$6 trillion of investments, including approximately \$2.3 trillion of corporate stock for about 120 million Americans. The retirement security of plan participants can be affected by how certain issues are voted on during company stockholders meetings.

The Employee Retirement Income Security Act of 1974 (ERISA) is the primary federal law governing these retirement plan investments and private sector employee benefit plans in general. ERISA assigns the Department of Labor (DOL) primary responsibility to enforce the fiduciary provisions of ERISA Title I. DOL administers this responsibility through EBSA.

Owning corporate stock gives a shareholder the right to vote on proposals concerning corporate policies and governance. Shareholder voting is the primary means by which shareholders can influence the company's operations, its corporate governance, and activities of social responsibility that may fall outside of financial considerations. Proxy-voting allows shareholders to vote when they cannot attend a shareholder meeting.

Since many retirement plans invest in corporate stock, proxy-voting is integral to the fiduciary act of managing retirement plan investments, and can 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. EBSA requires fiduciaries to vote solely for the plan's economic interests and requires named fiduciaries periodically to monitor proxy-voting decisions made by third parties.

We conducted the audit to determine to what extent EBSA had assurances that proxies were voted solely for the economic benefit of plan participants and beneficiaries.

To accomplish our audit, we reviewed applicable EBSA policies, procedures, and enforcement actions for fiscal years 2008 through 2010. We interviewed retirement plan fiduciaries, investment managers, EBSA officials, and Securities and Exchange Commission (SEC) officials to gain an understanding of the proxy process and voting decisions. We reviewed a stratified random sample of 43 retirement plans with common stock investments.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. Our objective, scope, methodology, and criteria are detailed in Appendix B.

## **RESULTS IN BRIEF**

EBSA does not have adequate assurances that fiduciaries or third parties voted proxies solely for the economic benefit of plans. EBSA's proxy-voting requirements do not specifically require fiduciaries or investment managers to document (1) the monitoring of proxy-voting activities or (2) the economic rationale for proxy-voting decisions. For the calendar year 2009, we found that fiduciaries did not document that they monitored proxy-voting decisions for 90 percent of plans we reviewed, and proxy voters were unable to provide documentation to substantiate the economic benefit of proxy-voting decisions for 2,455 of 3,194 proposals (77 percent), representing votes on 574 million shares of stock with values totaling \$11.6 billion.

We also noted EBSA has devoted few resources to enforcing proxy-voting requirements. While EBSA did conduct three proxy-voting projects between 1988 and 1996, EBSA did not routinely review proxy vote decisions. According to EBSA, it lacks the statutory authority to assess penalties in cases that did not result in financial losses to plans as ERISA bases assessed penalties on monetary losses and it is difficult to attribute monetary losses to proxy voting decisions. EBSA also stated court cases have shown that fiduciaries may not need documentation to support their fiduciary decisions.

Without additional transparency and enhanced enforcement activities, concerns about proxy-voting that has no clear connection to increasing the value of investments may not be properly addressed.

We made three recommendations to the Assistant Secretary for Employee Benefits Security: (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, (2) revise proxy-voting requirements in 29 CFR 2509.08-2 to require documented support for fiduciary monitoring and the economic benefit for proxy-voting decisions, and (3) include fiduciary proxy-vote monitoring in enforcement investigations

to ensure that the economic benefit for proxy-voting decisions are appropriately documented.

In response, the Assistant Secretary for Employee Benefits Security stated that EBSA would support expanding ERISA civil penalties for all fiduciary breaches, including proxy voting violations, but would not support an amendment to ERISA specifically for proxy-voting. EBSA also did not believe imposing an administrative burden and expense on plans by requiring more documentation was justified. In addition, they did not feel there was a basis for uniquely singling out fiduciary proxy voting activities for a special documentation rule that does not apply to other fiduciary actions. The Assistant Secretary's entire response is contained in Appendix D.

While the extent to which the lack of authority to assess penalties extends beyond proxy-voting is beyond our audit scope, we accept EBSA's position. However, EBSA did not state what actions it was taking to resolve the issue in either proxy-voting alone or in overall ERISA enforcement. Corrective action to resolve the larger issue, including proxy-voting, would resolve the specific proxy-voting issue as well.

