



Financial Factors in Selecting Plan Investments - Final Rule

Ethically responsible investing has been a hot topic in recent years. In response to increasing demand from investors, a new class of “sustainable investing” vehicles – that is, investments that focus on non-pecuniary interests such as environmental, social, and governance (“ESG”) factors – has emerged in the marketplace in recent years.

The availability of ethically responsible investment options raises an important question for fiduciaries of ERISA-covered retirement plans: to what extent are plan fiduciaries permitted to consider non-financial interests such as ESG factors when selecting plan investments?

The Department of Labor (DOL) first addressed the application of the fiduciary duties of prudence and loyalty under ERISA to plan investments that promote non-pecuniary benefits in Interpretive Bulletin 94-1 (IB-94-1), which stated that when competing investments serve the plans economic interests equally well, fiduciaries may use non-pecuniary considerations as a “tie-breaker.”

Since IB-94-1, additional guidance came in 2008 with IB 2008-0, in 2015 with IB 2015-01, and more recently with a 2018 Field Assistance Bulletin. Each one of these pieces of guidance made clear that ERISA requires plan fiduciaries to consider the financial interests of the plan participants and beneficiaries above everything else.

In June 2020 the DOL published a proposed rule on ESG investing, noting concern “that the growing emphasis on ESG investing may be prompting ERISA plan fiduciaries to make investment decisions for purposes distinct from providing benefits to participants and beneficiaries and defraying

reasonable expenses of administering the plan.” The DOL added that it was “concerned that some investment products may be marketed to ERISA fiduciaries on the basis of purported benefits and goals unrelated to financial performance.”

The final rule, published October 30, 2020, prohibits fiduciaries from selecting investments based solely on non-pecuniary considerations. However, in the case of participant-directed plans such as 401(k) plans that allow participants to select from a broad range of investment options, plan fiduciaries may in some circumstances offer ESG or other investment options that focus on non-pecuniary interests as one of the plan’s available investment alternatives, provided that generally applicable fiduciary duties are otherwise satisfied in connection with the investment.

The final rule adds the following six “core additions” to the current investment duties regulation at 29 CFR 2550.404a-1:

Loyalty Duty- the final rule continues to treat the original 1979 regulation’s provisions on the fiduciary duty of prudence as a safe harbor. In addition, the rule separately sets out a new provision regarding a fiduciary’s duty of loyalty under ERISA section 404(a)(1)(A) as minimum requirements for meeting the statutory standard of loyalty.

Pecuniary Factors- the final rule adds a specific provision to confirm that ERISA fiduciaries must evaluate investments and investment courses of action based solely on pecuniary factors. This provision also states that the duty of loyalty prohibits fiduciaries from subordinating the interests of participants to unrelated objectives and bars them from sacrificing investment return or taking on

additional investment risk to promote non-pecuniary goals.

Reasonable Alternatives- The final rule adopts the provision that requires fiduciaries to consider reasonably available alternatives to meet their prudence duties under ERISA, however this does not suggest a fiduciary has to evaluate an infinite number of possible alternatives.

Investment Analysis and Documentation- The final rule includes new regulatory text setting forth required investment analysis and documentation requirements for those limited circumstances in which plan fiduciaries may use non-pecuniary factors to choose between or among investments that the fiduciary cannot distinguish based on pecuniary factors alone.

Investment Alternatives- The final rule does not categorically prohibit the fiduciaries of plans from considering or including, as designated investment alternatives, investment funds, products, or model portfolios that support non-pecuniary goals if the plans allow participants and beneficiaries to choose from a broad range of investment alternatives, as defined in 29 C.F.R. § 2550.404c-1(b)(3). However, fiduciaries must first satisfy the prudence and loyalty provisions in ERISA and the final rule, including the overarching requirement to evaluate investments solely based on pecuniary factors when selecting any such investment fund, product, or model portfolio.

QDIAs- the final rule prohibits plans from adding or retaining any investment fund, product, or model portfolio as a QDIA (as described in 29 C.F.R. § 2550.404c-5), or as a component of such a default investment alternative, if its objectives or goals or its principal investment strategies include, consider, or indicate the use of one or more non-pecuniary factors. ■