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ESG and Qualified Plans: The Who, What, When, Where, Why (and, Most Importantly, How) ERISA Plan Fiduciaries Prudently Consider ESG-Related Investments

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Mr. Campbell concentrates his practice in Employee Benefits advice, specializing in ERISA Title I issues, including fiduciary conduct and prohibited transactions. He also serves as an expert witness in ERISA litigation. The former Assistant Secretary of Labor for Employee Benefits, head of the Employee Benefits Security Administration, Mr. Campbell was ERISA's primary Federal regulator and law enforcement official. He played a key role in ERISA retirement and health reform initiatives of the prior decade, and his regulatory and policy decisions had a fundamental impact on the structure and operation of ERISA plans, including:

- Proposing the initial 408(b)(2) service provider and 404(a)(5) participant disclosure regulations
- Issuing final regulations establishing Qualified Default Investment Alternatives (QDIAs), electronic fee disclosure, and participant access to investment advice
- Administering an enforcement program reporting more than $2.6 billion in monetary results and more than 200 criminal indictments

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Nearly 30 Years of History: DOL and ESG

- DOL first addressed ESG-related investments in ERISA plans in 1994 (then called "economically targeted investments").
- Four guidance documents over four Presidential Administrations (1994, 2008, 2015, 2018) were generally consistent in their fiduciary direction, though they differed in tone. They agreed that:

1. Investments with ESG-related features, when selected through the same prudent and thorough fiduciary process used for other plan investments, may be utilized consistent with ERISA's fiduciary duties of prudence and loyalty; and
2. It is not prudent to select investments that are expected to provide a plan with a lower rate of return or higher risk than available alternative investments with commensurate rates of return or degrees of risk.

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Trump ***Proposal*** was Focused on ESG…

Controversial proposal garners extensive negative comments:

1. Singles out ESG investments for additional fiduciary review and scrutiny;
2. Permits “pecuniary” ESG factors to be used (factors material to analysis under generally accepted investment theories).
3. Permits ESG factors to be tie-breaker for “economically indistinguishable” investments.
4. BUT does not allow ESG-related investments to be QDIAs
5. AND does not define ESG!

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…But, ***Final Rule*** No Longer Mentions ESG Specifically

Final Financial Factors rule modified and improved somewhat:

1. No longer singles out ESG—now applies “pecuniary” test to ***all*** factors with no specific mention of ESG.
2. Can only use “pecuniary” factors to select (those material to analysis during time period plan will hold investment).
3. Can use “non-pecuniary” factors as tie-breaker.
4. DIA can have “non-pecuniary” aspects, as long as selected only on basis of “pecuniary” factors.
5. Limited ability for “non-pecuniary” factors to be present in QDIAs at all.
6. Effective 1/12/21, applies when plan next reviews investments after that, grandfather for existing QDIA until April 2022.

Biden DOL: Trump Rule Suspended…

- Biden January Executive Order directed review of Financial Factors rule.
- DOL review cited concerns that Trump rule:
  - confused fiduciaries,
  - chilled investment in “appropriate” ESG vehicles, and
  - created a false “perception that fiduciaries are at risk” when selecting ESG investments
- DOL announced in March that it will suspend enforcement of the rule—the rule still exists, but it will not be enforced.

…And Will Replace It with an ESG-Friendly New Rule

- Biden issued new May Executive Order directing DOL to propose new Financial Factors rule by September 2021.
- EO also called for review of ESG in Federal employees' Thrift Savings Plan.
- New Spring Regulatory Agenda confirms September proposal date.
- DOL meeting with stakeholders now.
- Likely to encourage ESG—"important role [ESG] integration can play in" plan investing.

We Don’t Have to Wait: Plans Can Select ESG Now

- Many investment managers are using ESG-factors as additional tools and metrics to diversify investments, reduce risks and potentially increase returns.
- Fiduciaries can and should consider ESG-related investments available to the plan—what DOL calls “the important role that [ESG] integration can play in the evaluation and management of plan investments.”
- Fiduciaries should use their prudent investment process to consider investments with ESG features just as they would other investments. ESG-related investments that pass investment process “screening” are as prudent as any other investments produced by that process.

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Thank you

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