Financial Factors in Selecting Plan Investments under ERISA

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On November 13, 2020, the Department of Labor (the "Department" or the "DOL") issued its final regulation entitled *Financial Factors in Selecting Plan Investments* (the "Final Regulation" or the "Final Rule").[1] The purpose of the Final Regulation was, for the first time, to establish by regulation how fiduciaries of plans or accounts covered by the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), can comply with ERISA's fiduciary duty provisions when making investment decisions or recommendations that take into account economic, social or governance ("ESG") factors. To that end, the Department promulgated a regulation that requires plan fiduciaries to only consider "pecuniary factors" when making fiduciary investment decisions and fiduciary investment recommendations except in very limited circumstances.

The purpose of this article is to help fiduciary advisers understand how they can comply with the Final Regulation. To that end, we (i) identify the fiduciaries who will be subject to the Final Regulation, (ii) describe the fiduciary standards of conduct applicable to such fiduciaries, (iii) provide an overview of prior DOL guidance on ESG and similar investing principles, (iv) summarize the requirements of the Final Regulation, and (v) discuss the implications for fiduciary advisers.

Fiduciaries Subject to the Final Regulation

The Final Regulation targets the conduct of persons who are fiduciaries for purposes of ERISA. A person, including an entity such as an advisory firm ("Adviser"), acts as a fiduciary for purposes of ERISA when such person, among other things, (i) exercises any authority or control with respect to the management or disposition of a plan's assets or (ii) renders investment advice with respect to plan assets for a fee or other compensation, or has any authority or responsibility to do so.[2]

A named fiduciary under a plan that is responsible for investing the assets of an ERISA-covered plan, e.g., an investment committee consisting of the sponsoring employer's employees, will often delegate its authority to invest plan assets to an Adviser who is an "investment manager" as defined in Section 3(38) of ERISA. Even in the absence of such a delegation, the Adviser may have discretion to manage some or all of the plan's assets.[3] In other circumstances, the Adviser will be the named fiduciary under a plan responsible for exercising investment discretion (for example, in the case of an "outsourced chief investment officer" or "OCIO" arrangement). Alternatively, the named fiduciary may hire the Adviser to provide investment advice to the named fiduciary. Similarly, a participant in a participant-directed defined contribution plan may hire an Adviser to manage the assets of his or her plan account or hire the Adviser to provide investment advice to the participant.

In all of these circumstances, the Adviser is a fiduciary and thus will be subject to the Final Regulation to the extent it wishes to consider ESG factors when making investment decisions or recommendations. Importantly, even if the Adviser does not exercise investment discretion, the plan's named fiduciary will rely upon the Adviser to provide fiduciary investment advice in accordance with ERISA. Accordingly, such Adviser must understand the Final Regulation.

ERISA Fiduciary Duties Applicable to Fiduciaries

An Adviser or named fiduciary responsible for investing assets of a plan or, in the case of a participant-directed defined contribution plan, the investment options made available under a plan are subject to ERISA's fiduciary duty provisions. The courts recognize that the standards

1. Financial Factors in Selecting Plan Investments, 85 Fed. Reg. 72846 (Nov. 13, 2020).
2. ERISA §3(21)(A)(ii).
3. ERISA §§402(c)(3) & 405(d)(1).

of conduct imposed by ERISA are the "highest known to law."[4] As relevant here, these duties include the duty of prudence and the duty of loyalty.[5] In the event that a fiduciary described above makes investment decisions or recommendations, including but not limited to a situation in which the fiduciary wishes to consider ESG factors, such investment fiduciary must comply with these duties.

Duty of Prudence

ERISA's duty of prudence requires that a fiduciary discharge his or her duties "with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of and enterprise of a like character and with like aims."[6] This duty is often referred to as the "prudent expert" standard.