We do not agree that there would be an undue administrative burden on plans. The Interpretive Bulletin requires plan fiduciaries to determine the economic benefit to the plan on proxy-voting. EBSA states fiduciaries are making these determinations; we are recommending these determinations be documented. EBSA states that when a manager's rationale on a vote for recurring issues is to follow a uniform internal policy the manager would only need to document the reasons for any vote which goes against the policy. For records we reviewed related to proxy-voting issues not covered by internal policies, the rationale for proxy-voting decisions, when documented, generally included a brief explanation directly in the proxy-voting record. Such a practice shows it would take minimal time to document the rationale for proxy-voting decisions.

Furthermore, EBSA proxy-voting regulations state fiduciaries must be prepared to articulate the economic benefit of proxy-vote decisions. We find it difficult to understand how plan fiduciaries can properly monitor proxy-voting activities by accepting verbal explanations of decisions made up to a year earlier, or what can be done if persons responsible for proxy-voting are no longer available to provide verbal explanations on proxy-votes.

The OIG maintains that without additional transparency and enhanced enforcement activities, EBSA cannot have adequate assurance that fiduciaries vote proxies solely for the economic benefit of plans.

## RESULTS AND FINDING

**Objective — To what extent does EBSA have assurances that proxies were voted solely for the economic benefit of plan participants and beneficiaries?**

---

*Proxy-voting may not be solely for the economic benefit of retirement plans.*

**Finding 1 — EBSA does not have adequate assurances that proxies were voted solely for the economic benefit of retirement plans.**

EBSA does not have adequate assurances that fiduciaries or third parties voted proxies solely for the economic benefit of plans, and their proxy-voting requirements do not specifically require fiduciaries or investment managers to document (1) the monitoring of proxy-voting activities or (2) the economic rationale for proxy-voting decisions.

### **Documentation Not Required for Monitoring and Economic Benefit of Proxy-voting Decisions**

EBSA's proxy-voting requirements in 29 CFR 2509.08-2 require whoever is voting proxies (generally named fiduciaries and investment managers) to consider only those factors that relate to the economic value of the plan's investment and not subordinate the interests of the participants and beneficiaries to unrelated objectives. According to the regulations, any objectives or considerations, or social effects unrelated to the plan's economic interests cannot be considered. In addition, the named fiduciary of a plan appointing an investment manager or other party to vote proxies must periodically monitor the activities with respect to the decisions made and actions taken by the investment manager regarding proxy-voting decisions. Fiduciaries must be prepared to articulate a clear basis for concluding that a proxy-vote is more likely than not to enhance the economic value of the plan's investment.

The regulations further state that compliance with the duty to monitor necessitates proper documentation of the activities 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. However, the regulations do not specifically state the fiduciaries or investment managers must document the economic benefit in proxy-voting decisions. Neither do the regulations specifically require fiduciaries to document the monitoring of proxy-voting decisions.

However, in its 1992 proxy-voting project report, EBSA stated that votes affecting the value of the stock must be documented along with the reasons for the particular vote or abstention. In its 1996 proxy-voting project report, EBSA stated that to facilitate client plans' monitoring of proxy voting, an investment manager should maintain, and make available for client review, records regarding votes cast and the rationale for each vote. The rationale for a manager's vote may be to follow a uniform internal policy for each recurring issue, and document the reasons for any vote which goes against the policy,

or the manager if it has no internal policy as to voting uniformly on recurring issues, will document the rationale on each specific vote. However, EBSA did not include specific documentation requirements in its regulations.

According to EBSA and the Office of the Solicitor of Labor, fiduciary court cases have shown that, absent specific requirements, and depending on the facts and circumstances, fiduciaries may not have to document the rationale for their fiduciary decisions. Specifically, in *Henry v. Champlain Enterprises Inc.*, the court found that the focus was not whether a fiduciary took adequate notes during its investigation, but whether the fiduciary acted with the prudence required of a fiduciary.

