

GAO

Report to the Ranking Minority  
Member, Committee on Health,  
Education, Labor, and Pensions,  
U.S. Senate

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August 2004

# PENSION PLANS

## Additional Transparency and Other Actions Needed in Connection with Proxy Voting





Highlights of [GAO-04-749](#), a report to the Ranking Minority Member, Committee on Health, Education, Labor, and Pensions, United States Senate

## Why GAO Did This Study

In 1998, about 100 million Americans were covered in private pension plans with assets totaling about \$4 trillion. The retirement security of plan participants can be affected by how certain issues are voted on during company stockholders meetings. Fiduciaries, having responsibility for voting on such issues on behalf of some plan participants (proxy voting), are to act solely in the interest of participants. Recent corporate scandals reveal that fiduciaries can be faced with conflicts of interest that could lead them to breach this duty. Because of the potential adverse effects such a breach may have on retirement plan assets, we were asked to describe (1) conflicts of interest in the proxy voting system, (2) actions taken to manage them, and (3) DOL's enforcement of proxy voting requirements.

## What GAO Recommends

GAO recommends that Congress consider amending ERISA to require fiduciaries to (1) develop proxy-voting guidelines, (2) disclose guidelines and votes annually, and (3) appoint an independent fiduciary to vote the company's own stock in its pension plan in certain instances. GAO recommends that DOL conduct another proxy enforcement study, and enhance coordination of enforcement strategies with SEC. DOL generally disagreed with our recommendations, but we believe that additional transparency and enhanced enforcement are needed.

[www.gao.gov/cgi-bin/getrpt?GAO-04-749](http://www.gao.gov/cgi-bin/getrpt?GAO-04-749).

To view the full product, including the scope and methodology, click on the link above. For more information, contact Barbara Bovbjerg at (202) 512-7215 or [bovbjergb@gao.gov](mailto:bovbjergb@gao.gov).

## PENSION PLANS

# Additional Transparency and Other Actions Needed in Connection with Proxy Voting

## What GAO Found

Conflicts of interest in proxy voting can occur because various business relationships exist, which can influence a fiduciary's vote. When a portion of a company's pension plan assets are invested in its own company stock, the internal proxy voter may be particularly vulnerable to conflicts of interest because management has an enhanced ability to directly influence their voting decisions. Although situations representing conflicts will occur, limited disclosure of proxy voting guidelines and votes may make proxy voting more vulnerable to such conflicts. Because of limited transparency, concerned parties do not have the information needed to raise questions regarding whether proxy votes were cast solely in the interest of plan participants and beneficiaries.

Some plan fiduciaries and the Securities and Exchange Commission (SEC) have taken steps to help manage conflicts of interest in proxy voting. Specifically, some plans voluntarily maintain detailed proxy voting guidelines that give proxy voters clear direction on how to vote on certain issues. The SEC has imposed new proxy voting regulations on mutual funds and investment advisers, requiring that specific language be included in the fund's guidelines on how fiduciaries will handle conflicts of interest. Some plan fiduciaries voluntarily make their guidelines available to participants and the public. In addition, some plans voluntarily disclose some or all of their proxy votes to participants and the public. Some plans also voluntarily put additional procedures in place to protect proxy voters from conflicts of interest in order to avoid breaches of fiduciary duty. For example, some plan sponsors hire independent fiduciaries to manage employer stock in their pension plans and vote the proxies associated with those stock. Plans may also hire proxy-voting firms to cast proxies to ensure that they are made solely in the interest of participants and beneficiaries.

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 Employee Retirement Income Security Act of 1974 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. And, 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.

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### **Abbreviations**

AMEX	American Stock Exchange
DeAM	Deutsche Bank Asset Management
DeIB	Deutsche Bank's Investment Banking
DOL	Department of Labor
EBSA	Employee Benefits Security Administration
EIN	Employer Identification Number
ERISA	Employee Retirement Income Security Act of 1974
ESOP	employee stock ownership plan
HP	Hewlett-Packard
IB	Interpretive Bulletin
IMs	investment managers
NASDAQ	National Securities Dealers Stock Exchange
NYSE	New York Stock Exchange
SARs	summary annual reports
SEC	Securities Exchange Commission
SPDs	summary plan descriptions
TAQ	Trade and Quote

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United States Government Accountability Office  
Washington, DC 20548

August 10, 2004

The Honorable Edward M. Kennedy  
Ranking Minority Member  
Committee on Health, Education, Labor, and Pensions  
United States Senate

Dear Senator Kennedy:

Pensions are an important source of income for millions of retirees, and the federal government has encouraged private employers to sponsor and maintain private pension and retirement savings plans for their employees. In 1998, about 100 million workers and retirees were covered in private defined benefit<sup>1</sup> or defined contribution<sup>2</sup> pension plans with assets totaling about \$4 trillion. In 2001, pension plans, as a whole, owned about 20 percent of the total corporate equity issued by U.S. companies, with private pension funds owning about 59 percent of that amount.<sup>3</sup> As shareholders, pension plans have certain rights, including the right to vote on certain corporate governance matters. Some matters such as the election of directors, executive compensation packages, and mergers and acquisitions are significant voting items that may affect long-term share value, while other matters may not. While they may vote in person, fiduciaries typically do not attend the annual meetings in which corporate policies are voted. Instead, they usually submit ballots prior to the meeting, generally via mail or online instructions. This is called proxy voting. According to the Department of Labor's (DOL's) interpretation of the Employee Retirement Income Security Act (ERISA) of 1974, with these

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<sup>1</sup>A defined benefit plan promises to provide a benefit that is generally based on an employee's salary and years of service. Defined benefit plans use a formula to determine the ultimate pension benefit that participants are entitled to receive. The employer, as plan sponsor, is responsible for making contributions that are sufficient for funding the promised benefit, investing and managing the plan assets, and bearing the investment risk.

<sup>2</sup>Under defined contribution plans, employees have individual accounts to which the employee, employees, or both make periodic contributions. Defined contribution plan benefits are based on the contributions to and investment returns (gains and losses) on individual accounts. In a defined contribution plan, the employee bears the risk and often controls, at least in part, how his or her individual account assets are invested.

<sup>3</sup>These data are according to the flow of funds data issued on March 2004 from the Federal Reserve Board. Mutual funds own about 18 percent of total corporate equity, while households directly own about 39 percent.

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voting rights, fiduciaries are required to cast votes solely in the interest of plan participants and beneficiaries.<sup>4</sup>

The retirement security of these plan participants can be affected by how certain issues are voted on during company stockholder meetings and, therefore, relies on fiduciaries acting solely in the interest of pension plan participants and beneficiaries. However, recent corporate scandals have highlighted the fact that fiduciaries are faced with conflicts of interest that could lead them to breach their responsibility to act solely on behalf of participants. For example, in 2002, the Securities Exchange Commission (SEC) investigated whether a vote cast in favor of a merger between Hewlett-Packard (HP) and Compaq by Deutsche Bank Asset Management (DeAM), a large asset manager with the fiduciary responsibility for voting proxies, was influenced by a conflict of interest. The SEC found that a material conflict of interest was created when DeAM failed to disclose to its advisory clients that Deutsche Bank's Investment Banking (DeIB) division was working for HP on the merger and had intervened in DeAM's proxy process on behalf of HP.

Because of conflicts of interest in the proxy voting system and the potential adverse effects of such conflicts on the retirement security of Americans, you asked us to describe (1) conflicts of interest in proxy voting, (2) actions taken by plans and plan fiduciaries to manage conflicts of interest, and (3) DOL's enforcement of proxy voting requirements.

To determine what conflicts exist in proxy voting, we conducted face-to-face and telephone interviews which included officials at DOL's Employee Benefits Security Administration (EBSA) and at SEC, securities and proxy voting industry professionals, officials of public and private pension plans, ERISA attorneys, asset managers, and proxy voting firms, research organizations, and proxy solicitors. We asked 25 shareholder activist professionals, academics, and economists to respond to a series of questions for a written reply and received 14 responses. To determine the

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<sup>4</sup>A plan fiduciary includes a person who has discretionary control or authority over the management or administration of the plan, including the management of plan assets. Any person who makes investment decisions with respect to a qualified employee benefit plan's assets is generally a fiduciary. The duties the person performs for the plan rather than their title or office determines whether that person is a plan fiduciary. Unless otherwise indicated, in this report we use the term fiduciary or plan fiduciary as those persons who have the responsibility for voting proxies. Plan fiduciaries have a responsibility to vote proxies on issues, including those that may affect the value of the shares in the plan's portfolio.

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extent to which certain companies' pension plans hold proxy voting power within the plan sponsor, we analyzed plan financial information filed annually (Form 5500 data) with DOL's EBSA. We analyzed data for the Fortune 500 companies for plan year 2001, which was the most recent year for which complete plan-specific data were available. To determine what safeguards fiduciaries have put in place to manage conflicts of interest, we reviewed proxy voting guidelines and interviewed a number of public and private pension plan sponsors, asset managers, proxy voting firm representatives, and other experts. To determine DOL's enforcement efforts in this area, we reviewed DOL enforcement material and previously issued GAO reports on DOL's enforcement program and interviewed officials at EBSA.

We conducted our work between April 2003 and May 2004 in accordance with generally accepted government auditing standards. See appendix I for more information on our scope and methodology.

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## Results in Brief

Experts we interviewed said that conflicts of interest exist in proxy voting and occur because of the various business relationships that may influence a proxy voter's vote. These experts also said that conflicts can exist in situations when an employee of the plan sponsor votes proxies—internally—or by a person or entity outside of the plan—externally. When a portion of a company's pension plan assets are invested in its own company stock, the internal proxy voter may be particularly vulnerable to conflicts of interest because management has the ability to directly influence voting decisions. For the external proxy voter, a variety of conflicts may arise due to business relationships. For example, when the external proxy voter is an investment manager that is part of a larger corporation that provides a variety of services, business relationships between branches of the corporation and the plan sponsor may influence the investment manager's proxy voting decisions. Consistent with current DOL requirements, proxy votes and guidelines are disclosed to the plan. Proxy voters are not required to publicly disclose proxy voting guidelines and votes, though plans are required to make voting guidelines available to participants upon request. Although conflicts will exist, limited disclosure may make proxy voters more vulnerable to such conflicts. Because of this limited transparency, concerned parties do not have the information needed to raise questions regarding whether proxy votes were cast in the sole interest of plan participants and beneficiaries.

