

§ 2509.94-1

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§ 2509.94-1 Interpretive bulletin relating to the fiduciary standard under ERISA in considering economically targeted investments.

This Interpretive Bulletin sets forth the Department of Labor's interpretation of sections 403 and 404 of the Employee Retirement Income Security Act of 1974 (ERISA), as applied to employee benefit plan investments in "economically targeted investments" (ETIs), that is, investments selected for the economic benefits they create apart from their investment return to the employee benefit plan. Sections 403 and 404, in part, require that a fiduciary of a plan act prudently, and to diversify plan investments so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so. In addition, these sections require that a fiduciary act solely in the interest of the plan's participants and beneficiaries and for the exclusive purpose of providing benefits to their participants and beneficiaries. The Department has construed the requirements that a fiduciary act solely in the interest of, and for the exclusive purpose of providing benefits to, participants and beneficiaries as prohibiting a fiduciary from subordinating the interests of participants and beneficiaries in their retirement income to unrelated objectives.

With regard to investing plan assets, the Department has issued a regulation, at 29 CFR 2550.404a-1, interpreting the prudence requirements of ERISA as they apply to the investment duties of fiduciaries of employee benefit plans. The regulation provides that the prudence requirements of section 404(a)(1)(B) are satisfied if (1) the fiduciary making an investment or engaging in an investment course of action has given appropriate consideration to those facts and circumstances that, given the scope of the fiduciary's investment duties, the fiduciary knows or should know are relevant, and (2) the fiduciary acts accordingly. This includes giving appropriate consideration to the role that the investment or investment course of action plays (in terms of such factors as diversification, liquidity and risk/return characteristics) with respect to that portion of the plan's investment portfolio within the scope of the fiduciary's responsibility.

Other facts and circumstances relevant to an investment or investment course of action would, in the view of the Department, include consideration of the expected return on alternative investments with similar risks available to the plan. It follows that, because every investment necessarily causes a plan to forgo other investment opportunities, an investment will not be prudent if it would be expected to provide a plan with a lower rate of return than available alternative investments with commensurate de-

grees of risk or is riskier than alternative available investments with commensurate rates of return.

The fiduciary standards applicable to ETIs are no different than the standards applicable to plan investments generally. Therefore, if the above requirements are met, the selection of an ETI, or the engaging in an investment course of action intended to result in the selection of ETIs, will not violate section 404(a)(1)(A) and (B) and the exclusive requirements of section 403.

[59 FR 32607, June 23, 1994]

§ 2509.94-2 Interpretive bulletin relating to written statements of investment policy, including proxy voting policy 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.

(1) PROXY VOTING

The fiduciary act of managing plan assets that are shares of corporate stock includes the voting of proxies appurtenant to those shares of stock. As a result, the responsibility for voting proxies lies exclusively with the plan trustee except to the extent that either (1) the trustee is subject to the directions of a named fiduciary pursuant to ERISA § 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 § 403(a)(2). Where the authority to manage plan assets has been delegated to an investment manager pursuant to § 403(a)(2), no person other than the investment manager has authority to vote 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 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 voting proxies. 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 § 403(a)(1), may be subject to the directions of a named fiduciary if the plan so provides.

The fiduciary duties described at ERISA § 404(a)(1)(A) and (B), require that, in voting proxies, the responsible fiduciary consider those factors that may affect the value of the plan's investment and not subordinate the interests of the participants and beneficiaries in their retirement income to unrelated objectives. These duties 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 interest of the participants and beneficiaries and without regard to its relationship to the plan sponsor.

It is the view of the Department 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. Moreover, if the named fiduciary is to be able to carry out its responsibilities under ERISA § 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 value of the plan's investment. Although the same principles apply for proxies appurtenant to shares of foreign corporations, the Department recognizes that in voting such

proxies, plans may, in some cases, incur additional costs. Thus, a fiduciary should consider whether the plan's vote, either by itself or together with the votes of other shareholders, is expected to have an effect on the value of the plan's investment that will outweigh the cost of voting. Moreover, a fiduciary, in deciding whether to purchase shares of a foreign corporation, should consider whether the difficulty and expense in voting the 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). Since the fiduciary act of managing plan assets that are shares of corporate stock includes the voting 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 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 § 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 which sets forth guidelines concerning investments and investment courses of action which 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. 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 directions of a named fiduciary pursuant to ERISA

§ 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 directions 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 § 404(a)(1)(D). An investment manager to whom such investment policy applies would be required to comply with such policy, pursuant to ERISA § 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 violate ERISA § 404(a)(1)(D). Moreover, ERISA § 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 § 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 § 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 § 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. Compliance with ERISA § 404(a)(1)(D) would require such investment manager to reconcile, insofar as possible, the conflicting policies (assuming compliance with each policy would be consistent with ERISA § 404(a)(1)(D)) and, if necessary and to the extent permitted by applicable law, vote the relevant proxies to reflect such policies in proportion to each plan’s interest in the pooled investment vehicle. If, however, the investment manager determines that compliance with conflicting voting policies would violate ERISA § 404(a)(1)(D) in a particular instance, for example, by being imprudent or not solely in the interest of plan participants, the investment manager would be required to ignore the voting policy that would violate ERISA § 404(a)(1)(D) in that instance. Such an investment manager may, however, 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. 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 § 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, is likely to enhance the 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. 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.