As a result, fiduciaries and investment managers are not documenting the monitoring of proxy-voting activities or the economic rationale of proxy-voting decisions. Specifically, for the 2009 plan year we found that fiduciaries were unable to substantiate that they monitored proxy-voting decisions for 90 percent of sampled plans. Furthermore, we examined proxy-voting in 43 plans for calendar year 2009 and only 4 plans had evidence that they had specifically monitored the proxy-voting activities of the plan. The remaining 39 plans could not provide documented support that they had monitored proxy-voting activities.

The lack of documentation of fiduciary monitoring over proxy-voting decisions is an ongoing concern. EBSA previously identified the lack of fiduciary monitoring in its proxy-voting study in 1996. The study found that additional improvement was needed in the plans' monitoring of investment managers to ensure that proxies are voted in accordance with stated policies. According to EBSA, most plans they reviewed did not monitor proxy-voting by their investment managers; EBSA stated only about 35 percent appeared to have performed substantive monitoring of investment managers.

In addition, for 2009 we found that proxy voters did not document the economic benefit of proxy-voting decisions for 2,455 (77 percent) of 3,194 proposals representing votes on 574 million shares of stock with values totaling \$11.6 billion. The following examples illustrate where fiduciaries did not document the economic benefit of proxy-voting decisions and the economic benefit is not apparent:

- A retirement plan fiduciary voted proxies in support of a proposal to implement a policy prohibiting grossing-up wages to pay for anticipated income taxes for executives on specific benefits. The fiduciary exercised the voting rights of 3.3 million shares of Honeywell, Inc. common stock valued at \$100 million. The documented rationale by the proposal's opponents stated that the grossing-up of wages was needed to attract and retain highly qualified executives with the leadership skills and experience necessary to drive results and change across a global organization and build long-term shareowner value. In contrast, the fiduciary did not document the economic benefit to the plan of the vote to support the proposal.

- A retirement plan fiduciary voted proxies to support 101 proxy proposals to approve related-party transactions. The fiduciary exercised the voting rights of 234,950 shares of OAO Gazprom foreign stock valued at approximately \$5.9 million to approve the related-party transactions. The fiduciary did not document the perceived economic benefit of the vote to support the proposals approving related-party transactions.
- A retirement plan fiduciary voted proxies to authorize Royal Dutch Shell, a foreign company, and its subsidiaries to donate to political organizations up to GBP£200,000 (about \$320,500 U.S.) and to incur political expenditures up to GBP£200,000. The fiduciary exercised the voting rights of 2800 shares common stock valued at approximately \$140,000. The fiduciary did not document the economic benefit of the vote to support the proposals.
- A retirement plan fiduciary voted proxies in support of a proposal to implement a comprehensive human rights policy. The fiduciary exercised the voting rights of 700 shares of Nucor Corporation common stock valued at \$21,280. The voting record stated, “ISS recommends voting for the proposal due to the lack of a comprehensive human rights policy based on internationally accepted norms.”

The economic benefit in these proposals is not apparent and neither the investment managers nor fiduciaries could provide documented economic rationale for the proxy-voting decisions.

As a result, it is questionable whether the fiduciary or investment manager making the proxy-voting decision complied with EBSA requirements to consider only the economic benefits to the plan when making proxy-voting decisions. It is also questionable whether fiduciaries who allow investment managers to make proxy-voting decisions are actually performing adequate monitoring of proxy-voting.

### **Few Proxy-Voting Enforcement Resources and the Lack of Authority to Assess Penalties**

We also noted EBSA has devoted few resources to enforcing proxy-voting requirements. While EBSA did conduct three proxy-voting projects between 1988 and 1996, EBSA did not routinely review proxy vote decisions. According to EBSA, it lacks the statutory authority to assess penalties in cases that did not result in identifiable financial harm to the plan because ERISA bases assessed penalties on monetary losses and it is difficult to attribute monetary losses to proxy-voting decisions. EBSA also stated court cases have shown that fiduciaries may not need documentation to support their fiduciary decisions.