Some plan fiduciaries and SEC have taken steps to help manage conflicts of interest in proxy voting. Some plans voluntarily maintain detailed

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proxy-voting guidelines that give proxy voters clear direction on how to vote on certain issues. SEC has imposed new proxy voting regulations on mutual funds and investment advisers requiring that specific language be included in policies and procedures on how fiduciaries will handle conflicts of interest. In addition, some plan fiduciaries voluntarily make their guidelines available to participants and the public. Furthermore, some plans voluntarily disclose to participants and the public how they voted on some or all of the issues in which they voted. Similarly, SEC now requires mutual funds to publicly disclose all proxy votes and policies and procedures. Some plans voluntarily put additional procedures in place to protect proxy voters from conflicts of interest that may lead to breaches of fiduciary duty. For example, some plans have a rule that, in the event that an attempt is made to influence a proxy vote, the voting responsibility on that issue moves from the proxy voter to a committee. Some plan sponsors have hired independent fiduciaries to manage employer stock in their pension plans. Plans may also hire an independent proxy voter or proxy-voting firm to cast proxy votes to ensure that they are solely in the interest of plan participants.

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, plan participants and others are not likely to have the information they need to raise questions regarding whether a vote has been cast solely in their interest. Second, ERISA presents legal challenges for prosecuting proxy voting cases. Specifically, it is often difficult to obtain evidence that the plan fiduciary was influenced in his or her voting by something other than the interests of plan participants because, among other things, the fiduciary's vote is based on judgment. Finally, even if such evidence existed, monetary damages are difficult to value and, because the department has no statutory authority to impose a penalty without assessing damages, fiduciary penalties are difficult to impose. In part, because of these challenges and its limited resources, DOL has devoted few resources to enforcing proxy voting practices by fiduciaries. For example, the agency conducted three enforcement studies between 1988 and 1996 to determine the level of compliance with proxy voting requirements among select fiduciaries. According to DOL, as a result of these proxy reviews, they found improvements over time within the proxy voting system as the number of voting fiduciaries and plan administrators who voted and established proxy voting guidelines increased. The department has not conducted similar reviews in recent years. DOL officials told us that they believe that proxy voters are generally in compliance, they receive few

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complaints and that with limited resources they focus instead on other priority areas, which may result in identifying violations that can be corrected. Furthermore, DOL officials said that they do not have specific investigations focused on proxy voting, and they do not allocate many resources to this issue.

This report contains Matters for Congressional Consideration to improve the disclosure of proxy voting guidelines and votes and the independence of fiduciaries voting proxies in certain circumstances. The report also contains recommendations for executive agency action to improve oversight and enforcement in this area. In its response to our draft report, DOL generally disagreed with our matters for congressional consideration and recommendations, saying that conflicts of interest affecting pension plans are not unique to proxy voting and that requiring independent fiduciaries and increased disclosures would increase costs and discourage plan formation. While we acknowledge that fiduciaries face conflicts beyond proxy voting issues and that DOL has limited statutory authority related to proxy voting, we believe that additional transparency and an enhanced enforcement presence are needed.

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## Background

ERISA established the broad fiduciary requirements related to private pension plans and was designed to protect the pension and welfare benefit rights of workers and their beneficiaries. The act requires a plan fiduciary to act "...solely in the interest of plan participants and beneficiaries and for the exclusive purpose of providing benefits" to them and to act "...with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use." Failure to act in accordance with these requirements might constitute a breach of fiduciary duty. Breaches of the fiduciary duty to act solely in the interest of plan participants and beneficiaries with respect to proxy voting could arise when a fiduciary has a conflict of interest. Conflicts of interest occur in a variety of ways in proxy voting. Conflicts occur when a plan fiduciary or proxy voter has either business or personal interests that compete with the interests of participants. When conflicts are not appropriately managed, they could lead to a breach of fiduciary responsibility or, at least, may raise concern that a breach has occurred. For example, an SEC investigation showed that DeIB division had an undisclosed business relationship with HP,

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which may have influenced the proxy voter's vote cast by DeAM about a merger between HP and Compaq Computer Corporation.<sup>5</sup>

ERISA's fiduciary requirements apply to plan sponsors, trustees, managers, and others who act as fiduciaries. These requirements do not explicitly address proxy voting; however, DOL—having responsibility for the investigation and enforcement of violations of ERISA, which includes provisions related to fiduciary responsibility—has stated that the fiduciary act of managing plan assets that are shares of corporate stock generally includes the voting of proxies pertaining to those shares of stock. The provisions of ERISA were enacted to address public concerns that funds of private employee benefit plans were being mismanaged and abused. DOL can take several actions to correct fiduciary violations it identifies. These include acceptance of voluntary fiduciary agreements to implement corrective actions, initiation of civil litigation in federal district court, and referral of certain violations to other enforcement agencies.

On the matter of proxy voting, DOL has issued several letters and bulletins discussing the duties of pension plan fiduciaries. For example, the "Avon Letter," released in 1988, stated that the voting of a proxy is a fiduciary duty and that the responsibility for voting falls on the plan's trustee unless otherwise delegated.<sup>6</sup> Through its "ISS letter," issued in 1990, among other things, DOL stated that with respect to monitoring activities, that the plan fiduciary, in order to carry out his or her fiduciary responsibilities, must be able to periodically review voting procedures and actions taken in individual situations so that a determination can be made whether the investment manager is fulfilling its fiduciary responsibility. Furthermore, DOL issued Interpretive Bulletin (IB) 94-2 in 1994, which clarified the guidance in the previous two letters and also stressed the importance of statements of investment policy, including voting guidelines. While DOL said that maintenance of such statements of investment policy are

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<sup>5</sup>SEC brought an enforcement action against Deutsche Bank Asset Management in connection with its voting of client proxies for the HP-Compaq merger transaction and imposed a \$750,000 penalty. The fine was imposed for not disclosing a conflict. SEC action found that DeAM violated its fiduciary duty to act solely in the best interests of its advisory clients by voting the proxies on the HP stock owned by its advisory clients without first disclosing the conflict.

<sup>6</sup>The Deputy Assistant Secretary of the Pension Welfare Benefits Administration (PWBA now known as EBSA) issued the Avon letter to Mr. Helmuth Fandl, Chairman of the Retirement Board of Avon Products, Inc., on February 23, 1988. Current U.S. Comptroller General David M. Walker was the Assistant Secretary of Labor for the PWBA from 1987 to 1989.

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consistent with ERISA, DOL officials said that they do not have the statutory authority to require plans to maintain such statements.

SEC, under the Investment Company Act of 1940, regulates companies, including mutual funds, that engage primarily in certain operations, such as investing, reinvesting, and trading in securities, and whose own securities are offered to the investing public. A primary mission of SEC is to protect investors and maintain the integrity of the securities markets through disclosure and enforcement. Employees in participant-directed pension plans might be given the choice of investing in securities, including employer securities, as well as a variety of mutual funds. Because plan participants may have such investment options, securities law protections applicable to investors are relevant to plan participants. In addition, some pension plans use investment managers to oversee plan assets and these managers may be subject to securities laws.

Congress previously studied the issue of DOL's enforcement and proxy voting. In the 1980s, reports emerged that fiduciaries were not voting their proxies or that conflicts of interest may have influenced the decisions of some plan fiduciaries. The Congress consequently became concerned about whether fiduciaries were fulfilling their responsibility to protect the interests of pension plan participants and beneficiaries. Because ERISA does not specifically lay out what the fiduciary responsibility is regarding proxy voting, many fiduciaries were thought to be unclear about their responsibility to vote proxies and maintain voting guidelines. This was cited as one of the major factors that led the Subcommittee on Oversight of Government Management, Senate Committee on Governmental Affairs, to conduct an investigation of and hold hearings in 1986 on DOL's enforcement of ERISA. Among other things, the Subcommittee concluded that disclosure of proxy votes would facilitate the DOL's enforcement efforts by providing the agency and other interested parties with much needed information. DOL officials believe that the agency does not have the statutory authority to require plan fiduciaries to publicly disclose their proxy votes and guidelines.

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## Business Relationships and Limited Disclosure of Votes Can Make Proxy Voting Vulnerable to Conflicts

Some experts we interviewed said that conflicts of interest exist in the proxy voting system and limited disclosure makes proxy voting vulnerable to conflicts of interest. Conflicts of interest occur because of the various business relationships that may influence a plan fiduciary's or proxy voter's vote. For example, when a company provides investment advisory services for a company-sponsored pension plan and also provides investment banking services to the company sponsoring that pension plan. Although conflicts will exist, limited disclosure makes proxy voting vulnerable to them. Because of this lack of transparency, participants do not have the information needed to raise questions regarding whether proxy votes were cast solely in their interest.

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## Fiduciary's Business Associations Can Create Conflicts of Interest

Business associations between a proxy voter and any entity that may influence their vote presents a conflict of interest. Some experts we interviewed explained that these associations may form whether proxies are internally or externally managed because company management has direct access to the proxy voter who is either an employee, in the case of internally voted proxies, or is a service provider, in the case of externally voted proxies.

When a portion of a company's pension plan assets are invested in its own company stock, the proxy voter may be particularly vulnerable to conflicts of interest because management has the ability to directly influence its voting decisions and, since company stock held in the company's own pension plan is typically managed internally,<sup>7</sup> the proxy voter may at times be more concerned about their own interests. While ERISA states that fiduciaries must act solely in the interest of pension plan participants, there is no requirement that an independent fiduciary be appointed to provide additional protections for participants with company stock in their pension plans.

Several experts explained that conflicts of interest that occur in this type of arrangement are considerably problematic. For example, one expert said that since proxy voting and other decisions relating to company stock are much more likely to be handled in-house, votes may be cast in

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<sup>7</sup>The named fiduciary could also delegate the proxy voting responsibility to a trustee bank, third-party proxy voting firm, or an independent fiduciary.

