DOL PROPOSAL WOULD REMOVE BARRIERS TO ESG INVESTING IN RETIREMENT PLANS

FALL FORUM 2021: SHAPING THE NEW NORMAL

By: Randy Myers

A proposed new rule from the U.S. Department of Labor should finally resolve any questions retirement plan fiduciaries have about incorporating environmental, social and governance factors into investment decisions made in those plans. Or maybe not. After all, the DOL's position has already changed several times in the not-so-distant past.

"ESG guidance coming out of the Department of Labor has sort of whiplash-inducing over the years," observed attorney Beth Dickstein. A partner with the law firm of Sidley Austin LLP, Dickstein spoke about the issue at the 2021 SVIA Fall Forum on the morning of October 13, just a few hours before the proposed new rule was released.

"If it's a Republican administration it's been more conservative, if it's a Democratic administration it's become a little less conservative," she said. "We've had various iterations."

Dickstein, who co-leads her firm's global employee benefits and executive compensation practice, noted that under the Trump administration the DOL had instructed plan fiduciaries to focus only on pecuniary factors in making investment decisions within their plan. The Trump administration "did recognize that certain types of ESG factors could actually be pecuniary, such as a dysfunctional corporate board or a company dumping toxic waste," she said. But its rules were nonetheless widely viewed as having a chilling effect on ESG investing in retirement plans. Indeed, Dickstein noted that she was aware of a situation in which a mutual fund company, was subjected to a "very focused" investigation by the DOL after including a "pretty innocuous" paragraph in the very lengthy disclosure language for one of its funds. That paragraph indicated the fund would consider ESG factors where it was believed it would enhance performance. Another client, which hired managers for a 401(k) plan, faced a similar inquiry, she said.

The proposed new rule, which the DOL says would remove barriers to plan fiduciaries' ability to consider climate change and other ESG factors when selecting investments and exercising shareholder rights, has not yet been finalized. It must go through a 60-day public comment period before that can happen. But Dickstein said that if the nation elects a Republican to the White House again in 2024 she would expect that any new, more liberal guidance around ESG investing would change again.

As it is, she said, most of the plan fiduciaries she talks with are not enthusiastic about offering an ESG-focused fund as an investment option right now for fear that it could lead to litigation. As an alternative, some offer a brokerage window to plan participants, through which they can access just about any type of fund they might want to use. In fact, under the existing guidance issued during the Trump administration that is still technically in place—even though the Biden DOL is not enforcing it—Dickstein said she would be nervous about putting an ESG fund in her own firm's plan, for which she serves as a fiduciary. But, she conceded, it is possible that "the new guidance will provide a little more comfort that having one of those funds would be okay."

In announcing the DOL's new proposed rule later that day—it's called "Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights"—the DOL said it would remove barriers to ESG investing in retirement plans.

"The proposed rule announced today will bolster the resilience of workers' retirement savings and pensions by removing the artificial impediments—and (the) chilling effect on environmental, social and governance investments—caused by the prior administration's rules," said Acting Assistant Secretary for the Employee Benefits Security Administration Ali Khawar in a DOL news release. "A principal idea underlying the proposal is that climate change and other ESG factors can be financially material and when they are, considering them will inevitably lead to better long-term risk-adjusted returns, protecting the retirement savings of America's workers."

In a subsequent call with reporters, PLANSPONSOR magazine later wrote that Khawar said the proposal "also affirmatively answers the question of whether ESG-focused investment options can be used as a retirement plan's qualified default investment alternative (QDIA)." Khawar also said the proposed new rule seeks to address what he called "the anti-proxy voting bias created by the previous administration's rules."

Under a DOL final rule released under the Trump administration in December 2020, retirement plan fiduciaries were barred from casting corporate-shareholder proxy votes in favor of social political positions that didn't advance the financial interests of retirement plan participants. The Biden administration, which hasn't been enforcing that rule, has held the position that fiduciaries "should be getting involved in these proxy contests and voting to help the environment," Dickstein said.

Amid all these changes, Dickstein noted that some underlying principles remain unchanged, namely that fiduciaries must always put the interests of plan participants first, and make sure they are investing prudently.