EBSA officials stated they believed that there is an overall compliance in proxy-voting activities. Furthermore, they stated that EBSA has a strategic enforcement plan, and based on this plan and its limited statutory authority and resources, they place their resources in areas that will result in identifying ERISA violations that EBSA can correct.

However, ERISA limits EBSA's enforcement authority in this area. ERISA ties enforcement actions to monetary losses and it is difficult, if not impossible, to attribute monetary losses to proxy-voting decisions. Specifically, under ERISA, EBSA assesses penalties based on monetary damages or the restoration of plan assets. This penalty is equal to 20 percent of the "applicable recovery amount," or any settlement agreed upon by the Secretary or ordered by a court to be paid.

However, the applicable recovery amount cannot be determined if damages cannot be valued. According to EBSA, it is difficult to link a single proxy vote to damages to the plan participants.

Based on these facts, if a fiduciary votes for example in favor of a human rights policy because of personal feelings, regardless of any economic impact on the plans, it is impossible to project what impact this has on the plan's investment. Therefore, enforcing the requirement to consider only the plans economic benefits is difficult at best.

Moreover, the fact that fiduciaries do not have to document the economic benefits and effects of proxy-voting decisions may further complicate proving that the fiduciary was influenced by something other than plan's economic interest. This difficulty is shown by the fact that DOL has never litigated an ERISA violation concerning a proxy-voting decision. Furthermore, EBSA has not assessed a penalty or removed a fiduciary because of a proxy-voting decision.

In comparison, the SEC can impose a penalty without first assessing and then securing monetary damages. Section 203 of the Investor Advisors Act of 1940 gives the SEC authority to assess penalties ranging from \$5,000 to \$500,000 per each act that violates any provision of the Securities Act of 1933, the Securities Exchange Act of 1934, or the Investment Company Act of 1940.

The use of this authority can be effective. For example, on May 7, 2009, the SEC issued an order imposing remedial sanctions and a cease-and-desist order to an investment management company regarding proxy-voting. The SEC found that an investment management company, after receiving complaints from some of its union-affiliated clients about pro-management proxy votes, had implemented a third-party proxy-voting service provider's guidelines that exactly followed the AFL-CIO proxy-voting recommendations. The investment management company then voted all of its clients' securities in accordance with these guidelines, regardless of whether the clients were union-affiliated. The investment management company had selected the guidelines at a time when it was participating in the annual AFL-CIO Key Votes Survey that ranked investment advisers based on their adherence to the AFL-CIO recommendations on certain votes.

In contrast, while EBSA did conduct three proxy-voting projects between 1988 and 1996, EBSA does not routinely review proxy vote decisions with the exception of ESOP

investigations. From FYs 2008 through 2009, EBSA opened 476 ESOP investigations, 17 of which included proxy-voting reviews. However, none of these investigations resulted in violations with identifiable monetary damages because of a fiduciary voting proxies.

## **Conclusion**

Without specific requirements to document monitoring and the economic rationale for proxy-voting decisions, EBSA does not have adequate assurances that proxies were voted solely for the economic benefit of plan participants and beneficiaries. Fiduciaries have hundreds of millions of proxy-voting rights representing trillions of dollars of retirement plan assets under management. Without additional transparency and enhanced enforcement activities, concerns about the fiduciary use of plan assets to support or pursue proxy proposals for personal, social, legislative, regulatory, or public policy agendas, which have no clear connection to increasing the value of investments used for the payment of benefits or plan administrative expenses, may not be properly addressed. This increases the potential risk to participants and beneficiaries who are invested in plans to accrue retirement income.

## **RECOMMENDATIONS**

We recommend that the Assistant Secretary for Employee Benefits Security Administration:

- (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;
- (2) Revise proxy-voting requirements in 29 CFR 2509.08-2 to require documented support for fiduciary monitoring and the economic benefit for proxy-voting decisions; and
- (3) Include fiduciary proxy vote monitoring in enforcement investigations to ensure that the economic benefit for proxy-voting decisions are appropriately documented.

