

Department of Labor Imposes New Restrictions on ESG Investments in Retirement Plans

Chad DeGroot
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Retirement plan fiduciaries and participants with the ability to direct the investment of their retirement accounts increasingly have considered environmental, social, and governance (ESG) factors important to their investment decisions. However, in a recently issued final rule, the DOL significantly restricted the ability of retirement plans and their participants to consider ESG factors in selecting investment vehicles or options.

The final rule leans on ERISA's fiduciary duties of prudence and loyalty by requiring that ERISA fiduciaries choose investments "based solely on pecuniary factors" relevant to a particular investment. In other words, the final rule requires that fiduciaries must look solely to economic factors, such as risk of loss and opportunity for gain when comparing investment vehicles, and that they do not consider non-economic factors, such as ESG factors, except where those factors may act as a "tiebreaker" among economically equivalent investments.

The final rule cautions against hastily concluding that nonpecuniary factors may be considered, and requires in such cases that fiduciaries document why investments are otherwise equivalent, how the selected investment compares to the alternative from a financial and investment composition standpoint, and how the ESG/non-pecuniary factors are consistent with the interests of participants under the plan. So, while the rule did not go so far as to specifically prohibit applying ESG factors in making investment decisions, fiduciaries may find that investing in ESG/non-pecuniary investments to be more burdensome now.

Attorneys

Chad R. DeGroot

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Note that while the final rule will be effective on January 12, 2021, it is possible that the new administration modifies the rule or curbs its enforcement, considering the ideological undertones.