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accordance with the wishes of the company's senior management.<sup>8</sup> In such cases, the company's management may not consider the best interest of plan participants and beneficiaries independently from management's opinion of what is best for the company. The Enron case provides an example of how management's own concerns may come before that of participants and beneficiaries.<sup>9</sup>

In addition, some experts said that when proxies are internally managed, the proxy vote may be influenced by the fiduciary's own personal concerns, particularly in instances when casting a vote solely in the interests of plan participants and beneficiaries means voting against company management. Specifically, if the plan fiduciary is a lawyer, investment analyst, or a member of the management team for the company, their proxy vote on management proposals such as a merger and acquisition or for individuals they have chosen to serve on the board of directors could be influenced by concerns about their personal standing, or job security, in the company. A few experts said that a fiduciary in this situation is not likely to vote against a management proposal such as an executive compensation package because of their own personal concerns. Additionally, DOL officials said that conflicts for an internal fiduciary could arise when the company is experiencing problems, which, if publicly known, would cause stock value to decline. In order to protect participants, fiduciary duty might require the fiduciary to publicly disclose the information to participants and other shareholders and sell shares of the company stock. Insider trading rules would, however, prevent the fiduciary from taking action on nonpublic information.<sup>10</sup> However, making this information public could cause a rapid decline in share value as investors sell off their shares of stock, thereby, potentially harming the company and the fiduciary's own personal standing in the firm.

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<sup>8</sup>Defined benefit plans may not acquire any qualifying employer security or qualifying employer real property in excess of 10 percent of fair market value of the plan's assets. Defined contribution plans are generally exempt from the 10 percent limitation.

<sup>9</sup>The DOL sued Enron, corporate directors, and the administrative committee on June 26, 2003, for violating ERISA. The suit alleges that certain company and plan officials failed to consider the prudence of Enron stock as an appropriate investment for the retirement plans and did nothing to protect the workers and retirees from extensive losses. The former corporate executive was also charged with misrepresenting Enron's financial condition to employees and plan officials and encouraging them to buy the stock.

<sup>10</sup>Insider trading rules state that a person or entity may not sell or buy stock based on information that is not publicly available.

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Because company management could influence the fiduciary responsible for voting the proxies related to the company's own stock,<sup>11</sup> management may have a significant amount of influence over the outcome of a proxy contest.<sup>12</sup> In order to assess the influence management could have in a proxy contest, we conducted an analysis of Fortune 500 companies. (See appendix I for further information on our methodology.) In our analysis, we compared the number of voting shares of company stock held in a company's pension plans<sup>13</sup> to the total voting shares held in the market. About 272 of the Fortune 500 companies that reportedly had their own company stock in their pension plans and in separate accounts, such as master trust agreements held over \$210 billion in employer securities in plan year 2001. Of those companies, 27 percent held at least 5 percent or more of company stock in their company's pension and benefit plans, while another 26 percent held between 2 and 5 percent. None of the Fortune 500 firms we analyzed held more than 21 percent of the total voting power of their company's stock in their pension and welfare benefit plans, while 47 percent held less than 2 percent of company stock in their company's pension and benefit plans.

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<sup>11</sup>Management also has access to other proxy voters—employees who participate in the company's pension plan which has company stock as an investment choice in their 401(k) plan or if the plan sponsor offers an Employee Stock Ownership Plan (ESOP). The plan fiduciary is responsible for voting unallocated stock and stock allocated to pension plan participants that has not been voted. Unallocated shares of stock are those that have not been distributed and are held by the company in a suspense account. Allocated shares of stock are those shares that have been both distributed to the employees of the company's pension plan and to outside investors (e.g., by institutional investors such as other pension plans and mutual funds, or individual investors). How the fiduciary must vote those stock is outlined in the plan documents. The directions provided in the plan documents may include voting by the trustee in accordance with fiduciary principles, voting by the trustee to mirror the vote for directed shares, and refraining from voting the shares on the assumption that the employee intended to cast a no vote.

<sup>12</sup>For defined benefit plans, plan assets are typically institutionally managed by an external asset manager. The external asset manager also has the responsibility to vote the proxies unless that responsibility is retained by the plan trustees. For defined contribution plans, pension plan participants may have the responsibility to vote the proxies for the shares of their own company's stock in their 401(k) plan account. This called pass through voting, which is required for a plan to receive Section 404(c) relief with respect to the investment in company stock. It is at the plan's discretion to permit pass thru voting to participants, though most defined contribution plans are designed to comply with Section 404(c).

<sup>13</sup>This includes company stock held in defined contribution plans (including ESOPs) and defined benefit plans, or indirectly through certain trusts, accounts, and other investment arrangements. This also includes allocated and unallocated stock.

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While the results showed that the pension and welfare benefit plans of the Fortune 500 companies we analyzed were not holding large percentages of the total voting power of a company's shares, these findings may still be significant. For example, in a contentious proxy contest such as a merger and acquisition where 51 percent of outstanding shares is needed to complete the merger, a company whose pension assets comprise just 2 percent of the total stock issued by a company might act as the deciding vote if the proxy contest is close. In this case, how the plan fiduciary or proxy voter casts its vote could make the difference between 49 percent and 51 percent—that is, the difference between the merger being approved or rejected. Some of the largest and most influential pension plans typically hold no more than 1 to 2 percent of any one company's shares in their plan's investment portfolios. As such, a Fortune 500 company whose pension plans holds more than 1 or 2 percent of its own company stock could give them an advantage in a proxy contest.

When the fiduciary is not an employee of the plan sponsor—that is, he or she is external to the company—experts explained that a variety of different types of conflicts might also arise because of business associations. For example, when the proxy voter is an investment manager that is part of a larger corporation that provides a variety of services, experts said that business relationships between the company's other branches and the plan sponsor might influence the investment manager's voting decisions. These relationships may influence the proxy voter to vote with the plan sponsor's management, particularly if the proxy voter wishes to maintain business relationships with the plan sponsor or create an opportunity for future business relationships. For instance, some experts we interviewed contend that DeAM division—the proxy voter in this case—was influenced by a business relationship between DeIB division and their mutual client, HP. SEC records reveal that DeAM reversed its vote to vote in favor of HP's merger after the investment banking division set up a meeting between the proxy voter and HP management. SEC found that, unbeknownst to DeAM's advisory clients, DeIB was working for HP on the merger and had intervened in DeAM's proxy process on behalf of HP. This created a material conflict of interest for DeAM, which has a fiduciary duty to act solely in the interests of its advisory clients. The SEC action found that DeAM violated this duty by

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voting the proxies on the HP stock owned by its advisory clients without first disclosing the conflict.<sup>14</sup>

While some experts we interviewed said that they believe most plan fiduciaries vote solely in the interest of participants and beneficiaries, others said that some fiduciaries might prioritize other interests when casting their votes. For example, a few experts said that fiduciaries are taking their proxy voting responsibility seriously and voting appropriately. Other experts we interviewed said that the proxy voting decisions of some external asset managers are often influenced by short-term quarterly returns on assets rather than on voting patterns that support long-term goals that benefit shareholders and participants. Some experts we interviewed also said that some external asset managers believe that they are retained and compensated because of superior investment performance and not because of how they vote proxies. Last, some experts said that there are only downsides to devoting resources to proxy voting.

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### Limited Disclosure May Make Proxy Voting Vulnerable to Conflicts of Interest

Experts we interviewed said that the limited disclosure might create inappropriate incentives and result in inadequate accountability, which may make proxy voting especially vulnerable to conflicts of interest. Proxy votes, in some cases, may not be monitored by the plan fiduciary and are not routinely disclosed to the public, two actions that could help ensure that fiduciaries cast votes solely in the interest of pension participants.

Limited disclosure and lack of adequate monitoring of proxy voting practices by plans hinders accountability for how votes are cast. Consistent with current DOL requirements, votes are disclosed to the appropriate plan fiduciaries.<sup>15</sup> Fiduciaries are not required to publicly disclose proxy voting guidelines and votes, though the plan would be

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<sup>14</sup>SEC found that DeAM violated Section 206(a) of the Investment Advisers Act of 1940 by failing to disclose to its clients any material fact about a potential or actual conflict of interest that may affect its unbiased service to its clients.

<sup>15</sup>According to the January 1990 interpretive letter to the Institutional Shareholder Services Inc., DOL advised that the named fiduciary must be able to comprehensively monitor proxy voting activities of the investment (or asset) manager so as to make an informed determination as to whether the investment manager has met its fiduciary obligations. Thus, the named fiduciary must have access to, and the investment manager must maintain accurate records of, the investment manager's voting procedure and actions taken in specific cases.

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required to make any written proxy voting guidelines available to participants upon request.<sup>16</sup> Hence, only plans have easy access to the information that allows them to monitor how proxy voters are voting. However, not all plans have the resources to devote to such monitoring; therefore, the attention given to the proxy voting responsibility can vary greatly by plan. Some large plans devote a significant amount of expertise and resources to proxy voting while other plans may not. Furthermore, a few experts said that in many cases where the proxy voting responsibility is delegated externally, the plan provides limited to no review of how the proxies were voted.

Experts we interviewed said that limited disclosure might provide incentives for fiduciaries to cast their votes according to their own interests. These experts also said that publicly disclosing proxy votes could help discourage voting that is inconsistent with participants' interests. For example, a few experts believed that the economic incentives for fiduciaries to vote with management could be significant enough, and the potential for penalties as a fiduciary weak enough, to make voting with management hard to resist.<sup>17</sup> Several experts explained that since breaches of fiduciary duty are very difficult to uncover, limited transparency prevents participants and others from raising questions regarding whether votes were made solely in the interest of participants. They also contend that increased transparency provided by public disclosure may provide participants, regulators, and others with more comprehensive information needed to hold fiduciaries and corporations accountable for their actions. In this regard, SEC concluded that shedding light on mutual fund proxy voting could illuminate potential conflicts of interest and discourage voting that is inconsistent with fund shareholders' best interests.

SEC's new disclosure rules for mutual funds and investment advisers may provide a limited benefit to some pension plan participants, while the new rule for investment advisers may also benefit pension plans whose proxies are voted externally. In 2003, SEC issued a final rule requiring mutual

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<sup>16</sup>See DOL Interpretive Bulletin 94-2 and a March 20, 1997 interpretive letter to Kirkland & Ellis with respect to the scope of the disclosure requirements of Section 104(b)(4).

