

DOL Proposed Rule Further Discourages ESG Investments by ERISA Plans

Written by Jeffrey D. Collins, Teresa A. Martland, Ellie Kang

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The U.S. Department of Labor (“DOL”) recently issued a proposed regulation (the “Proposed Rule”) under the Employee Retirement Income Security Act of 1974 (“ERISA”) to reinforce its long-standing position that fiduciaries of ERISA plans may not sacrifice investment returns or assume additional investment risks in pursuit of environmental, social, corporate governance or other similarly oriented (“ESG”) objectives. The Proposed Rule is generally consistent with DOL’s prior guidance on ESG issues, except that the Proposed Rule, if finalized, would impose certain specific obligations (including documentation requirements) on ERISA plan fiduciaries considering ESG-oriented investing, as described below.

ERISA requires that a fiduciary act “solely in the interest” of the plan participants and beneficiaries and “for the exclusive purpose” of providing benefits and paying reasonable administrative expenses, using the so-called “prudent expert” standard set forth in ERISA. The “investment duties” regulations under ERISA prescribe how a fiduciary may discharge its ERISA duties of loyalty and prudence when evaluating an investment. Over the years, DOL has articulated its views on whether (and to what extent) ESG investing comports with ERISA’s fiduciary duties. While DOL’s stance on ESG investing has evolved marginally with each presidential administration, DOL has not deviated materially from its fundamental position that an ERISA plan fiduciary may not use ESG factors as a primary reason for choosing an investment.

The Proposed Rule, if finalized, would amend the “investment duties” regulations under ERISA by reiterating its long-standing position on ESG-oriented investing by ERISA plans and expressly imposing certain obligations on fiduciaries with respect to such investment. The following describes the key provisions of DOL’s position as reflected in the Proposed Rule, and notes the new requirements set forth in the Proposed Rule:

- Fiduciaries must evaluate investments based solely on pecuniary factors that have a material effect on the return and risk of an investment and may not subordinate the interests of participants and beneficiaries to the fiduciary’s interests or any other interests.
- The Proposed Rule would require that fiduciaries considering a particular investment for the plan’s investment portfolio must compare such investment to available alternative investments with respect to how such investment would impact the level of diversification, degree of liquidity and potential return of the portfolio in comparison to the alternative investments.
- ESG factors may be considered as pecuniary factors in evaluating an investment only if they present material economic risks or opportunities.
- ESG factors may be used as the “tie-breaker” in the rare instances where two alternative investments appear economically indistinguishable. The Proposed Rule would require that, in such case, the fiduciary must document specifically why the investments were determined to be economically identical and why the selected investment was chosen.
- The Proposed Rule expressly provides that ESG-oriented investment may be offered as part of designated investment alternatives in an individual account plan (such as a “401(k)” plan), provided that the fiduciary uses only objective risk-return criteria to select and monitor all investment alternatives (including any ESG-oriented investments), the fiduciary documents its selection and monitoring of the investment, and the ESG-oriented investment alternative is not added as, or as a component of, a qualified default investment alternative.

ERISA plan fiduciaries should consider whether their current policies and procedures with respect to ESG-oriented investments would be adequate in light of the affirmative obligations set forth in the Proposed Rule. In addition, investment managers offering their funds to

plan fiduciaries or otherwise managing ERISA separate accounts or “plan assets” funds should consider the implications of the Proposed Rule for any ESG factors influencing the funds’ investment decisions (including how ESG factors are described in the funds’ marketing and disclosure materials).

Comments on the Proposed Rule may be submitted to DOL until July 30, 2020. If finalized, the Proposed Rule will become effective on 60 days after the date of publication of the final rule.

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