DOL ISSUES FINAL RULE RESTRICTING ESG INVESTMENTS IN RETIREMENT PLANS

Hodgson Russ Employee Benefits Newsletter
December 31, 2020

On October 30, 2020, the U.S. Department of Labor issued its final rule on Financial Factors in Selecting Plan Investments ("Final Rule"). The Final Rule amends the investment regulations under ERISA, requiring retirement plan fiduciaries to satisfy their duties of prudence and loyalty by selecting investments based solely on pecuniary considerations.

Consistent with the Proposed Regulations issued in June (see our article here), the Final Rule restricts retirement plan fiduciaries from considering non-pecuniary environmental, social and governance ("ESG") factors when selecting the investments to be offered to plan participants. Non-pecuniary factors may only be taken into account in "tiebreaker" situations where two investment alternatives are indistinguishable in terms of pecuniary factors.

The Final Rule departs from the Proposed Regulations in the following respects:

- Replaces all references to ESG with "non-pecuniary" because of the lack of a precise, consistent definition of ESG;
- Removes specific language regarding which investment characteristics might constitute pecuniary ESG considerations;
- Separates regulatory provisions related to the duties of prudence and loyalty, and clarifies that the duty of prudence provisions continue to provide a safe harbor, whereas the duty of loyalty provisions are minimum standards;
- Incorporates new language regarding the investment analysis and documentation requirements that must be satisfied for plan fiduciaries to consider non-pecuniary factors in "tiebreaker" situations; and
- Adds language indicating that fiduciaries must consider "reasonably available alternatives" to indicate that fiduciaries need not "scour the market" or evaluate every possible investment alternative to satisfy the Final Rule.

The Final Rule sets forth the following fiduciary principles:

1. ERISA fiduciaries must satisfy the duties of prudence and loyalty by evaluating and selecting investments based solely on pecuniary factors – e.g., financial considerations that have a material effect on risk and/or return based on appropriate investment horizons;

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2. Compliance with the duty of loyalty prohibits fiduciaries from subordinating the interests of participants to unrelated objectives, from sacrificing investment returns, or taking on additional investment risk to promote non-pecuniary goals;
3. Fiduciaries must consider reasonably available alternatives to satisfy the duties of prudence and loyalty;
4. Fiduciaries must satisfy investment analysis and documentation requirements if non-pecuniary factors are used in "tiebreaker" situations where investment alternatives are indistinguishable based on pecuniary factors, including demonstrating;
   a. Why pecuniary factors were not sufficient to select the investment;
   b. How the selected investment compares to alternative investments with regard to liquidity, diversity, and returns; and
   c. How the non-pecuniary factor(s) are consistent with the interests of participants in their retirement income or financial benefits under the plan; and
5. ERISA fiduciaries of participant-directed retirement plans are not outright prohibited from including an investment fund that promotes non-pecuniary goals so long as a fiduciary's evaluation of the investment is based solely on pecuniary factors.

The Final Rule becomes effective January 12, 2021. Because the Final Rule is prospective in effect, plan fiduciaries are not required to immediately divest their ESG investment offerings. However, the DOL stated in preambles to the Final Rule that fiduciaries nonetheless have an ongoing duty to monitor ESG investment offerings, and to consider whether investments featuring non-pecuniary factors continue to be viable under the fiduciary standards of the Final Rule, sufficient to be retained. In contrast, plan administrators have until April 30, 2022 to implement the obligation to divest QDIAs that are not compliant with the Final Rule.

Department of Labor, Employee Benefits Security Administration, 29 CFR Parts 2509 and 2550, Financial Factors in Selecting Plan Investments, 88 Fed. Red. 72846 (November 13, 2020).