<sup>17</sup>Voting with management is not necessarily against the interests of participants and beneficiaries. In some cases, voting in favor of a management proposal would benefit participants. As with any proxy decision, the vote should be based on analysis and should be made solely in the interest of participants.

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funds to publicly disclose their proxy votes on an annual basis and to adopt and disclose proxy voting policies and procedures to shareholders. However, this rule may provide some benefit for pension plan participants in defined contribution plans. Specifically, pension plan participants who invest their defined contribution dollars in mutual funds might find proxy voting results cast by investment managers of their funds on the web site of the mutual fund provider. On the other hand, defined benefit plan participants may receive little benefit from this rule if defined benefit plans invest few assets in mutual funds.<sup>18</sup> Furthermore, SEC's new disclosure rule for investment advisers requires investment advisers to inform their clients how they can obtain information on how the clients' securities were voted. However, this rule may provide little benefit to plan participants in defined contribution and defined benefit plans since this ruling requires disclosure to the plan as the client and not to plan participants.

SEC's new disclosure rule for investment advisers may also provide protections beyond those provided by ERISA for private pension plans whose proxies are voted externally. SEC's new disclosure rule for investment advisers may provide requirements that are either not specifically stated or covered in DOL interpretations of ERISA. For example, SEC requires, in part, that investment advisers<sup>19</sup> exercising proxy voting authority over client securities adopt and implement proxy voting policies and procedures for voting clients' proxies.<sup>20</sup> ERISA, on the other hand, does not require fiduciaries to maintain statements of investment policy, which includes statements of proxy voting policy. Also, SEC requires that voting policies and procedures must describe how the adviser addresses material conflicts between its interests and those of its

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<sup>18</sup>Under defined benefit plans, the employer, as the plan sponsor, bears the investment risk as well as those risks associated with voting proxies.

<sup>19</sup>This rule applies to all investment advisers registered with SEC that exercise proxy voting authority over client securities.

<sup>20</sup>This new rule also requires that the written policies and procedures for voting client proxies must be reasonably designed to ensure that the adviser votes client securities in the best interests of the clients, to disclose to clients how they may obtain information about those policies and procedures, and to disclose to clients how they may obtain information on how the adviser has voted their proxies. The rule amendments also require advisers to maintain certain records relating to proxy voting. The rule and rule amendments are designed to ensure that advisers vote proxies in the best interest of their clients and provide clients with information about how their proxies are voted. This new rule also requires investment advisers to furnish a copy of written policies and procedures to clients upon request.

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clients with respect to proxy voting, while ERISA does not. SEC's investment adviser rule may provide no benefit to plans that retain voting responsibility because it covers only investment advisers that exercise proxy voting authority over client securities.

Certain changes in the retirement savings environment are making the need for enhanced transparency more important. For example, the shift from defined benefit plans to defined contribution plans increases the need for disclosure to plan participants.<sup>21</sup> Because under a defined contribution plan participants bear the investment risk, as with shareholders, participants need information to be more active in protecting their retirement assets. SEC reported that the proposal generated significant comment and public interest. Of the approximately 8,000 comment letters, the overwhelming majority supported the proposals and urged SEC to adopt the proposed amendments. Many commenters, including individual investors, fund groups that currently provide proxy-voting information to their shareholders, labor unions, and pension and retirement plan trustees, supported the proposals.<sup>22</sup> Furthermore, one expert said that pension plans should be required to disclose votes and guidelines to participants because participants cannot switch plans the way shareholders can switch their money from one investment company to another. This expert further said that having policies such as these in place makes ERISA stronger especially given the impact that having their money tied up in a retirement portfolio could potentially have on a participant's retirement assets. Additionally, the expert said that the differences between disclosures provided to shareholders and pension plan participants should be eliminated.

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<sup>21</sup>DOL statistics show that the number of single employer and multiemployer defined benefit plans are on the decline, while the number of defined contribution plans being adopted is on the rise. The decline in defined benefit plans is attributed to the fact that fewer plans are being adopted, some employers are replacing defined benefit plans with defined contribution plans, and some defined benefit plans have been terminated.

<sup>22</sup>Many fund industry members supported the proposed amendments regarding the disclosure of policies and procedures. However, most fund industry members opposed the proposed amendments that would require disclosure of a fund's complete proxy voting record and disclosure of votes that are inconsistent with fund policies and procedures.

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## Some Plan Fiduciaries Have Taken Actions to Manage Conflicts

To manage conflicts, some plan fiduciaries have taken special actions, some of which are similar to SEC requirements for mutual funds. One such action is the maintenance by fiduciaries of detailed proxy voting guidelines that give proxy voters clear direction, reducing ambiguity and vulnerabilities related to conflicts that may influence the voter. Additionally, some fiduciaries include in their guidelines information on what the plan does when a conflict of interest exists on a proxy vote; they also publicly disclose their guidelines. Some plans also disclose a record of all their votes cast to participants and the public. Some pension plans also put additional procedures and structural protections in place to help manage conflicts.

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## Some Fiduciaries Have Developed Detailed Proxy-Voting Guidelines to Manage Conflicts

To help manage conflicts, some fiduciaries use detailed proxy voting guidelines that they make public. However, such guidelines are not required by ERISA, nor does DOL give guidance to fiduciaries as to the level of detail and specificity that guidelines should contain. Hence, some plan guidelines vary widely in their level of detail and specificity and some provide only minimal guidance. For example, some plan officials we interviewed said that their guidelines instruct proxy voters to always vote in the best economic interest of participants, while other experts said that some guidelines only instruct proxy voters to vote with management but offer no guidance beyond this broad statement. Other plans, on the other hand, create detailed, up-to-date guidelines. Some plans that we reviewed, for example, maintain guideline documents that direct proxy voters which way to vote, or factors to consider in deciding which way to vote, on a wide range of routine and non-routine proxy issues. The issues include, but are not limited to, board of director elections, auditor selections, executive compensation, reincorporation, capital issues (such as stock issuance), environmental and social concerns, and mergers and acquisitions. In addition, some plans, according to plan officials we spoke with, review their guidelines on a regular basis, and update them if needed. This allows the guidelines to reflect new issues in corporate governance. For example, in 2002, one plan updated its guidelines twice to reflect new corporate governance issues arising from the Sarbanes-Oxley Act.<sup>23</sup>

Detailed guidelines reduce ambiguity in the proxy voting process by providing direction to help fiduciaries determine how to vote. For

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<sup>23</sup>The Sarbanes-Oxley Act was passed in 2002 and contained a number of corporate governance and accounting provisions in response to recent corporate scandals.

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example, detailed guidelines may instruct a voter how to analyze an executive compensation vote based on a number of factors, so that the vote is made in what the fiduciary believes is solely in the interest of participants. As a result, proxy voters have clear direction on how to vote on a specific voting issue. For example, one plan official said that because their guidelines are clear, there is no confusion about how to vote on any proxy issue. Furthermore, a plan fiduciary or proxy voter may use detailed guidelines to defend against complaints about votes by demonstrating that a given vote was based on their guidelines and was not influenced by a conflict of interest.

Some guidelines include what steps a proxy voter should take to prevent a fiduciary breach and ensure that the vote is made solely in the interest of participants when a conflict of interest exists. Similar to the recent SEC rule requiring mutual funds and investment advisers to disclose “the procedures that a mutual fund company/complex and investment advisers use when a vote presents a conflict...” some pension plan fiduciaries include such a discussion in their guidelines. For example, the guidelines of one plan fiduciary we examined indicate that, in the case of a conflict of interest, the issue is to be reported to the president and general counsel of the plan sponsor who decide how to proceed and ensure that a record of the conflict and the related vote is maintained. In addition, some fiduciaries provide further detail about what constitutes a conflict of interest. For example, one plan’s guidelines define a conflict of interest as being “a situation where the Proxy Analyst or Proxy Committee member, if voting the proxy, has knowledge of a situation where either” the plan fiduciary “or one of its affiliates would enjoy a substantial or significant benefit from casting its vote in a particular way.”

In addition to developing detailed guidelines, some plan fiduciaries voluntarily make their guidelines/policies and procedures available to the public, as SEC has required mutual funds to do. Some public pension plans disclose their guidelines on their Web sites, making them available not only for participants and beneficiaries but also the general public. The officials of some private plans indicated to us that they would probably produce a copy of their guidelines if explicitly requested by a participant, though they admitted that such a request is rarely, if ever, made. SEC addressed the issue of disclosure, when, in 2003, it began to require mutual funds to disclose their voting policies and procedures in their registration statement. Mutual fund policies and procedures are required to be available at no charge to shareholders upon request. Also, mutual funds must inform shareholders that the policies and procedures and votes are available through SEC’s Web site, and, if applicable, on the fund’s Web

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site. SEC made the case for guideline disclosure by stating that, “shareholders have a right to know the policies and procedures that are being used by a fund to vote proxies on their behalf.” Many fund industry members publicly supported SEC’s disclosure rule through comment letters sent to SEC after the rule proposal was released. Officials for one mutual fund company, for example, supported guideline disclosure because the transparency resulting from disclosure would encourage mutual funds to make better proxy voting decisions, which in turn could enhance fund performance. Also, they believed that guideline disclosure would deter casting proxy votes that are not in the best interest of shareholders.

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### Some Fiduciaries Disclose Proxy Votes, Providing Greater Incentive to Vote Appropriately

Some plan fiduciaries also publicly disclose their proxy votes in an attempt to manage conflicts of interest. We met with officials of some public pension plans that disclose proxy votes on their Web sites, making them available not only to participants and beneficiaries, but also to the public.<sup>24</sup> While some public plans disclose only the votes of a few hundred different equities, other plans disclose all their votes. These funds present a list of companies and how relevant proxies for that company have been voted during a specified timeframe. In addition, one plan sometimes includes a note that briefly explains the rationale for their vote (e.g., why they withheld their vote for a certain director). Two plans, whose officials we met with, also disclose the number of shares that were voted on each proxy.

In April 2003, a SEC rule went into effect requiring mutual funds to disclose, on an annual basis, a record of all proxy votes cast during the previous year. Mutual fund votes are required to be available on the fund’s Web site or provided at no charge to shareholders upon request. Also, mutual funds must inform shareholders that the votes are available through SEC’s Web site. SEC, in its rule release on mutual fund proxy vote

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<sup>24</sup>A public pension plan is a pension, annuity, retirement, or similar fund or system maintained by a state or local government that provides a retirement benefit to the state or local government employee. Some of the largest pension plans in the United States such as the California Public Employees Retirement System and the New York City Employees Retirement System are public pension plans. These public plans are not governed by ERISA.