In 1979, the Department issued a regulation in which it provided a fiduciary "safe harbor" that described how a fiduciary responsible for investing plan assets may comply with the duty of prudence (the "Investment Duties Regulation").[7] The regulation requires that a fiduciary give "appropriate consideration" to the facts and circumstances relevant to its investment decision, including the role that the investment decision plays in the relevant portion of a plan's investment portfolio for which the fiduciary is responsible.[8] Appropriate considerations include, but are not limited to, the risk-benefit associated with the investment decision, as well as the portfolio's level of diversification, liquidity, and current and projected return relative to the anticipated cash flow requirements and funding objectives of the plan.[9] It is important to note that in satisfying ERISA's duty of prudence, a fiduciary need not achieve a perfect result, but rather a process demonstrating his or her reasoned investment determination—commonly referred to as "procedural" prudence.[10]

Duty of Loyalty

ERISA's duty of loyalty, also known as the "exclusive purpose" rule, requires that fiduciaries discharge their duties with respect to a plan solely in the interest of the participants and beneficiaries, for the exclusive purpose of providing benefits to participants and their beneficiaries and defraying reasonable expenses of the plan.[11] The DOL has consistently construed this duty to prohibit fiduciaries from subordinating the economic interests of plan participants and beneficiaries in their retirement income to unrelated objectives.[12] Similarly, courts have interpreted the "exclusive purpose" rule to require fiduciaries to act with "complete and undivided loyalty to the beneficiaries,"[13] observing that their decisions must "be made with an eye single to the interests of the participants and beneficiaries."[14] Further, the Supreme Court has held that such interests must be understood to refer to "financial" rather than "non-pecuniary" benefits.[15]

Application of Fiduciary Principles to ESG Investing Prior to the Issuance of a DOL ESG Regulation

Over the past 30 years, the DOL has addressed questions concerning the compatibility of investment decisions that consider ESG factors with ERISA's duties of prudence and loyalty.

4. *Donovan v. Bierwith*, 680 F.2d 263, 272 n. 8 (2d Cir. 1985).
5. ERISA §404(a).
6. ERISA §404(a)(1)(B).
7. 29 CFR 2550.404a–1.
8. *Id.*
9. *Id.*
10. *Donovan v. Mazzola*, 716 F2d 1226 (9th Cir. 1983); *See also GIW Industries, Inc. v. Trevor*, 895 F2d 729 (11th Cir. 1990).
11. ERISA §404(a)(1)(A); See also ERISA §403(c)(1).
12. 29 CFR 2509.94–1.
13. *Donovan v. Mazzola*, 716 F.2d 1226, 1238 (9th Cir. 1983).
14. *Donovan v. Bierwirth*, 680 F.2d 263, 271 (2d Cir. 1982).
15. *Fifth Third Bancorp v. Dudenhoeffer*, 573 U.S. 409, 421 (2014).

Notably, the issuance of the DOL's guidance tends to follow Presidential elections in which a change in political party occurs. Accordingly, the tenor of the guidance changes because, generally, Democratic Administrations are more open to the consideration of ESG factors than Republican Administrations. However, while over the years the DOL's guidance has gone through several iterations, its emphasis on the duties of prudence and loyalty, especially a fiduciary's obligation to prioritize plan participants' and beneficiaries' economic interests in the investment decision-making process, has remained constant. We summarize the DOL guidance below in order to put in context how the DOL arrived at the Final Regulation.

Interpretive Bulletin 94-1

In the DOL's 1994 interpretive bulletin ("IB 94-1")—the first comprehensive guidance addressing investment decisions based on non-pecuniary benefits—the DOL expressed that economically targeted investments ("ETIs"), i.e. investments that are selected for the economic benefits they create in addition to the investment return to the plan, were not incompatible with ERISA's fiduciary duties of prudence and loyalty.[16] The DOL stated that the "appropriate considerations" described in the Investment Duties Regulation must be observed in a comparative manner with alternative investment choices, and that so long as an ETI would provide a greater expected risk-adjusted return than comparable investment alternatives, and was suitable in light of other appropriate considerations, an ETI would not violate ERISA's duties of prudence and loyalty.[17] Further, the DOL expressed that when a fiduciary determines that investment choices provide comparable expected risk-adjusted returns, the fiduciary may consider collateral benefits as the deciding factor and such decision would not violate ERISA's duties of prudence and loyalty—a standard commonly referred to as the "all things being equal" or "tie breaker" test.[18]

