

Publications

DOL and ESG Investing: Evolving Guidance

ATTORNEYS & PROFESSIONALS

Jon Breyfogle

jbreyfogle@groom.com

202-861-6641

Jim Cole

jcole@groom.com

202-861-0175

Michael Del Conte

mdelconte@groom.com

202-861-6657

Jennifer Eller

jeller@groom.com

202-861-6604

Ellen Goodwin

egoodwin@groom.com

202-861-6630

David Kaleda

dkaleda@groom.com

202-861-0166

Michael Kreps

mkreps@groom.com

202-861-5415

Jason Lee

jlee@groom.com

202-861-6649

David Levine

dlevine@groom.com

202-861-5436

Arsalan Malik

amalik@groom.com

202-861-6658

Scott Mayland

smayland@groom.com

On April 23, 2018, the Department of Labor (“DOL”) released Field Assistance Bulletin No. 2018-01 (“FAB 2018-01” or the “FAB”). The FAB is intended to provide guidance to regional enforcement offices from the DOL national enforcement office about how to interpret prior DOL guidance related to an ERISA plan’s exercise of shareholder rights and how fiduciaries can take environmental, social, or governance (“ESG”) factors into account when making plan investments.^[1]

The guidance continues DOL’s seesawing on the extent that plan fiduciaries can take economic benefits created apart from investment return to the plan into account when making investment decisions (“Collateral Benefits” created by “Economically Targeted Investments” or “ETIs”). Each of the last two Democratic administrations took a more neutral stance towards ESG considerations. In contrast, the last two Republican administrations suggested that ESG considerations should more rarely be taken into account.

As an overview, ERISA requires fiduciaries to act with the care, skill, prudence, and diligence a hypothetical prudent person would use. ERISA also requires fiduciaries to act “solely” in the interest of a plan’s participants and beneficiaries and for the “exclusive purpose” of providing benefits and paying reasonable administrative expenses. For years, plan fiduciaries have been concerned about whether Collateral Benefits, in addition to investment returns, can be considered in the decision to invest plan assets and vote plan proxies while still complying with ERISA’s fiduciary duty provisions.

Below we first describe the key points from FAB 2018-01 and then provide a summary of the ever changing regulatory framework ERISA fiduciaries have been instructed to use when considering proxy voting and investing in ETIs.

The FAB

Economically Targeted Investing

FAB 2018-01 provides commentary on Interpretive Bulletin 2015-01's ("IB 2015-01") ETI investing guidance. The FAB generally points out limitations to potentially more expansive interpretations of prior guidance that broadly permit or even require consideration of ESG factors when investing plan assets. The tone suggests a contrasting view by the Department of IB-2015 while simultaneously affirming that it is still the law of the land.

First, while DOL continues to acknowledge that ETI factors can be a "tie-breaker," it cautions plan fiduciaries against converting factors that could be Collateral Benefits into relevant investment return economic factors, such as by concluding that the ESG factors "promote positive general market trends or industry growth." Instead, FAB 2018-01 states that fiduciaries must "not too readily treat ESG factors as economically relevant." In particular, the FAB suggests that ESG factors that could be more than tie breakers must "present material business risk or opportunities that company officers and directors need to manage as part of a business plan and that qualified investment professionals would treat as economic consideration under generally accepted investment theories."

FAB 2018-01 goes further in discussing the use of ESG factors as part of a plan's Investment Policy Statement ("IPS"). Here, it reminds plan fiduciaries that while an IPS is part of the documents governing a plan, Title I of ERISA directs fiduciaries to only follow plan documents to the extent they are consistent with ERISA.^[2] In the ESG context, DOL states this means that managers may at times have to "disregard" a plan's investment policy statement.

Initially, FAB 2018-01 appears to provide some helpful language regarding the addition of ESG-themed investment alternatives to a 401(k) plan's investment lineup. It states that, "a prudently selected, well managed, and properly diversified ESG themed investment alternative could be added to the available investment options on a 401(k) plan platform without requiring the plan to forgo adding other non-ESG-themed investment options to the platform." However, DOL then goes on to discourage the use of ESG themed options as QDIAs: "Nothing in the QDIA regulation suggests that fiduciaries should choose QDIAs based on collateral public policy goals." In fact, DOL hypothesizes that plan participants could have competing views on Collateral Benefits and that a fiduciary could thus violate his or her duty of loyalty by favoring some participants' views over others. Unfortunately, DOL muddles its guidance further by distinguishing, in a footnote and without explanation, "non-ESG-themed investment funds" that incorporate ESG factors in investment selection and proxy voting from "ESG-themed funds" (e.g., socially responsible Index Fund, religions Belief Investment Fund, or Environmental and Sustainable Investment Fund). It is unclear from the FAB how or why such a distinction should be made.

Shareholder Engagement Activities

FAB 2018-01 also provides new color on Interpretive Bulletin 2016-01 ("IB 2016-01") in which DOL indicated that proxy voting and shareholder engagement can be consistent with a fiduciary's obligation under ERISA. Here though, the FAB asserts that DOL primarily characterized these activities permissible because they "typically do not involve a significant expenditure of funds."