We appreciate the cooperation and courtesies that EBSA personnel extended to the Office of Inspector General during this audit. OIG personnel who made major contributions to this report are listed in Appendix E.



Elliot P. Lewis  
Assistant Inspector General for Audit

# Appendices

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**Appendix A****Background**

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The private retirement system in the United States involves about \$6 trillion of investments, including approximately \$2.3 trillion of corporate stock for about 120 million Americans. Owning this corporate stock includes the right to vote on corporate issues. How a plan votes on corporate issues during company stockholders meetings can affect the retirement security of plan participants and beneficiaries.

The ERISA is the primary federal law governing these retirement plan investments and private sector employee benefit plans in general. ERISA assigns the Department of Labor primary responsibility to enforce the fiduciary provisions of ERISA Title I. DOL administers this responsibility through EBSA.

Owning corporate stock gives a shareholder the right to vote on proposals concerning corporate policies and governance. Shareholder voting is the primary means by which shareholders can influence the company's operations, its corporate governance, and even activities of social responsibility that may fall outside of financial considerations. Proxy-voting allows shareholders to vote when they cannot attend a shareholder meeting.

Under DOL regulations, the fiduciary act of managing plan assets that are shares of corporate stock includes the management of voting rights attached to those shares of stock. EBSA's regulations 29 CFR Part 2509.08-2 on proxy-voting requires fiduciaries to vote solely for the plan's economic interests. When deciding how to vote proxies, fiduciaries must consider only those factors that relate to the economic value of the plan's investment and cannot subordinate the economic interests of the participants and beneficiaries to unrelated objectives. Objectives, considerations, and economic effects unrelated to the plan's economic interests cannot be considered.

Furthermore, the named fiduciary appointing an investment manager must periodically monitor the activities with respect to the decisions made and actions taken by the investment manager with regard to proxy-voting decisions. 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.

In issuing the regulations, EBSA expressed strong concern regarding shareholder activism and the use of plan assets to promote particular legislative, regulatory, or public policy positions that have no connection to the payment of benefits or plan administrative expenses. The Department rejected a construction of ERISA that would permit plan fiduciaries to expend ERISA trust assets to promote myriad public policy preferences, and believes that these principles apply with equal force to a plan fiduciary's support or pursuit of a proxy proposal. Fiduciaries must be prepared to articulate a clear basis for concluding that a proxy-vote is more likely than not to enhance the economic value of the plan's investment.

In 1986 the Senate Subcommittee on Oversight of Government Management, conducted an inquiry on DOL's enforcement of ERISA. One factor that led to the inquiry was ERISA does not specify what the fiduciary responsibility is regarding proxy-voting, causing many fiduciaries to be unclear about their responsibility to vote proxies and maintain voting guidelines.

Between 1988 and 1996, EBSA conducted three proxy-voting projects and found, among other things, that additional improvement was needed in plans' monitoring of investment managers to ensure that proxies were voted in accordance with stated policies.

In 2004, the General Accountability Office issued an audit report entitled "Pension Plans: Additional Transparency and Other Actions Needed in Connection with Proxy-voting." GAO found that DOL has never found a violation that resulted in monetary damages, and as a result, it has never assessed a penalty or removed a fiduciary as a result of a proxy-voting investigation. DOL's enforcement of proxy-voting requirements has been limited for several reasons. First, participant complaints about voting conflicts are infrequent, at least in part, because votes cast by a plan fiduciary or proxy voter generally are not disclosed; therefore, participants and others are not likely to have information they need to raise questions regarding whether a vote has been cast solely in their interest. Second, for DOL, the ERISA presents legal challenges for bringing cases such that it is often difficult to obtain evidence that the fiduciary was influenced in his or her voting by something other than the sole interests of plan participants. Finally, even if such evidence existed, monetary damages are difficult to value and fines are difficult to impose. Additionally, DOL has no statutory authority to impose a penalty without first assessing damages and securing a monetary recovery. In part, because of these challenges, DOL has devoted few resources to enforcing proxy-voting by plans.