Interpretive Bulletin 2008-1

In the DOL's 2008 interpretive bulletin that replaced IB 94-1 ("IB 2008-1"), the DOL reiterated its prior guidance, emphasizing, in part, that fiduciaries may never subordinate the economic interests of plan participants to unrelated objectives and that investment decisions may be based only on factors related to the economic interest of a plan.[19] Like in IB 94-1, the DOL acknowledged situations in which investment alternatives could provide equal economic value to a plan, requiring consideration of a "tie-breaker" factor outside of the economic interest of the plan.[20] In these limited circumstances, the DOL expressed that in order to be compliant with ERISA, a fiduciary must document its investment decision-making process to illustrate its comparative economic analysis and the resulting tie.[21] Additionally, the DOL provided examples of the tie-breaker test, including one in which it instructed that a plan sponsor consider prudent financial criteria before considering its investment policy that targets environmentally-friendly companies.[22]

Interpretive Bulletin 2015-1

Concerned that IB 2008-1, with its documentation requirement, had unduly discouraged fiduciaries from considering ETI and ESG factors, the DOL issued a 2015 interpretive bulletin ("IB 2015-1"), which withdrew the previous bulletin and reinstated IB 94-1.[23]

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16. 29 CFR 2509.94–1.
17. *Id.*
18. *Id.*
19. 72 Fed. Reg. 61734, 61735.
20. *Id.*
21. *Id.*
22. *Id.* at 61736.
23. 80 Fed. Reg. 65135, 65136.

As with its previous guidance, the DOL explained that an investment fiduciary should consider factors that potentially influence risk and return, but notably, it stated that sometimes ESG factors may have a direct relationship to the economic value of a plan's anticipated investment.[24] In these instances, ESG factors would be proper in a fiduciary's primary comparative analysis as they would impact the economic merits of an investment decision, rather than merely serving as a tie-breaker if ever investment alternatives were determined to be economically equivalent.[25] The DOL also explained that its interpretation of the duties of prudence and loyalty with respect to investing extended to a fiduciary's selection of investment managers and the selection of designated investment alternatives in defined contribution individual account plans, e.g. an option offered in a 401(k) investment menu.[26]

Field Assistance Bulletin 2018-01

In the DOL's 2018 field assistance bulletin ("FAB 2018-01"), the DOL clarified its stance in IB 2015-1 regarding ESG investment considerations.[27] The DOL expressed its view that there are some ESG issues that present "material business risk or opportunities" to companies that company officers and directors need to manage as part of the company's business plan, and that qualified investment professionals would treat as material economic considerations under generally accepted investment theories.[28] The DOL cautioned, however, that fiduciaries should not readily treat ESG factors as economic in nature, and that in the few instances that these factors are treated as such, the weight given to those factors should be appropriate to the relative level of risk and return involved compared to other relevant economic factors.[29] As with its previous guidance, the DOL reemphasized ERISA's duties of prudence and loyalty, stating that prudent investment decision-making requires a focus on financial factors that have a material effect on the return and risk of an investment, and that the economic interests of the plan in providing retirement benefits should always come first.[30]

Additionally, the DOL expounded upon its stance in IB 2015-01 regarding the application of the duties of prudence and loyalty to the selection of investment options for individual account plans, i.e. 401(k) investment menu.[31] According to the DOL, adding participant-requested ESG-related funds to a menu would not necessarily require a plan to forgo other non-ESG themed investment alternatives, especially as these platforms are intended to provide a broad range of investment options.[32] Thus, in such cases, the DOL expressed that it would not take any issue with a prudently selected, well-managed, and properly diversified ESG-themed designated investment alternative that is added to a 401(k) investment menu.[33] However, with respect to qualified default investment alternatives ("QDIA"), the DOL noted that nothing in the Department's regulation creating a fiduciary safe harbor for QDIAs that meet certain requirements suggests that fiduciaries should choose QDIAs based on collateral public policy.[34]