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disclosure, stated that the overall costs of disclosure are reasonable.<sup>25</sup> The experience of the plans we examined that disclose their votes indicates that their costs are not substantial and not a serious burden because proxy voting is done electronically, and voting records are required to be maintained.

Some experts we interviewed argue that proxy vote disclosure can benefit participants by giving them information on how the plan votes proxies and providing an incentive to the plan fiduciary or proxy voter to vote appropriately. Disclosure would allow plan participants to review votes and raise questions as to whether votes were made appropriately. The knowledge that participants and beneficiaries might complain to the plan and to others if they believe a breach of its fiduciary duty has taken place may encourage fiduciaries to vote appropriately to avoid such problems. Some experts said that participants would be overwhelmed by the information and would not understand what to do with it. In addition, a few experts have said that it is possible that, while participants might not have the time or the knowledge to analyze proxy votes, an investigative journalist might look at votes of a certain pension plan and publicly discuss any possible breaches they have uncovered or notify the appropriate authorities if any breaches are found or are suspected.

Proxy voting disclosure may also influence the voting behavior of fiduciaries, as seen in the example of one large mutual fund. As reported in the news, one large mutual fund voted in favor of the full slate of directors nominated to serve on the board of directors on 29 percent of proxy contests in which they voted in 2003, while in 2002 the fund had voted in favor of the full slate in 90 percent of the contests.<sup>26</sup> And while the fund had voted for 100 percent of auditor approvals in 2002, in 2003 it had voted for only 79 percent. Experts we interviewed said that SEC's disclosure rules might have contributed to that change in behavior. Nine of 12 respondents to our written interview support proxy vote disclosure by

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<sup>25</sup>Opponents to vote disclosure argued against the rules largely by arguing that disclosure would be prohibitively costly. However, in its final rule, SEC noted that several fund groups that currently provide disclosure of their complete proxy voting records to their shareholders commented that although there are start-up costs for compliance systems, this cost decreases over time, and that the overall costs of the disclosure are minimal. SEC found arguments made by funds that are providing this disclosure to be particularly persuasive and continue to believe that the costs of disclosure are reasonable.

<sup>26</sup>Ken Brown, "Vanguard Gives Corporate Chiefs A Report Card," *Wall Street Journal*, November 10, 2003. pg. C.1.

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pension plan fiduciaries and many experts we spoke with also support proxy vote disclosure by plans. Very few respondents and experts we interviewed believed that disclosure of votes would not benefit pension plan participants. Specifically, they cited as reasons that: (1) the costs of disclosure outweigh any benefits to participants; (2) there is the potential for politicizing proxy voting; (3) disclosure may serve as a detriment to the investment manager's investment strategy; and (4) participants lack interest in proxy voting.

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### Some Fiduciaries Have Voluntarily Taken Additional Steps to Manage Conflicts of Interest

Some plan fiduciaries have voluntarily taken additional steps to help manage conflicts of interest that may lead to breaches of fiduciary duty, including implementing structural protections and special proxy voting procedures. For example, a few plans we reviewed structure their organization to separate those who cast votes from executives who make policy decisions about the plan. Some plans delegate the responsibility for proxy voting in a way that protects against fiduciary breaches. One public plan, for example, had external asset managers cast proxy votes, but decided to bring the proxy voting process in house to avoid having the plan's proxies voted on both sides of an issue. By doing all voting internally, plan fiduciaries can provide better safeguards ensuring that votes are cast solely in the interest of participants and provide consistency to how votes were cast.

In order to address concerns about conflicts of interests related to employer stock in pension plans, a few pension plan officials we interviewed said that their company stock is managed and proxies are voted by an independent fiduciary outside of the company. In other cases, some fiduciaries use independent proxy-voting firms for research and analysis or to cast proxy votes on their behalf. For example, officials from one plan that we met with told us that they use an outside proxy-voting firm to make the vote decision when a conflict exists. One asset manager, for example, did so during a contentious merger in which their Chief Executive Officer was a director of the acquiring company. Some fiduciaries we met with have an outside proxy-voter execute proxy votes based on their plan's own guidelines. Other fiduciaries simply use outside proxy-voter firms to provide analysis and research, which the fiduciary may then use to help determine how to vote.

Outside proxy voting firms are not without their own conflicts of interest, however. Some proxy-voting firms have expanded to other services. One firm, for example, provides a service to corporations in helping design proxies to improve the chances that proxy issues will succeed. A conflict of interest would exist when the proxy-voting firm has to vote on a proxy

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that it helped create or when it must vote a proxy for the same company from which it received revenue for some other service.

In addition to the structural protections some fiduciaries have put into place, some fiduciaries have implemented special procedures that are used when a conflict exists. For example, according to officials at one company we interviewed, if a proxy vote is to be cast not in accordance with the plan's guidelines, then the vote is decided by the plan's proxy committee, which is also required to note why the vote was inconsistent with plan guidelines. At other plans we reviewed, in the event that an attempt is made to influence a proxy vote, the plan's executive committee makes the vote decision. Additionally, officials from one private plan said that when a material conflict of interest exists an independent third-party proxy voter is given the responsibility to determine how to vote, based on the plan's guidelines. Furthermore, this plan has a "Material Conflict of Interest Form" which is filled out and signed by the voting analyst and a member of the plan sponsor's proxy committee. This form includes information on the stock being voted, the issue being voted on, what the plan's proxy voting guidelines indicate about that issue, details on the conflict of interest, and certification from the third-party proxy voter on how the vote was cast. In addition, at another plan, when a material conflict of interest exists during a proxy vote, the vote is reported to the president and general counsel of the plan sponsor. They decide how to address the situation, such as getting an outside vote recommendation or disclosing the existence of the conflict. A record of meeting notes and issues surrounding conflicts are maintained by the plan in case any questions arise.

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## The Department of Labor's Related Enforcement Efforts Have Been Limited

The Department of Labor'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 fiduciary or proxy voter generally are not disclosed; therefore, participants and others are not likely to raise questions regarding whether a vote may not have been cast solely in their interest. In addition, for the department, ERISA presents legal challenges for bringing proxy voting cases.<sup>27</sup> Specifically, because of the subjective nature of fiduciary votes, it is difficult to obtain evidence that would prove the plan fiduciary was influenced by something other than the interests of participants. Furthermore, even if such evidence could be obtained, monetary damages are difficult to value and, because the department has no statutory authority to impose a penalty without assessing damages, fiduciary penalties are difficult to impose. In part, because of these challenges, but also because of its limited resources, DOL's reviews of proxy voting in recent years have been limited. As a result, some experts we interviewed do not view the department as a strong enforcement agent.

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## Identifying and Proving Breaches in the Proxy Voting System Is Difficult

Challenges exist in the proxy voting system that limit DOL's ability to identify breaches and to prove that a fiduciary was influenced to act contrary to the interests of plan participants. In March 2002, we reported that DOL enforces ERISA primarily through targeted investigations. DOL determines what issues it will investigate using a multifaceted enforcement strategy, which ranges from responding to participant and others' concerns to developing large-scale projects involving a specific industry, plan type, or type of violation.<sup>28</sup> DOL also uses the Annual Returns/Reports of Employee Benefit Plans (Form 5500 Returns) to

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<sup>27</sup>DOL noted, however, that it filed amicus briefs in three proxy voting cases. In *O'Neill v. Davis*, 721 F.Supp. 1013, 1015 (N.D.Ill. 1989), a DOL amicus brief was instrumental in obtaining a holding that "the voting of Plan-owned shares by the Plan's trustees was a fiduciary act under ERISA, and one which the trustees were bound to exercise in the sole interest of the Plan participants." DOL also filed two amicus briefs in *Grindstaff v. Green*, 133 F.3d 416 (6<sup>th</sup> Cir. 1998), where, over a strong dissent, the court rejected DOL's views on the extent to which ERISA's fiduciary duties attach to plan fiduciaries' voting of plan shares. DOL officials said that they also filed a brief on the voting of plan shares and exercise of other shareholder rights on plans' behalf in district court in *Krause v. Columbia Quarry Co.*, 4:98 CV 01373 ERW (E.D. Mo.), although that case wound up being decided on other grounds.

<sup>28</sup>Throughout this report, references to DOL's regular investigations refer to those investigations that are not specifically aimed at detailed reviews of proxy voting practices.

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identify potential issues for investigation.<sup>29</sup> In addition, its regional outreach activities, while aimed primarily at educating both plan participants and sponsors, are used to gain participants' help in identifying potential violations.

Although DOL's strategy includes a number of ways to target investigations, DOL officials consider information provided by plan participants and beneficiaries an integral starting point to developing many of its investigations. For instance, through information provided in summary annual reports (SARs), summary plan descriptions (SPDs), individual benefit statements, and other related reports, participants have access to financial and operational information regarding their pension plan and their accrued benefits. The information provided in these reports can help participants and beneficiaries monitor their plans and identify some warning signs that might alert them that possibly there is a problem warranting DOL's attention.

While participant complaints might be useful in targeting some DOL investigations, relying on participant complaints may not currently be the most effective way to identify potential proxy voting cases. Because of the current limited level of disclosure, DOL receives few complaints related to proxy voting. For instance, as previously mentioned, the SARs and other related reports provide plan financial and operational information; however, they do not contain proxy voting information such as voting guidelines and a record of how votes were cast. In addition, DOL officials told us that proxy votes and guidelines are disclosed to the plan and guidelines must be made available to participants and beneficiaries when requested. However, one expert explained that participants generally do not know to ask for this information. As such, they are not likely to raise questions about whether or not a vote was cast solely in their interest. Likewise, because proxy votes are not publicly disclosed, complaints to DOL from those outside of plan participants and beneficiaries are less likely to occur.

In addition to difficulties identifying potential breaches in the proxy voting system, difficulties proving under ERISA that a fiduciary was influenced to act contrary to the interests of plan participants are also a challenge for DOL. Because a plan fiduciary's vote requires judgment, determining what

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<sup>29</sup>The Form 5500 Returns are forms that most qualified retirement plans must file annually with the Internal Revenue Service.