**Appendix B****Objective, Scope, Methodology, and Criteria**

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**Objective**

The objective of this audit was to determine to what extent EBSA has assurances that proxies were voted solely for the economic benefit of plan participants and beneficiaries.

**Scope**

Our scope included EBSA policies, procedures, and enforcement actions pertaining to proxy-voting activities for fiscal years 2008 and 2010. Additionally, we reviewed all prior EBSA proxy-voting studies. We obtained and reviewed fiduciaries voting records and proxy policies from selected retirement plans for the year ended December 31, 2009. We conducted fieldwork at EBSA headquarters in Washington D.C.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

**Methodology**

We interviewed retirement plan fiduciaries, officials at EBSA, the Office of the Solicitor of Labor, the SEC, and GAO to gain an understanding of the proxy-voting process, oversight, and enforcement, and related issues. We also met with representatives of business and labor to discuss their views on proxy-voting. Additionally, we reviewed all prior EBSA proxy-voting studies.

To determine whether fiduciaries were able to demonstrate an economic benefit for proxy-voting decisions, we selected and reviewed a stratified random sample of 43 out of 4,992 retirement plans with corporate common stock investments, including employer related securities, of \$20 million or greater for plan year 2007, the most complete form 5500 filing year available during our audit. The 43 sampled plans and 4,992 retirement plans had end-of-year common stock values of \$222 billion and \$2.5 trillion respectively. We reviewed supporting documentation for plan monitoring and the voting records for 3,194 corporate proposals, both management and shareholder initiated. We contacted plan fiduciaries and investment managers to determine the economic rationale for voting decisions on these proposals.

We randomly selected two investment managers per plan to review voting records and supporting documentation. For sampled plans with only one investment manager, we selected that investment manager. For each investment manager selected we reviewed all proxy proposals sponsored by shareholders. Wherever voting records did not identify shareholder proposals, we utilized internet websites and the proxy statements filed with

the SEC. In order to be more conservative and have a higher level of confidence, the results of these tests were not extrapolated to the universe.

In planning and performing our audit, we considered the Employment Benefit Security Administration's internal controls that were relevant to our audit objective. We confirmed our understanding of these controls through interviews, obtaining, and reviewing proxy studies, policies, procedures, and enforcement actions. Our consideration of internal controls relevant to our audit objective would not necessarily disclose all matters that might be significant deficiencies. Because of inherent limitations in internal controls, misstatements or noncompliance may nevertheless occur and not be detected.

To achieve the audit's objective, we relied on computer-processed data from ERISA Filing Acceptance System II (EFAST2) Form 5500 Series plan filings. We assessed the reliability of this data by (1) performing analytical tests of data elements, (2) interviewing EBSA officials knowledgeable about EFAST2 data and system controls, (3) reviewing OIG and GAO reports on EFAST2 system, and (4) tracing selected data elements to plan documents. Based on these tests and assessments, we concluded the data was sufficiently reliable to be used in meeting the audit's objective.

### **Criteria**

We used the following criteria to accomplish our audit:

- 29 CFR Part 2509.08-2- Interpretive Bulletin Relating to Exercise of Shareholder Rights
- EBSA Advisory Opinion 2007-07A
- SEC Final Rule - Proxy-voting by Investment Advisers IA-2106

**Appendix C**

**Acronyms and Abbreviations**

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DOL	Department of Labor
EBSA	Employee Benefits Security Administration
ESOP	Employee Stock Option Plan
ERISA	Employee Retirement Income Security Act of 1974
GAO	Government Accountability Office
OIG	Office of Inspector General
SEC	Securities and Exchange Commission

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## EBSA Response to Draft Report

U.S. Department of Labor

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

MAR 29 2011

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.

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**Appendix E**

**Acknowledgements**

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Key contributors to this report were Ralph McClane (Audit Director), Jason Jelen, Marisela Sookraj, Richard Donna, Steve Chiang, Naomi Byberg, Angela Stewart, Katherine Mitomi, Wilma Perez, Cassie Galang, and Mary Lou Casazza.

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