

# ESG INVESTING FOR ERISA PLANS

- **November 2020**

- Under Trump administration, DOL regulations dropped environmental, social and governance (ESG) terminology and set a high standard for considering factors other than purely financial projections for investment alternatives
- A pecuniary factor is a factor that the plan fiduciary determines “will likely have a material effect on an investment’s risk and/or return, based on appropriate investment horizons consistent with the plan’s investment objectives and funding policy”
- Non-pecuniary factors can be considered if the plan fiduciary (i) determines and documents why pecuniary factors are not sufficient to select between available alternatives, (ii) compares the pecuniary factors of the alternatives and (iii) explains why considering non-pecuniary factors is in the best interests of the plan’s participants and beneficiaries and served the retirement or other financial interests of the plan

- **March 2021**

- Under Biden administration, DOL stated that it will not enforce November 2020 regulations or pursue enforcement actions against plan fiduciaries for failure to comply with November 2020 regulations

# ESG INVESTING FOR ERISA PLANS

- **October 2021**

- Proposed regulations allow ESG factors and other “collateral benefits” (such as social good) to be used as a tie breaker when deciding between financially-equivalent investments
- Climate change and other ESG factors can be financially material to plan investments and therefore “will inevitably lead to better long-term risk-adjusted returns, protecting the retirement savings
- ESG funds can be a plan’s default investment for participants who do not make investment elections
- DOL is accepting comments on the proposed regulations through December 13, 2021; regulations only take effect once finalized and published

57272 Federal Register / Vol. 86, No. 196 / Thursday, October 14, 2021 / Proposed Rules

**DEPARTMENT OF LABOR**  
**Employee Benefits Security Administration**  
**29 CFR Part 2550**  
**RIN 1210-AC09**  
**Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights**  
**AGENCY:** Employee Benefits Security Administration, Department of Labor.  
**ACTION:** Proposed rule.

**SUMMARY:** The Department of Labor (Department) in this document proposes amendments to the Investment Duties regulation under Title I of the Employee Retirement Income Security Act of 1974, as amended (ERISA), to clarify the application of ERISA’s fiduciary duties of prudence and loyalty to selecting investments and investment courses of action, including selecting qualified default investment alternatives, exercising shareholder rights, such as proxy voting, and the use of written proxy voting policies and guidelines.

**DATES:** Comments on the proposal must be submitted on or before December 13, 2021.

**ADDRESSES:** You may submit written comments, identified by RIN 1210-AC09 to either of the following addresses:

- **Federal eRulemaking Portal:** [www.regulations.gov](http://www.regulations.gov). Follow the instructions for submitting comments.
- **Mail:** Office of Regulations and Interpretations, Employee Benefits Security Administration, Room N-5655, U.S. Department of Labor, 200 Constitution Avenue NW, Washington, DC 20210, Attention: Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights.

**Instructions:** All submissions received must include the agency name and Regulatory Identifier Number (RIN) for this rulemaking. Persons submitting comments electronically are encouraged not to submit paper copies. Comments will be available to the public, without charge, online at [www.regulations.gov](http://www.regulations.gov) and [www.dol.gov/agencies/ebsa](http://www.dol.gov/agencies/ebsa) and at the Public Disclosure Room, Employee Benefits Security Administration, Suite N-1512, 200 Constitution Avenue NW, Washington, DC 20210.

**Warning:** Do not include any personally identifiable or confidential business information that you do not want publicly disclosed. Comments are public records posted on the internet as received and can be retrieved by most internet search engines.

**FOR FURTHER INFORMATION CONTACT:** Fred Wong, Acting Chief of the Division of Regulations, Office of Regulations and Interpretations, Employee Benefits Security Administration, (202) 693-8500. This is not a toll-free number.

**Customer Service Information:** Individuals interested in obtaining information from the Department of Labor concerning ERISA and employee benefit plans may call the Employee Benefits Security Administration (EBSA) Toll-Free Hotline, at 1-866-444-EBSA (3272) or visit the Department of Labor’s website ([www.dol.gov/ebsa](http://www.dol.gov/ebsa)).