Proposed ESG Regulation: Financial Factors in Selecting Plan Investments

On June 22, 2020, the DOL went further than the guidance it issued in FAB 2018-01, proposing to formally amend the above-described Investment Duties Regulation. The Department's proposed *Financial Factors in Selecting Plan Investments* regulation (the "Proposed Rule") aimed to address compliance with the duties of prudence in light of increasing interest in ESG-based

24. *Id.*
25. *Id.*
26. *Id.* at 65136-65137.
27. DOL Field Assistance Bulletin No. 2018-01 (April 23, 2018).
28. *Id.*
29. *Id.*
30. *Id.*
31. *Id.*
32. *Id.*
33. *Id.*
34. *Id.*

investments in the marketplace.[35] Further, unlike the Investment Duties Regulation promulgated in 1979, the Department proposed to amend such regulation to include compliance with the duty of loyalty because, in its view, ESG considerations impacted the duty of loyalty as well as the duty of prudence. Further, the DOL proposed to modify the safe harbor guidance in the Investment Duties Regulation related to the duty of prudence to assure that plan fiduciaries gave appropriate weight to ESG factors when making investment decisions.[36]

The proposed safe harbor would have allowed fiduciaries to satisfy both the duties of prudence and loyalty with regard to the consideration of ESG factors so long as additional requirements were met.[37] These additional conditions required "pecuniary-only" considerations materially impacting risk and return and "no-subordination" of the economic interests of plan participants and beneficiaries to unrelated or non-pecuniary interests that sacrifice investment return or take on additional risk.[38] Reflecting the DOL's previously expressed views, the Proposed Rule's amendments would have required a fiduciary to conduct a comparative analysis between its anticipated investment and available investment alternatives, based on "appropriate considerations" discussed in the Investment Duties Regulation.[39] In accordance with the DOL's stance in IB 2015-1 and FAB 2018-1, the Proposed Rule's amendments included language stating that ESG considerations may present "material business risk and opportunities," and would thus be pecuniary, along with the DOL's admonition regarding characterizing ESG factors as pecuniary.[40] Additionally, the Proposed Rule's amendments included a "tie-breaker" provision for instances in which investment alternatives are determined to be economically indistinguishable, with an accompanying documentation requirement to serve as a procedural prudence safeguard.[41] The documentation must include the fiduciary's basis for concluding that a distinguishing factor could not be found and the reason the selected investment was chosen based on the purposes of the plan, diversification of investments, and the financial interests of the plan participants and beneficiaries in receiving benefits from the plan.[42]

Unlike in prior guidance, the Proposed Rule also specifically addressed a fiduciary's compliance with the duties of prudence and loyalty in connection with defined contributions plans in which the plan participants may direct the investment of assets held in their accounts, i.e., participant-directed plans. Consistent with the DOL's position in FAB 2018-01, the Proposed Rule's amendments would have permitted the offering of ESG-themed designated investment alternatives for such plans so long as the fiduciary met certain conditions.[43] The proposed amendments would have required that (1) the fiduciary use only objective risk-return criteria, such as benchmarks, expense ratios, fund size, long-term investment returns, volatility measures, investment manager tenure, and mix of asset types, (2) the fiduciary document its evaluation of objective risk-return criteria, (3) and the fiduciary does not add ESG-oriented funds as a QDIA or a QDIA with an ESG-oriented investment strategy.[44] Considering that participants are often defaulted into QDIAs, the DOL expressed its belief that it would be "inappropriate for participants to be defaulted into a retirement savings fund with other objectives absent their affirmative decision."[45] Notwithstanding the proposed amendments, the DOL suggested that fiduciaries should carefully review a fund's prospectus and other investment disclosures for references to ESG-related investment strategies and approaches before selecting designated investment alternatives.[46]

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35. 85 Fed Reg. 39113, 39114.
36. *Id.*
37. *Id.* at 39127.
38. *Id.*
39. *Id.*
40. *Id.*
41. *Id.*
42. *Id.*
43. *Id.*
44. *Id.*
45. *Id.* at 39119.
46. *Id.* at 39118.

