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ESG Ping-Pong®

by Kenneth F. Ginder on April 12, 2021

The recent regulatory back-and-forth over the investment of ERISA-governed retirement plan assets based on environmental, social, and corporate governance ("ESG") factors has demonstrated that ESG investing will remain under an intense spotlight for some time to come, and the rules can change quickly. As a result, investment fiduciaries should proceed cautiously when incorporating ESG factors; bearing in mind both the current state of the rules (and how they may change), and the information regulators, participants, or beneficiaries will likely request when seeking to understand the selection of ESG investments and compliance with ERISA.

In June 2020, the U.S. Department of Labor ("DOL") issued proposed regulations outlining the duties of an ERISA fiduciary when considering an investment that incorporates ESG factors. The proposed rule reflected the DOL's concerns regarding ESG investments within retirement plans, and our August, 2020 post noted that the DOL would likely move quickly to finalize the rule.

In October 2020 the DOL issued a final rule and in our December, 2020 Client Advisory we noted that, although all ESG terminology had been removed from the final rule, the rule would likely have a chilling effect on ESG investing. Coming on the heels of the final rule in December 2020, the DOL issued a separate final rule on proxy voting, which reflects the DOL's specific concern that plan assets could be used improperly to vote shares to support ESG issues not connected to increasing the value of the investment.

On March 10, 2021, the DOL, under a new administration, issued a statement that, until it publishes further guidance, it will not enforce the final rules on ESG investments and proxy voting described above. The non-enforcement policy is in response to a January 25, 2021 Executive Order directing agencies to review certain regulations that are or may be inconsistent with policies that promote and protect public health and the environment and that ensure agency activities are guided by the best science and protected by processes that ensure the integrity of Federal decision-making.

The DOL further explained that it had heard from many stakeholders who questioned whether the two rules (i) properly reflect the scope of fiduciary duties under ERISA, (ii) were rushed, (iii) failed to adequately consider and address substantial evidence submitted on the use of ESG considerations in improving investment value and long-term investment returns for retirement investors, and (iv) may have had a chilling effect on the appropriate integration of ESG factors, particularly where the rules clearly allow such factors. As a result of these concerns, the DOL intends to revisit the rules.

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Although the DOL will not enforce the rules until further guidance is issued, fiduciaries should proceed cautiously. The DOL's non-enforcement policy does not revoke the final rules and there is no timetable for when any changes may be made. In the meantime, the DOL's policy does not preclude participants and beneficiaries from bringing civil actions against fiduciaries for violating the rules. Perhaps most importantly, these recent regulatory developments indicate that (i) ESG investments will continue to be under a spotlight for the foreseeable future and (ii) the rules can change quickly. Consequently, fiduciaries of ERISA-governed retirement plans should carefully consider whether ESG investments are appropriate in this ping-ponging environment.

If a fiduciary intends to incorporate ESG factors (or has already done so) regarding retirement plan investments, it should be aware that last year the DOL examined a number of plans it believed to be offering ESG investments. A sample introductory letter from the DOL states that it "seeks to better understand the fiduciaries' selection of ESG funds for inclusion in the Plan's investment options and compliance with their duty to administer the Plan" in accordance with ERISA. The letter then requests extensive information regarding the plan fiduciaries' utilization of ESG factors when selecting and monitoring investment options for the plan. The requests are instructive, and include the following:

- All investment policies or guidelines, including any concerning the use of ESG factors, and all proxy voting policies for the plan.
- All documents relating to the fiduciaries' use or consideration of ESG factors in connection with the investment options for the plan, selection of investment funds for inclusion in the plan's fund line-up, or monitoring investment performance.
- Documents that show the names, addresses, and responsibilities of all persons or entities with responsibility for making investment decisions, or providing investment advisory or consulting services, that take into account ESG factors in connection with the plan's investments.
- Any meeting notes or minutes relating to the consideration of ESG factors by plan fiduciaries.
- Identification of any investment holdings or transactions which were based in whole or part on the consideration of ESG factors, and all related gain/loss information, financial statements, and disclosures or communications describing the operation, investment risks, management, or investment performance.
- Any statements or document furnished to the participants related to the plan's use of ESG factors or describing the fund line-up for the plan.

The requests demonstrate the breadth of information the DOL may consider in order to understand the ESG investment selection and monitoring processes followed by fiduciaries. Although the DOL is currently in a non-enforcement posture, it is prudent for fiduciaries considering ESG factors to be prepared to address such a request from the DOL, participants, or beneficiaries. Fiduciaries should review the plan's investment policy statement to confirm they are acting in a manner consistent with that statement and document that they followed a prudent process for fund selection (and for monitoring fund performance), including documenting the rationale for the decisions made. Until the ESG Ping-Pong® game is over, ERISA fiduciaries need to proceed cautiously in this area.

Please contact a member of Verrill's Employee Benefits & Executive Compensation Group if you have questions regarding ESG investing.

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