DOL FINALIZES RULE PERMITTING ESG INVESTMENTS IN RETIREMENT PLANS & ISSUES PROPOSED EXPANSION OF VOLUNTARY FIDUCIARY CORRECTION PROGRAM

Hodgson Russ Employee Benefits Alert
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DOL Publishes Final ESG Rule. The back and forth associated with the developing rules for environmental, social, and governance ("ESG") investments by ERISA plans has reached a new plateau with the issuance of a final rule entitled "Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights" that removes barriers fiduciaries confronted when seeking to include ESG investment options in retirement plans ("Final Rule").

ERISA requires plan fiduciaries to act prudently and diversify plan investments so as to minimize the risk of losses. ERISA also requires that fiduciaries act solely in the interest of the plan's participants and beneficiaries, and for the exclusive purpose of providing benefits to participants and beneficiaries. To maximize benefits, the focus of retirement plan fiduciaries on the plan's financial returns and risk to beneficiaries must be paramount. Within this statutory framework in 2020, the Trump administration issued a final rule which generally required plan fiduciaries to select investments based solely on consideration of "pecuniary factors." The 2020 Rule fundamentally barred retirement plan fiduciaries from selection investment options based upon ESG considerations.

The Final Rule, which goes into January 30, 2023, retains the core principal that the duties of prudence and loyalty require retirement plan fiduciaries to focus on relevant risk-return factors and not subordinate the interests of participants and beneficiaries to objectives unrelated to the provision of benefits under the plan. However, the rule amends the current regulations to clarify that a fiduciary's determination with respect to an investment or investment course of action must be based on factors that the fiduciary reasonably determines are relevant to a risk and return analysis – and such factors *may include* the economic effects of climate change and other ESG factors. So, while there is no mandate to consider ESG factors under this Final Rule, fiduciaries must consider factors they reasonably determine are relevant to a risk and return of the investments, and those factors may include the economic effects of climate change and other ESG considerations on the particular investment or investment course of action.

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Consistent with the focus on risk and return, the Final Rule amends the 2020 Rule's "tiebreaker" test, which allowed collateral benefits to be considered only when two investments are "economically indistinguishable." The Final Rule instead requires the fiduciary to prudently conclude that competing investments, or competing investment courses of action, equally serve the financial interests of the plan over the appropriate time horizon. In such cases, a fiduciary is permitted to select the investment, or investment course of action, based on collateral benefits other than investment returns. The Final Rule also removes the 2020 Rule's special documentation requirement imposed in the tie-breaker context.

There are a few other noteworthy changes:

- Proxy Voting - The Final Rule clarifies that the management of shareholder rights, such as the right to vote proxies, is part of the fiduciary duty to manage plan assets invested in shares of stock. Proxies should be voted as part of the process of managing the plan's investment in company stock unless a responsible plan fiduciary determines voting proxies may not be in the plan's best interest (e.g., when voting proxies may involve exceptional costs or unusual requirements).
- Consideration of Participant Preferences - Fiduciaries may take participants' preferences into account when constructing a menu of prudent investment options for participant-directed individual account plans, so long as the prudent risk/return analysis supports the offering.
- No Separate Treatment of QDIAs - The Final Rule's standards applied to selecting qualified default investment alternatives are no different from those applied to other investment choices.

DOL Considering VFCP Expansion. Separately, the DOL is exploring an expansion of their Voluntary Fiduciary Correction Program (VFCP), under which plan fiduciaries can avoid civil enforcement and penalties for breaches of certain ERISA obligations. The proposed changes to VFCP include the addition of a self-correction component for employers who fail to remit employee salary withholding contributions or participant loan repayments to retirement plans in a timely manner. The self-correction feature would allow employers to notify EBSA electronically of the correction of late remittances of deferrals or loan repayments, subject to the following conditions:

1. Participant contributions or loan repayments to the plan must be remitted no more than 180 calendar days from the date of withholding or receipt.
2. Lost earnings using the DOL's online calculator must not exceed $1,000.
3. The plan sponsor or fiduciary self-correcting the late remittances must not be under investigation as defined in the program.
4. Self-correctors must use an online tool to complete and file the self-correction component notice, and complete and retain the self-correction retention record checklist.

If you have any questions regarding the new ESG guidance, the new VFCP proposal, or any other aspect of your employee benefits plan, please contact any member of our **Employee Benefits** group.