Emphasizing that the size of the expenditure is important to determining whether it is permissible under ERISA, DOL states, "[t]he IB was not intended to signal that it is appropriate for an individual plan investor to routinely incur significant expenses and to engage in direct negotiations with the board or management of publicly held companies with respect to which the plan is just one of many investors." Similarly, FAB 2018-01 states that IB 2015-01 "was not meant to imply that plan fiduciaries, including appointed investment managers, should routinely incur significant plan expenses to, for example, fund advocacy, press, or mailing campaigns on shareholder resolutions, call special shareholder meetings, or initiate or actively sponsor proxy fights on environmental or social issues relating to such companies."

Finally, FAB 2018-01 cautions fiduciaries who believe there are special circumstances that warrant "routine or substantial" shareholder engagement expenditures to document an "analysis of the cost of the shareholder activity compared to the expected economic benefit (gain) over an appropriate investment horizon. "Thus, DOL appears to be signaling that, as a matter of enforcement, it will require additional documentation regarding significant expenditures of plan assets for shareholder proxy voting activities.

A Short History of the Regulatory Seesaw

The DOL initially set forth its view on Collateral Benefits in Interpretive Bulletin 94-01 ("IB 1994-01"). IB 1994-01 stated that a plan fiduciary could consider such benefits so long as the fiduciary determined, pursuant to the process it would use with regard to any other investment, that the investment was prudent. The Department observed in IB 1994-01 that "an investment will not be prudent if

it would be expected to provide a plan with a lower rate of return than available alternative investments with commensurate degrees of risk or is riskier than alternative available investments with commensurate rates of return.” This is known as the “everything being equal test.”

In 2008, DOL issued Interpretive Bulletin 2008-01 (“IB 2008-01”) to replace IB 1994-01. IB 2008-01 established an arguably more rigorous view of the “everything being equal test,” in which plan fiduciaries would be required to determine in a contemporaneous writing that the investment chosen with regard to Collateral Benefits “is truly equal [to alternative options], taking into account a quantitative and qualitative analysis of the economic impact on the plan” before entering into the investment selected on the basis of such Collateral Benefits. IB 2008-01 stated that plan fiduciaries would only be able to make this determination “rarely” and, as a result, a fiduciary could only consider Collateral Benefits in “very limited circumstances.”

Most recently, in 2015, DOL issued IB 2015-01 to replace IB 2008-01. The basic text of IB 2015-01 is virtually identical to IB 1994-01, but the preamble language arguably expanded the permissible considerations for ETIs. There, DOL expressed the view that ESG factors are not merely Collateral Benefits, but can be an integral part of the economic analysis performed by the plan fiduciary when considering an investment. The DOL explained that plan fiduciaries may address ETIs or incorporate ESG factors in investment policy statements and utilize ESG-related tools, metrics, and analyses to evaluate investments.

FAB 2018-01 is the latest “evolution” of the Department’s views on considering ESG factors when plan fiduciaries invest in ETIs and vote proxies. In general, it seeks to clarify limitations to the IB 2015-01 guidance while acknowledging that those regulations govern the Department’s enforcement of ERISA.

[1] A DOL field assistance bulletin may receive substantial deference if it interprets the issuing agency’s own ambiguous regulation, *Auer v. Robbins*, 519 U.S. 452, 461–463 (1997), or if it interprets an ambiguous statute as part of the exercise of its congressionally delegated rulemaking authority. *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 842–845 (1984). *But see Garcia v. W. Waste Servs., Inc.*, 969 F. Supp. 2d 1252, 1258 (D. Idaho 2013) (finding that a DOL field assistance bulletin defining “commercial motor vehicle” was not entitled to deference because it offered no explanation for deviating from the statute’s unambiguous definition). If DOL issues a field assistance bulletin without first publishing a notice seeking public commentary, the resulting opinion is entitled to judicial respect only to the extent it has the “power to persuade.” *Solis v. Plan Ben. Servs., Inc.*, 620 F. Supp. 2d 131, 137 (D. Mass. 2009) (quoting *Skidmore v. Swift & Co.*, 323 U.S. 134, 140 (1944)).

[2] We note that DOL’s statement that an IPS is a plan document could itself be problematic. The circuit courts are not uniform in their treatment of IPSs as “plan documents” for fiduciary purposes under ERISA Section 404(a)(1)(D). *Compare Kirschbaum v. Reliant Energy, Inc.*, 526 F.3d 243, 250 (5th Cir. 2008) (IPS “not a constitutive Plan document”), *with Faircloth v. Lundy Packing Co.*, 91 F.3d 648, 656 (4th Cir. 1996) (“[T]he investment policy [is a] formal document under which the [plan] is managed.”). While ERISA does not require plans to have IPSes, most plans have them. In the large plan space, plan fiduciaries typically customize their IPS to match their processes and to maintain flexibility. In the smaller plan space, many IPSes are drafted by plan consultants and may not match the processes used by plan fiduciary committees. In light of this guidance, plan fiduciaries may want to revisit their IPSes to ensure they are not creating foot-faults that DOL could view as “breaches of plan documents.”

[DOL and ESG Investing: Evolving GuidanceDownload](#)