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influenced his or her vote can be difficult. If a plan fiduciary can provide his or her rationale for voting a certain way—proving that, in his or her opinion, proxies were voted solely in the interest of plan participants—it is very difficult for DOL or others to prove otherwise. Proving a fiduciary breach requires evidence that the plan fiduciary was influenced in the voting by something other than the interests of plan participants. Certain information—such as existing conflicts of interest between the plan fiduciary and some other influential party, the plan fiduciary’s own self-interest, or the potential impact of certain votes, for instance—are important when trying to establish that such influence was acted upon. Absent this or similar information, leaks by informed parties—whistleblowers—are likely to be the only way one might prove a breach actually occurred.

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### Monetary Damages Are Difficult to Value and Penalties Are Difficult to Impose

Another challenge that DOL faces is that monetary damages are difficult to value and, therefore, penalties and other sanctions are difficult to impose. According to DOL, it is difficult to link a single proxy vote to damages to the plan participants. This is often the case because there are many economic variables that have an impact on share value. That is, underlying economic factors such as fiscal policy, monetary policy, unemployment, the threat of inflation, the global economy, and currency valuations are all major determinants of share value. Therefore, it is difficult to isolate the effect a single proxy vote may have had. Also, because of the potential for a vote to have a long-term rather than a short-term effect on share value, damages may not be immediately evident.

In addition, while the research community and others have differing opinions about whether proxy votes have economic value, where it is believed that these votes do have a value, the determination of this value can be complicated. For example, in response to our written interview, most experts who responded to this question indicated that valuing proxy votes is a complex task, its difficulty dependent upon variables such as the issue being voted on and an entities’ governance structure. One respondent said that a case could possibly be made if a decline in the value of a company could be tied to the specific point in time when the plan fiduciary voted for a self-serving measure. However, the fiduciary’s vote would have to be significant enough to affect the outcome of the proxy contest. Using the Hewlett-Packard situation as an example, the respondent added that one cannot know what the value of Hewlett-Packard shares would have been if the merger had not gone through and thus one cannot calculate the difference between that value and the current value of the merged Hewlett-Packard/Compaq shares.

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Additionally, others commented that, in the end, DeAM's vote might not have affected the outcome of the proxy contest.

With respect to penalties, unlike SEC, which has the authority to impose a penalty without first assessing and then securing monetary damages, DOL does not have such statutory authority and, as such, must assess penalties based on damages or, more specifically, the restoration of plan assets.<sup>30</sup> Under Section 502(1), ERISA provides for a mandatory 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 "applicable recovery amount," or any settlement agreed upon by the Secretary or ordered by a court to be paid in a judicial proceeding instituted by the Secretary. However, the applicable recovery amount cannot be determined if damages have not been valued. As we reported in 1994, this penalty can be assessed only against fiduciaries or knowing participants in a breach who, by court order or settlement agreement, restore plan assets.<sup>31</sup> Therefore, if (1) there is no settlement agreement or court order or (2) someone other than a fiduciary or knowing participant returns plan assets, the penalty may not be assessed. Because DOL has never found a violation that resulted in monetary damages, it has never assessed a penalty or removed a fiduciary as a result of a proxy voting investigation.

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### As a Result of Challenges, DOL Has Devoted Few Resources to Proxy Voting Issues

As a result of challenges in the proxy voting system, DOL has devoted few resources to proxy voting over the last several years. Between 1988 and 1996, DOL conducted three enforcement studies to determine the level of compliance with proxy voting requirements among select fiduciaries (see table 1). The first of these projects was initiated in May 1988,<sup>32</sup> when the department looked at the management of plan votes from a broad range of investment managers, with a particular focus on certain contested issues considered at annual shareholders' meetings in that year. Then in 1991,

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<sup>30</sup>DOL can also seek removal of a fiduciary for breaches of fiduciary duty or seek other sanctions.

<sup>31</sup>See U.S. General Accounting Office, *Pension Plans: Stronger Labor ERISA Enforcement Should Better Protect Plan Participants*, GAO/HEHS-94-157 (Washington, D.C.: August 8, 1994).

<sup>32</sup>Current U.S. Comptroller General David M. Walker was the Assistant Secretary of Labor for the PWBA from 1987 to 1989. The report was issued in March 1989.

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DOL started its second project to determine how banks were fulfilling their responsibilities with respect to proxy voting practice. DOL looked at proxy voting procedures at 75 banks, covering the application of procedures during the 1989 or 1990 proxy season. Finally, during its last project, the department once again reviewed the practices of investment managers—12 in total—alongside 44 pension plans, with respect to corporate governance issues. It reviewed certain proxy votes at five annual shareholders' meetings held in 1994 and general proxy voting policies and practices. According to DOL, overall the enforcement studies found that there were improvements in proxy voting practices as virtually all plans and investment managers in the studies voted their proxies. The enforcement studies also found that additional improvement is needed in the plans' monitoring of investment managers to ensure that proxies are voted in accordance with stated policies. Furthermore, they found that although investment managers appear to have the records to enable clients to review managers' decisions on proxy voting, few plan clients actually review the reports that are automatically provided to them. In the situations in which reports are available upon request, few plans request a copy. Given these findings, the department has not conducted similar reviews in recent years to determine current levels of compliance. DOL officials told us that they believe that proxy voters are generally in compliance, that they receive few complaints in this area, and that they focus most of their limited resources on other priority areas, which may result in identifying violations that can be corrected.

**Table 1: Summary of the Department of Labor’s Proxy Projects**

Years	Project	Scope	Summary of findings
1988 -1989	No. 1	<p>General fiduciary compliance review of investment managers (IMs) with control over employee benefit plan assets subject to ERISA.</p> <p>Focused on certain contested issues considered at annual shareholders’ meetings in 1988.</p>	<p>Not all investment managers who voted on behalf of employee benefit plans were delegated the authority to vote proxies. Instead, many managers assumed the duty of voting as part of their overall responsibilities.</p> <p>Not all managers had internal decision making procedures or written proxy voting guidelines in place when they voted proxies, and those that did often had a policy to simply vote with management.</p> <p>Managers often lacked accurate recordkeeping with regard to whether proxies had been received and voted.</p>
1991 - 1992 <sup>a</sup>	No. 2	<p>Review of 75 banks’ proxy voting practices (covering the application of procedures during the 1989 or 1990 proxy season only).</p>	<p>Many banks lacked a policy that addressed the maintenance and retention of proxy voting records or related materials’.</p> <p>Several banks had policies to abstain from voting or not vote on certain issues.</p> <p>Many banks followed the “Wall Street Rule,” giving the proxy to management of the company or selling the shares of stock.</p>
1994 - 1996	No. 3	<p>Review of practices of 12 IMs and 44 pension plans with respect to corporate governance issues covered by Interpretive Bulletin 94-2.</p> <p>Focused on certain proxy votes at five annual shareholders’ meetings held in 1994 and the general policies and practices with respect to proxy voting.</p>	<p>Most plans delegated the authority to vote proxies to an IMs via written agreement.</p> <p>Most IMs received written proxy voting policies from their clients, but on an irregularly basis.</p> <p>Fourteen of 44 plans reviewed submitted proxy voting guidelines to their IMs; over half had no proxy guidelines; and 7 retained the authority to vote proxies.</p> <p>The content of the guidelines were mixed—some general, some quite detailed.</p> <p>All IMs tracked proxy-related items and kept written documentation justifying votes cast; most had written procedures to report votes to clients, but few did so automatically.</p> <p>Most plans did not monitor proxy voting by their IMs, about 35 percent appeared to have performed substantive monitoring of IMs.</p>

Source: DOL Proxy Project Report, March 2, 1989; Speech by David George Ball, Assistant Secretary, Pension and Welfare Benefits Administration, February 17, 1992; Proxy Project Report, February 23, 1996.

<sup>a</sup>Results of the second proxy project were not released in a formal report.

DOL officials said that they typically do not conduct specific investigations focused on proxy voting, and they allocate few resources to this issue. They, instead, focus its limited resources according to their Strategic Enforcement Plan.<sup>33</sup> However, proxy voting practices may be examined

<sup>33</sup>The primary purpose of the Strategic Enforcement Plan is to establish a general framework through which EBSA’s enforcement resources may be efficiently and effectively focused to achieve the agency’s policy and operational objectives.

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during their investigations of investment managers. DOL said that its investment management investigative guide has steps for reviewing proxy voting, but the investigators have discretion whether to review proxy voting practices. According to DOL officials, investigators receive training on the general fiduciary obligations of named fiduciaries and investment managers with respect to the voting of proxies on plan-owned stock. When asked how often these reviews included the examination of proxy voting, DOL officials responded that this information is not tracked.

Some plan fiduciaries and industry experts that we interviewed have indicated that DOL lacks visibility as an enforcement agent in this area. For example, some experts said that DOL's examination of proxy voting practices does not seem to occur routinely and that it is not clear what enforcement action DOL has taken in recent years related to proxy voting. Additionally, others have described an environment that provides little incentive to do what is best for participants, indicating that fiduciaries have no expectation that DOL will take action should they breach their proxy voting responsibilities. One DOL official said that the department has made its position on proxy voting known and issued clear guidance on what is required of fiduciaries. Also, given its limited statutory authority and resources, the department has a strategic enforcement plan, and based on this plan, they place their limited resources in areas that will result in identifying violations that can be corrected.<sup>34</sup>

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## Conclusions

The retirement security of pension plan participants is dependent on decisions made each day in the market place by pension plan fiduciaries. DOL guidance requires fiduciaries to cast proxy votes solely in the interest of plan participants and beneficiaries. While ERISA requires that voting guidelines be made available to participants upon request, ERISA does not require disclosure of proxy votes to participants and the public. Increased transparency of both proxy guidelines and votes could provide participants and others with information needed to monitor actions that affect retirement assets. Nor does ERISA require, as current SEC

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<sup>34</sup>For example, in the area of tender offers, the Polaroid ESOP (or NationsBank) case was a major enforcement action brought by DOL in a case where DOL was able to show losses to the plan for fiduciary breach involving a failure properly to exercise shareholder rights (in that case, a failure to tender shares). See *Harman v. NationsBank Trust Co.* (Georgia) N.A., 126 F.3d 1354 (11<sup>th</sup> Cir. 1997), *reh'g denied*, 135 F.3d 1409 (11<sup>th</sup> Cir.), *cert. denied*, 525 U.S. 816 (1998). Another enforcement action involving fiduciaries' misuse of shareholder powers was *Martin v. Feilen*, 965 F.2d 660 (8<sup>th</sup> Cir. 1992), *cert. denied*, 506 U.S.1054 (1993) (involving, in part, failure of plan fiduciaries to bring a shareholder derivative action).