[59 FR 38863, July 29, 1994]

§ 2509.94-3 Interpretive bulletin relating to in-kind contributions to employee benefit plans.

(a) *General.* This bulletin sets forth the views of the Department of Labor (the Department) concerning in-kind contributions (i.e., contributions of property other than cash) in satisfaction of an obligation to contribute to an employee benefit plan to which part 4 of title I of the Employee Retirement Income Security Act of 1974 (ERISA) or a plan to which section 4975 of the Internal Revenue Code (the Code) applies. (For purposes of this document the term “plan” shall refer to either or both types of such entities as appropriate). Section 406(a)(1)(A) of ERISA provides that a fiduciary with respect to a plan shall not cause the plan to engage in a transaction if the fiduciary knows or should know that the transaction constitutes a direct or indirect sale or exchange of any property between a plan and a “party in interest” as defined in section 3(14) of ERISA. The Code imposes a two-tier excise tax under section 4975(c)(1)(A) on any direct or indirect sale or exchange of any property between a plan and a “disqualified person” as defined in section 4975(e)(2) of the Code. An employer or employee organization that maintains a plan is included within the definitions of “party in interest” and “disqualified person.”¹

In *Commissioner of Internal Revenue v. Keystone Consolidated Industries, Inc.*, ___ U.S. ___, 113 S. Ct. 2006 (1993), the Supreme Court held that an employer’s contribution of unencumbered real property to a tax-qualified defined benefit pension plan was a sale or exchange prohibited under section 4975 of the Code where the stated fair market value of the property was credited against the employer’s obligation to the defined benefit

pension plan. The parties stipulated that the property was contributed to the plan free of encumbrances and the stated fair market value of the property was not challenged. 113 S. Ct. at 2009. In reaching its holding the Court construed section 4975(f)(3) of the Code (and therefore section 406(c) of ERISA), regarding transfers of encumbered property, not as a limitation but rather as extending the reach of section 4975(c)(1)(A) of the Code (and thus section 406(a)(1)(A) of ERISA) to include contributions of encumbered property that do not satisfy funding obligations. *Id.* at 2013. Accordingly, the Court concluded that the contribution of unencumbered property was prohibited under section 4975(c)(1)(A) of the Code (and thus section 406(a)(1)(A) of ERISA) as “at least both an indirect type of sale and a form of exchange, since the property is exchanged for diminution of the employer’s funding obligation.” 113 S. Ct. at 2012.

(b) *Defined benefit plans.* Consistent with the reasoning of the Supreme Court in *Keystone*, because an employer’s or plan sponsor’s in-kind contribution to a defined benefit pension plan is credited to the plan’s funding standard account it would constitute a transfer to reduce an obligation of the sponsor or employer to the plan. Therefore, in the absence of an applicable exemption, such a contribution would be prohibited under section 406(a)(1)(A) of ERISA and section 4975(c)(1)(A) of the Code. Such an in-kind contribution would constitute a prohibited transaction even if the value of the contribution is in excess of the sponsor’s or employer’s funding obligation for the plan year in which the contribution is made and thus is not used to reduce the plan’s accumulated funding deficiency for that plan year because the contribution would result in a credit against funding obligations which might arise in the future.

(c) *Defined contribution and welfare plans.* In the context of defined contribution pension plans and welfare plans, it is the view of the Department that an in-kind contribution to a plan that reduces an obligation of a plan sponsor or employer to make a contribution measured in terms of cash amounts would constitute a prohibited transaction under section 406(a)(1)(A) of ERISA (and section 4975(c)(1)(A) of the Code) unless a statutory or administrative exemption under section 408 of ERISA (or sections 4975(c)(2) or (d) of the Code) applies. For example, if a profit sharing plan required the employer to make annual contributions “in cash or in kind” equal to a given percentage of the employer’s net profits for the year, an in-kind contribution used to reduce this obligation would constitute a prohibited transaction in the absence of an exemption because the amount of the contribution obligation is measured in

¹Under Reorganization Plan No. 4 of 1978 (43 FR 47713, October 17, 1978), the authority of the Secretary of the Treasury to issue rulings under the prohibited transactions provisions of section 4975 of the Code has been transferred, with certain exceptions not here relevant, to the Secretary of Labor. Except with respect to the types of plans covered, the prohibited transaction provisions of section 406 of ERISA generally parallel the prohibited transaction of provisions of section 4975 of the Code.