**SUPPLEMENTARY INFORMATION:**

**A. Background and Purpose of Regulatory Action**

**1. General**

Title I of the Employee Retirement Income Security Act of 1974 (ERISA) establishes minimum standards that govern the operation of private-sector employee benefit plans, including fiduciary responsibility rules. Section 404 of ERISA, in part, requires that plan fiduciaries act prudently and diversify plan investments so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so.<sup>1</sup> Sections 403(c) and 404(a) also require fiduciaries to act solely in the interest of the plan’s participants and beneficiaries, and for the exclusive purpose of providing benefits to participants and beneficiaries and defraying reasonable expenses of administering the plan.<sup>2</sup>

For many years, the Department’s non-regulatory guidance has recognized that, under the appropriate circumstances, ERISA fiduciaries can make investment decisions that reflect climate change and other environmental, social, or governance (“ESG”) considerations, including climate-related financial risk, and choose economically targeted investments (“ETIs”) selected, in part, for benefits apart from the investment return.<sup>3</sup> The Department’s non-regulatory guidance has also recognized that the fiduciary act of managing employee benefit plan assets includes the management of voting rights as well as other shareholder rights connected to shares of stock, and that management of those rights, as well as shareholder engagement activities, is subject to

ERISA’s prudence and loyalty requirements.<sup>4</sup> On June 30 and September 4, 2020, the Department published in the **Federal Register** proposed rules to remove prior non-regulatory guidance from the CFR and to amend the Department’s Investment Duties regulation under Title I of ERISA at 29 CFR 2550.404a-1 (hereinafter “current regulation” or “Investment Duties regulation,” unless otherwise stated). The stated objective was to address perceived confusion about the implications of that non-regulatory guidance with respect to ESG considerations, ETIs, shareholder rights, and proxy voting. See 85 FR 39113 (June 30, 2020); 85 FR 55219 (Sept. 4, 2020). The preambles to the 2020 proposals expressed concern that some ERISA plan fiduciaries might be making improper investment decisions, and that plan shareholder rights were being exercised in a manner that subordinated the interests of plans and their participants and beneficiaries to unrelated objectives. See 85 FR 39116; 85 FR 55221.

On November 13, 2020, the Department published a final rule titled “Financial Factors in Selecting Plan Investments,” 85 FR 72846 (Nov. 13, 2020), which adopted amendments to the Investment Duties regulation that generally require plan fiduciaries to select investments and investment courses of action based solely on consideration of “pecuniary factors.” The current regulation also contains a prohibition against adding or retaining any investment fund, product, or model portfolio as a qualified default investment alternative (QDIA) as described in 29 CFR 2550.404c-5 if the fund, product, or model portfolio reflects non-pecuniary objectives in its investment objectives or principal investment strategies. On December 16, 2020, the Department published a final rule titled “Fiduciary Duties Regarding Proxy Voting and Shareholder Rights,” 85 FR 21658 (December 16, 2020), which also adopted amendments to the Investment Duties regulation to establish regulatory standards for the obligations of plan fiduciaries under ERISA when voting proxies and exercising other shareholder rights in connection with plan investments in shares of stock.

On January 20, 2021, the President signed Executive Order 13990 (E.O. 13990), titled “Protecting Public Health and the Environment and Restoring Science to Tackle the Climate Crisis,”

<sup>1</sup> 29 U.S.C. 1104.  
<sup>2</sup> 29 U.S.C. 1103(c) and 1104(a).  
<sup>3</sup> See, e.g., Interpretive Bulletin 2015-01, 80 FR 6215 (Oct. 29, 2015).  
<sup>4</sup> See, e.g., Interpretive Bulletin 2016-01, 81 FR 92875 (Dec. 29, 2016).

# ESG INVESTING FOR ERISA PLANS

- Selecting plan investments is a fiduciary act under ERISA
  - Plan fiduciaries must act solely in the interest of participants and beneficiaries and cannot place other interests above financially preparing participants for retirement
  - Plan fiduciaries must act with the care, skill, prudence and diligence that a prudent person familiar with such matters would use similar circumstances
- DOL has historically limited the extent to which factors other than the financial risk and returns of a fund can be considered in selecting investments for an ERISA
- Current standards for taking ESG factors into account when selecting investments for ERISA plans are unclear because the DOL is no longer enforcing current law (November 2020 regulations)
- Most plan fiduciaries remain cautious about considering non-financial factors when selecting plan investments because an underperforming fund could be the basis for participant claims or litigation or may need to be phased out again if DOL guidance changes