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regulations do for mutual fund investment companies and investment advisers, that plans include in their guidelines language regarding what actions fiduciaries will take to respond to conflicts of interest. However, some plan fiduciaries have taken actions to manage conflicts of interest, including maintaining proxy voting guidelines and disclosing votes. Likewise, a few plan sponsors have hired independent fiduciaries to manage company stock in their pension plans.

DOL's role in enforcing ERISA's fiduciary provisions, including proxy voting requirements, is essential to ensuring that plan fiduciaries are voting solely in the interest of plan participants and beneficiaries. Yet, DOL has faced a number of enforcement challenges, including legal requirements restricting its ability to assess penalties under ERISA. Furthermore, DOL officials said that the agency does not have the statutory authority to require plan fiduciaries to periodically and publicly disclose proxy votes and guidelines. SEC, because of its role in protecting all investors, including those in participant-directed retirement savings plans, has taken steps to increase transparency in the mutual fund industry. DOL's inability to take similar steps with respect to pension plan fiduciaries may provide inappropriate incentives for fiduciaries not to act solely in the interest of plan participants when voting proxies. Furthermore, given both DOL and SEC goals to protect plan participants as investors, coordination of their efforts to achieve this goal is important.

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## Matters for Congressional Consideration

If the Congress wishes to better protect the interest of plan participants and increase the transparency of proxy voting practices by plan fiduciaries, it should amend ERISA to require that plan fiduciaries

- develop and maintain written proxy-voting guidelines;
- include language in voting guidelines on what actions the fiduciaries will take in the event of a conflict of interest; and
- given SEC's proxy vote disclosure requirements for mutual funds, annually disclose votes as well as voting guidelines to plan participants, beneficiaries, and possibly also to the public. From a practical perspective, this disclosure could apply to all votes, but at a minimum, it should include those votes that may affect the value of the shares in the plan's portfolio. Such disclosures could be made electronically on the applicable Website. Since many plans often use multiple fiduciaries for voting proxies, the plan also could provide participants and others directions on how voting records by the various fiduciaries could be

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obtained. We believe that Congress should assure that participants have the right to request proxy voting records at least annually, consistent with their current right to request other plan documents.

Congress should also consider amending ERISA to give the Secretary of Labor the authority to assess monetary penalties against fiduciaries for failure to comply with applicable requirements.

Finally, Congress should consider amending ERISA to require that, at a minimum, an independent fiduciary be used when the fiduciary is required to cast a proxy vote on contested issues or make tender offer decisions in connection with company stock held in the company's own pension plan. In our view, this independent fiduciary requirement would not affect votes by a participant in an eligible individual account plan.

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## Recommendations for Executive Action

To improve oversight and enforcement of proxy voting, we recommend that the Secretary of Labor direct the Assistant Secretary of EBSA to increase the Department's visibility in this area by

- conducting another enforcement study and/or taking other appropriate action to more regularly assess the level of compliance by plan fiduciaries and external asset managers with proxy voting requirements. Such action should include examining votes, supporting analysis, and guidelines to determine whether fiduciaries are voting solely in the interest of participants and beneficiaries, and
- enhancing coordination of enforcement strategies in this area with SEC.

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## Agency Comments and Our Evaluation

We provided a draft of this report to DOL and SEC for their review and comment. DOL's comments are included in appendix II; SEC did not provide written comments. Both agencies provided technical comments, which we have incorporated as appropriate. In its response to our draft report, DOL generally disagreed with our matters for congressional consideration and recommendations, saying that conflicts of interest affecting pension plans are not unique to proxy voting and that requiring independent fiduciaries and increased disclosures would increase costs and discourage plan formation. DOL also said that the enforcement studies of proxy voting practices undertaken previously by the department provide an adequate measure of compliance in this area and, therefore, to undertake new such studies, with an expectation of finding no significant level of noncompliance, would be an inappropriate use of resources.

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Our recommendations and matters for congressional consideration are predicated on two principles: additional transparency and enhanced enforcement presence. We believe that disclosing pension plans' proxy voting guidelines and votes makes it more likely that votes will be cast solely in the interest of plan participants, and that a visible enforcement presence by DOL helps to reinforce the public interest in this result. So although we agree with certain of DOL's points, we cannot agree that additional transparency and an enhanced enforcement presence would not be beneficial. Furthermore, because DOL believes that it does not have the authority to require proxy voting guidelines and disclosure of votes, and, in our view, it is important to shed more light on events such as proxy voting—particularly contested proxy votes—we believe Congress should consider amending ERISA to include such requirements.

We acknowledge that plan fiduciaries face conflicts beyond proxy voting and that conflicts associated with casting a proxy vote may be no greater than the potential for conflicts in making other fiduciary decisions. However, our work and, therefore, our recommendations are focused on issues related to proxy voting. Furthermore, we found that DOL's enforcement in this area has been limited, which may not be the case in its oversight of other fiduciary actions. For example, tender offer decisions made by fiduciaries may suffer from similar conflicts. DOL, however, has been able to develop investigative cases and secure positive results for plan participants and beneficiaries in connection with this area. However, DOL has not been similarly successful in developing proxy voting cases. Given that plan participants may be particularly vulnerable when internal fiduciaries vote employer stock held in the plan sponsor's own pension plan, we believe it is an appropriate safeguard to require an independent fiduciary be appointed to vote these proxies. We are recommending independent fiduciaries for certain circumstances. Furthermore, in our view, this independent fiduciary requirement would not affect votes by a participant in an eligible individual account plan.

In disagreeing with our recommendation that Congress consider amending ERISA to require that an independent fiduciary be used to vote proxies for employer stock held in a plan sponsor's own pension plan, DOL said that the Congress already considered, but did not include, an independence requirement for plan fiduciaries when it passed ERISA in 1974. We acknowledge that Congress did not require independent fiduciaries when it originally enacted ERISA. However, the conflicts of interest associated with plan holdings of company stock have received increased public attention in the last several years, and we believe the Congress should

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reconsider ERISA's current legal requirements in connection with company stock.

In response to our recommendation that DOL conduct another enforcement study to determine the level of compliance with proxy voting requirements, DOL said that it has seen no evidence of a negative change in the level of compliance and that another proxy enforcement study would absorb a considerable amount of resources. Rather than conducting another proxy enforcement study, DOL said that it would evaluate proxy voting information during its investigations in the financial services area. As we discuss in our report, limited statutory authority and other challenges are obstacles to effective DOL enforcement in this area. Furthermore, we understand that DOL must balance efforts in this area with other enforcement priorities. The statutory changes we have suggested, if enacted, may help DOL's enforcement efforts in the future. Nonetheless, even with such changes, we believe that conducting reviews of proxy voting issues on a periodic basis is important to ensure compliance and increase DOL's presence and visibility in this area. We acknowledge that conducting another enforcement study is just one of various options available to DOL to accomplish these goals and have altered our recommendation to be explicit on this point. However, in our view, any review in this area should go beyond simply determining whether fiduciaries cast proxy votes, and should include assessing whether plans are monitoring proxy voting practices by external investment managers and evaluating whether fiduciaries voted solely in the interest of plan participants and beneficiaries.

Regarding our matter for congressional consideration that plan fiduciaries be required to disclose proxy voting guidelines and votes, at a minimum, to plan participants, DOL noted that appropriate plan fiduciaries are required to monitor proxy voting information and that proxy voting guidelines are available to participants upon request. DOL further said that requiring disclosure to the general public or even to all participants would significantly increase costs to plans. Recognizing that ERISA's disclosure requirements are focused on plan participants and beneficiaries, not the general public, we modified our matter for congressional consideration to state that proxy guidelines and votes should at a minimum be disclosed to participants and beneficiaries. Our report addressed concerns about the potential costs of disclosing proxy voting guidelines and votes by suggesting that such information could be made available electronically.

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Unless you publicly announce its contents earlier, we plan no further distribution until 30 days after the date of this report. At that time, we will send copies of this report to the Secretary of Labor, the Chairman of the Securities and Exchange Commission, appropriate congressional committees, and other interested parties. We will also make copies available to others on request. In addition, the report will be available at no charge on GAO's Web site at <http://www.gao.gov>.

If you have any questions concerning this report, please contact me at (202) 512-7215 or George Scott at (202) 512-5932. See appendix III for other contributors to this report.

Sincerely yours,

A handwritten signature in black ink that reads "Barbara D. Bovbjerg". The signature is written in a cursive style with a large, looped initial "B".

Barbara D. Bovbjerg  
Director, Education, Workforce,  
and Income Security Issues

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# Appendix I: Scope and Methodology

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To determine what conflicts exist in the proxy voting system and the extent to which fiduciary breaches occur as a result of these conflicts, we interviewed officials at the Department of Labor's Employee Benefits and Security Administration (DOL) and at the Securities and Exchange Commission (SEC). Using a standard set of questions, we conducted interviews with proxy voting experts, academics, economists, and Employee Retirement Income Security Act (ERISA) attorneys. We also interviewed various proxy voting experts which include academics, ERISA lawyers, industry experts, pension plan sponsors, asset managers, proxy voting firm representatives, proxy soliciting companies, and plan practitioners. These experts were, in part, selected from news articles involving abuses in the mutual fund industry, from news reports regarding corporate scandals such as Enron, from reported highly contested proxy contests, from historical articles dated back to the proxy scandals in the 1980s and 1990s, and from recent reports in the news and SEC's Web site pertaining to SEC's proxy voting disclosure proposals. Experts were also selected based on published research on proxy voting, based on discussions with plan sponsors and industry experts, congressional testimony, and Congressional Research Service reports.

