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DOL to Review ESG Investing, Proxy Voting Rules

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On April 10, 2019, President Trump signed the *Executive Order on Promoting Energy Infrastructure and Economic Growth* ("Executive Order") to "promote private investment in the Nation's energy infrastructure." The Executive Order is intended to increase the production of crude oil and natural gas in the United States and is relevant to private employee benefit plans because it directs the Department of Labor ("DOL") to review retirement plan energy investment trends and the agency's proxy voting guidance. Although the Executive Order will not have an immediate impact on employee benefit plans, it may result in additional guidance and/or regulations in the future.

Background

Over the past decade, institutional investors have become more active with respect to environmental, social, and governance ("ESG") issues. For example, there has been a material increase in the number of shareholder initiatives to compel public companies to make disclosures related to environmental issues and sustainability. The Executive Order signals a concern from the White House that these efforts may be hampering the energy sector.

Section 5 of the Executive Order states that there is already an existing regulatory framework that provides for disclosures of "material" information to investors and that corporations have fiduciary duties to shareholders. The implication is that investor activism is potentially unnecessary and could undermine national energy policy goals. Given that the Employee Retirement Income Security Act of 1974 ("ERISA") is one of the few federal statutes that regulates investor behavior, the Executive Order gives the DOL another opportunity to focus on ESG investing and proxy voting activities by benefit plans.

Last year, the DOL issued ESG investing and proxy voting guidance in Field Assistance Bulletin 2018-01 ("FAB 2018-01"). [*See* Groom Alert: DOL and ESG Investing: Evolving Guidance], in which the DOL reiterated its longstanding position that plan fiduciaries may not sacrifice investment returns or assume greater investment risks to promote collateral social policy goals. The guidance advised that fiduciaries "must not too readily treat ESG factors as economically relevant to the particular investment choices at

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issue when making a decision" and the fact that an investment promotes ESG factors or promotes market trends or industry growth does not necessarily mean that the investment is a prudent choice for retirement investors.

With respect to proxy voting, the DOL recognized that a "reasonable expenditure of plan assets to more actively engage with company management" may be prudent in certain circumstances when, for example, ESG concerns, "present significant operational risks and costs to business, and that are clearly connected to long-term value creation for shareholders" but cautioned that "plan fiduciaries may not increase expenses, sacrifice investment returns, or reduce the security of plan benefits in order to promote collateral goals."

Review of Retirement Plan Investment Behavior

The Executive Order first directs the DOL to review "available data" filed by retirement plans "to identify whether there are discernible trends with respect to such plans' investments in the energy sector." The Secretary of Labor must provide an "update" to the Assistant to the President for Economic Policy within 180 days. It is notable that the Executive Order does not require the DOL to produce a written report or make the results of the review public.

The DOL's review of energy investment trends will likely be focused on Form 5500 data, which is the primary retirement plan investment related data readily available to the DOL. However, it is unclear whether such data will be particularly useful for identifying trends given the limited nature of the disclosures on the Schedule H and the fact that the schedule of assets filed by large plans is not currently searchable electronically. In fact, in DOL's 2016 proposal to revise the Form 5500, the agency noted that plan investment information was not filed in a standardized format and "as a result, policymakers, the Agencies and the public have difficulty accessing key information about the plan's investments."[1]

The DOL could presumably procure more useful data by exercising its investigatory authority, but that would be a resource-intensive project that may exceed the DOL's current capacity and would likely take significantly longer than the six-month time frame outlined in the Executive Order.

Plan Fiduciary Proxy Voting

The Executive Order next directs the DOL to review its existing proxy voting guidance "to determine whether any such guidance should be rescinded, replaced, or modified to ensure consistency with current law and policies that promote long-term growth and maximize return on ERISA plan assets." The directive does not limit the guidance review to the energy sector, so the DOL could take a more

[1] 81 Fed. Reg. 47534, 47554 (Jul. 21, 2016).

comprehensive approach. The review must be completed within 180 days, though the DOL is not explicitly required to issue new guidance.

Plan Fiduciary Proxy Voting

The Executive Order should not have an immediate impact on benefit plans' ESG investing activities. The DOL's reviews likely will not be completed until the fall, at the earliest, and it is unclear whether the reviews will result in material changes to the agency's policies. Moreover, many institutional investors, including public plans and sovereign wealth funds, are not subject to ERISA, so any new guidance may have only a limited impact on investor behavior. However, like FAB 2018-01, the Executive Order demonstrates the Trump Administration's interest in limiting the impact of institutional investors' ESG focus on the fossil fuel energy industry.

Finally, while there may not be an immediate direct impact on ESG investing and proxy voting activities, the Executive Order's mandated reviews may have certain collateral consequences for ERISA plans. In light of the resources needed for the DOL to complete its reviews by the 180-day deadline, it is reasonable to expect that the DOL will reallocate resources from *other* initiatives important to the regulated community (*e.g.*, advisory opinions, prohibited transaction exemptions), at least in the near-term. Resources for other initiatives could be further limited if the DOL concludes that an investigative effort is needed to assess ERISA plan investment trends.

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