ERISA Fiduciaries May Factor Climate Change Issues Into Economic Analysis of Investments

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New guidance from the US Department of Labor ("DOL") clarifies the role of environmental, social and governance issues (referred to as "ESG factors") in investment decisions by ERISA fiduciaries. ERISA Interpretive Bulletin 2015-01 recognizes that ESG factors, which include climate change, may directly affect the economic value of an investment, and makes clear that ERISA fiduciaries should appropriately consider such factors in investment decisions.

This Bulletin, effective October 26, 2015, provides welcome guidance to ERISA fiduciaries who may have been reluctant to consider ESG factors in investment decisions for fear of violating the ERISA requirement that a plan fiduciary act solely in the best interests of plan participants. Prior DOL guidance allowed ESG factors to be considered as a tiebreaker where the rate of return and risk factors of two investments were similar (the "all things being equal" test),[1] but in Interpretive Bulletin 2008-01, the DOL warned that "fiduciary consideration of collateral, non-economic factors in selecting plan investments should be rare." IB 2008-01 also suggested that additional analysis and documentation by fiduciaries might be required when ESG factors were considered.

Concerned that IB 2008-01 had "unduly discouraged" ERISA fiduciaries from considering ESG factors, the DOL has withdrawn that Bulletin and replaced it with IB 2015-01. The DOL noted that it was particularly concerned that the 2008 guidance might be "dissuading fiduciaries from pursuing investment strategies that consider [ESG] factors, even where they are used solely to evaluate the economic benefits of investments and identify economically superior investments."

IB 2015-01 reiterates the DOL position that a plan fiduciary must act solely in the best interests of plan participants, and may not subordinate the economic interests of plan participants to ESG objectives, but clarifies that within that context, ESG factors may be considered in one of two ways:

1. *As primary components of economic analysis.*

   Where ESG factors may directly affect the economic return of an investment, such factors should appropriately be part of a primary analysis of an investment's risk. DOL describes this situation as follows:

   > *Environmental, social, and governance issues may have a direct relationship to the economic value of the plan's investment. In these instances, such issues are not merely collateral considerations, or tie-breakers, but rather are proper components of the fiduciary's primary analysis of the economic merits of competing investment choices.*[2]

   Climate change, for example, is increasingly viewed by investors as such a primary economic factor. A new report by the University of Cambridge Institute for Sustainability Leadership suggests that investment portfolios could lose up to 45% as a consequence of short term shifts in climate change sentiment, a risk which the report finds could be significantly mitigated by factoring in such issues.[3]

2. *As a tie-breaker.*

   Where a fiduciary is deciding between otherwise equal investment choices, ESG factors may appropriately be used as a "tie-breaker."

The DOL also clarified that consideration of ESG factors does not require additional documentation or evaluation by fiduciaries beyond that required by fiduciary standards applicable to plan investments generally.

This new guidance should provide welcome news to ERISA fiduciaries looking to factor sustainability and climate change related factors into investment decisions and portfolio management.

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[1] DOL Interpretive Bulletin 94-01.

[2] Preamble, DOL Interpretive Bulletin 2015-01

[3] "Unhedgeable Risk: How Climate Change Sentiment Impacts Investment." November 12, 2015.

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