To determine what safeguards fiduciaries have put in place to protect against breaches, we interviewed a number of public and private pension plan sponsors, asset managers, proxy voting firm representatives, and other experts. These public and private pension plans were selected for their promising practices based on discussions with industry experts, from pension industry publications and other published reports of the corporate governance practices of these plans. To explore the practices of internally managed plans, we interviewed various proxy voting experts and interviewed officials of the plans listed in the Pensions and Investments with internally managed assets.

To determine DOL's enforcement of proxy voting requirements, we interviewed officials at EBSA and reviewed DOL enforcement material and previously issued GAO reports on DOL's enforcement program.

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## Obtaining Total Number of Employer Securities Held in the Company's Own Pension and Welfare Benefit Plans

To determine the extent to which private pension plans invested in their own employer securities, we obtained the total value of the employer stock in the company's pension and welfare benefit plans. To do so, we analyzed plan financial information filed annually (Form 5500s) with the Internal Revenue Service and EBSA. The Form 5500 report is required to be submitted annually by the administrator or sponsor for any employee benefit plan subject to ERISA as well as for certain employers maintaining a fringe benefit plan. The report contains various schedules with information on the financial condition and operation of the plan. The total value of employer shares information is provided on either schedule H or schedule I depending on the number of participants covered by the plan. EBSA provided us with a copy of the 2001 electronic Form 5500 database for our analysis.<sup>1</sup> We assessed the reliability of these data for our purposes by evaluating the electronic records selected for analysis for outliers, duplicate records, and otherwise inappropriate values. Form 5500 records that did not meet our review standards were eliminated from our analysis.

We decided to focus our analysis of companies with Form 5500 data to those corporations listed in the Fortune 500.<sup>2</sup> To do so, we matched each Fortune 500<sup>3</sup> company to their pension plans on the basis of their Employer Identification Numbers (EINs).<sup>4</sup>

We used several methods to identify EINs associated with each corporation. We started with a list of EINs for Fortune 500 companies that was purchased from Compustat (a database from Standard & Poors). To

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<sup>1</sup>Plan year 2001 is the most recent year for which plan-specific Form 5500 data were available for our review.

<sup>2</sup>Fortune 500 companies are those representing the 500 largest corporations that are based in the United States, ranked in order of revenues. The Fortune 500 list is released annually in April. The rankings are based on reported revenues in corporate annual reports (10Ks) filed in the year leading up to January 31. Therefore, only public corporations and private corporations that voluntarily release a 10K are included. For example, the April 2004 Fortune 500 list is based on revenues reported between February 1, 2003, and January 31, 2004.

<sup>3</sup>Not all 500 companies were included in our analysis. For example, some companies on the Fortune 500 are privately owned and, therefore, don't have publicly traded stock. Furthermore, there are a handful of companies that were on the Fortune 500 in 2001 but have since gone bankrupt, or are no longer public. This often made it difficult to find the appropriate data for those companies and when that was the case, they were eliminated from the analysis.

<sup>4</sup>An EIN, known as a federal tax identification number, is a nine-digit number that the Internal Revenue Service assigns to organizations.

identify the EINs for the remaining companies, we searched the 10K annual filing statement for each relevant company. We then searched those companies whose Form 5500s reported that they held their own employer securities at the year's plan end year date.<sup>5</sup> This resulted in a database for filing year 2001 containing the information of 490 Form 5500 returns filed by 272 of the Fortune 500 companies.

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## Obtaining the Total Number of Shares Outstanding for Selected Fortune 500 Companies

To analyze the total voting power of those 272 Fortune 500 companies on our list for plan year 2001, we obtained the proxy statements filed with SEC as form 14-A DEF for those companies. Form 14-A DEF statements are the final annual proxy statements sent to all shareholders of a corporation that detail all the issues that are to be voted on. The statements also list the number of shares entitled to vote on the proxy issues and, where applicable, the number of votes per share (e.g., some companies might issue different classes of preferred stock which entitle the owner to more than one vote per share). For each company, we multiplied the number of shares outstanding for each class of share by the number of votes entitled to that class and added up those figures for all classes of shares to get a reflection of total number of shareholder votes. We used data from the 14-A DEF statements filed as soon after the end of calendar year 2001, which was typically in the spring of 2002.

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## Obtaining the Closing Price for Our Fortune 500 Companies

We also obtained share price data from the New York Stock Exchange's (NYSE) Trade and Quote (TAQ) database. We used that database to obtain the closing price (the price of the last transaction of the day) on the day indicated as the plan end of year date from the Form 5500 for each company. The TAQ database contains a listing of intraday transactions (including shares involved and the price) for all companies listed on the NYSE, the National Securities Dealers Stock Exchange (NASDAQ) and the American Stock Exchange (AMEX). To ensure the reliability of the TAQ price date, GAO economists previously conducted a random crosscheck of

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<sup>5</sup>Additionally, we included the employer securities held by master trust investment accounts associated with Fortune 500 benefit plans. A "master trust" is a trust in which assets of more than one plan sponsored by a single employer or by a group of employers under common control are held. In such cases, a benefit plan reports the value of its interest in the master trust account and not any employer securities held by the master trust. Accordingly, we included employer securities reported by master trusts accounts held by Fortune 500 benefit plans.

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the TAQ data with data provided by NADAQ, Yahoo! Finance, and other publicly available stock data sources.

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## Computing the Number of Voting Shares Held in Fortune 500 Company Pension and Welfare Benefit Plans

From the 5500 data, we obtained the total value at yearend for company stock holdings by corporations in their pension and welfare benefit plans. From the TAQ database, we obtained the closing price of the stock on the plan yearend date. We then divided the closing price of the stock into the total value at yearend to get a number of voting shares held in the company's pension and welfare benefit plans.<sup>6</sup>

We then divided the total votes outstanding (i.e., total number of votes based on available classes of stock for each of our Fortune 500 companies) by the number of votes controlled by the pension plan to obtain the voting power, or the percentage of votes controlled by the company's pension and welfare benefit plans.

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<sup>6</sup>We assumed that those shares held by the company and its pension plan(s) are common stock with one vote per share for computation of voting power. To the extent that assumption is inaccurate, our estimates for the voting power of plans in their own company might also be inaccurate.

# Appendix II: Comments from the Department of Labor

**U.S. Department of Labor**

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



July 9, 2004

Barbara D. Bovbjerg  
Director, Education, Workforce, and  
Income Security Issues  
United States General Accounting Office  
Washington, DC 20548

Dear Ms. Bovbjerg:

Thank you for giving the Department of Labor (DOL) the opportunity to offer remarks regard the General Accounting Office's (GAO) draft report entitled "Pension Plans: Additional Transparency and Other Actions Needed in Connection with Proxy Voting" (GAO-04-749). This letter provides comments on the recommendations contained in the draft report; we have already provided technical comments directly to you and your staff.

The GAO report recommends that Congress amend ERISA to require fiduciaries to implement proxy voting guidelines, to disclose these guidelines and proxy votes cast on an annual basis, and to require the appointment of an independent fiduciary to cast proxy votes. These recommendations appear to be predicated on the notion that proxy-voting issues present unique conflict of interest concerns for ERISA fiduciaries, and that these potential conflicts expose plan participants and beneficiaries to significant risks.

The report concludes legislative action is necessary as "conflicts of interest in proxy voting can occur because various business and personal relationships exist, which can influence a fiduciary's vote." In so concluding, however, the report overlooks the fact that Congress did not include an independence requirement for plan fiduciaries when it passed ERISA in 1974, and instead expressly allowed corporate officers and other persons to "wear two hats." While Congress recognized that this created the possibility of conflicts of interest, it addressed these possible conflicts through the high standards of fiduciary duty, the personal liability of fiduciaries for their decisions, the creation of prohibited transactions and similar provisions. Requiring wholly independent fiduciaries would increase costs and discourage the formation of voluntary employee benefit plans. The potential for a conflict of interest in casting a proxy vote is no greater than the potential for a conflict of interest in making dozens of other fiduciary decisions in an ERISA plan. As in those other decisions, the issue is whether the fiduciary acted in the best interests of the participants and beneficiaries.

Part of the Department's duty to oversee ERISA plans is to monitor the exercise of fiduciary duties, including how fiduciaries manage potential conflicts. With respect to proxy voting, the Department has examined the issue on a regular basis, issued several forms of guidance on ERISA's requirements, and filed amicus briefs in several key court cases. In addition, the Department has conducted three specific enforcement studies of

proxy voting practices that determined fiduciaries generally comply with ERISA and, since the completion of the last study, has seen no evidence of a negative change in the level of compliance—indeed, industry best practices embrace proxy guidelines. The Department now includes steps for reviewing proxy voting in its investment management investigative guide and, when such reviews have taken place, few, if any, violations have been uncovered.

The three proxy enforcement studies absorbed a considerable amount of resources, as would any new proxy enforcement study. Given the DOL's other pressing enforcement priorities, the diversion of needed resources to an enforcement study that we have no reason to believe will find significant non-compliance with ERISA would be an inappropriate use of resources. Understanding proxy voting practices is very important, but rather than undertaking another study, the DOL will capture for further evaluation additional proxy voting information during our investigations in the financial services area.

The report also concludes that proxy votes and voting guidelines should be distributed to all participants and be released to the general public. Proxy voting information is required to be monitored by appropriate plan fiduciaries and proxy guidelines are available to participants upon request. Requiring disclosures of proxy voting to all participants would significantly increase printing, mailing and administrative costs to the plan. Current law strikes the proper balance between cost and access by guaranteeing that fiduciaries monitor compliance with proxy guidelines and any participant who wishes to may receive copies of any guidelines upon request.

We appreciate having had the opportunity to review and comment on this draft report.

Sincerely,



Ann L. Combs

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# Appendix III: GAO Contacts and Staff Acknowledgments

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## Contacts

George A. Scott, Assistant Director (202) 512-5932  
Kimberley M. Granger, Senior Economist and Analyst-in-Charge  
(202) 512-3708

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## Staff Acknowledgments

Other major contributors include Gwendolyn Adekun, Matthew Rosenberg, Gene Kuehneman, Lawrance Evans, Alison Bonebrake, Derald Seid, Corinna Nicolaou, Michael Maslowski, Roger J. Thomas, Richard Burkard, and Kenneth J. Bombara.

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