The Department received hundreds of substantive written comments in response to the Proposed Rule. Many Advisers and a wide variety of other commenters representing other constituencies, e.g., plan sponsors, opposed the Proposed Rule.[47] While the Department stated in the preamble that ESG factors could be pecuniary in nature, some commenters were of the view that other preamble language and the proposed regulatory language strongly suggested that ESG factors are inherently non-pecuniary and, as such, would not be "appropriate considerations" under ERISA.[48] As such, according to the commenters, the Department failed to recognize that in many cases ESG factors are in fact pecuniary in nature.[49] Further, commenters were concerned that the Proposed Rule established a standard that would be difficult to apply and would unreasonably expose fiduciaries to fiduciary liability risk under ERISA.[50] In that regard, the commenters believed that the Proposed Rule established a presumption that the ESG factors were imprudent and put the burden of proving otherwise on plan fiduciaries.[51]

Final ESG Regulation: Financial Factors in Selecting Plan Investments

On October 30, 2020, the DOL finalized its amendments to the Investment Duties Regulation in the form of the Final Rule.[52] In response to the comments it received, the DOL made some changes to streamline the language in the regulation and the process for demonstrating compliance. However, there were few, if any, material changes pertaining to how Advisers and other fiduciaries should approach ESG investing. At bottom, the Final Rule requires that fiduciaries evaluate investment opportunities based upon pecuniary factors only. However, if fiduciaries are unable to distinguish investments based on pecuniary factors (a circumstance that the DOL continues to view as a "rare" event), the Final Rule permits fiduciaries to consider non-pecuniary factors as a tie-breaker provided that they comply with the Final Rule's documentation requirement. Like the Proposed Rule, the Final Rule also includes restrictive conditions for investments that are a plan's QDIA.

Pecuniary Factors Versus Non-Pecuniary Factors

The text of the Final Rule does not refer to ESG factors. The Department noted that in its view, pension plan investments are often selected on the basis of "non-pecuniary benefits" intended to further causes related to "environmental, social, and corporate governance considerations" and that "[v]arious terms have been used to describe this and related investment behaviors, such as socially responsible investing, sustainable and responsible investing, environmental, social, and corporate governance (ESG) investing, impact investing, and economically targeted investing."[53] Because such terms, in the DOL's view, "do not have a uniform meaning and the terminology is evolving," the Department chose to focus the text of the Final Rule on the requirement that a fiduciary only consider "pecuniary" factors with limited exceptions set forth in the Final Rule.[54]

The Final Rule includes the "appropriate considerations" language found in the 1979 Investment Duties Regulation.[55] Therefore, the Final Rule requires that in order to comply with ERISA's duty of prudence, an investment fiduciary must (i) give "appropriate consideration to those facts and circumstances that, given the scope of such fiduciary's investment duties, the fiduciary knows or should know are relevant to the particular investment or investment course of action involved, including the role the investment or investment course of action plays in that portion of the

47. American Benefits Council Comment Letter (July 30, 2020); Investment Adviser Association Comment Letter (July 30, 2020); The Securities Industry Financial Markets Association Comment Letter (July 30, 2020).
48. *Id.*
49. *Id.*
50. *Id.*
51. *Id.*
52. 85 Fed Reg. 72846, 72846.
53. 85 Fed Reg. 72846, 72846.
54. *Id.* at 72857.
55. *Id*. at 72884.

plan's investment portfolio with respect to which the fiduciary has investment duties; and (ii) act accordingly.[56] A fiduciary meets the "appropriate consideration" requirements if the fiduciary determines that "the investment or investment course of action is reasonably designed…to further the purposes of the plan, taking into consideration the risk of loss and the opportunity for gain (or other return) associated with the investment or investment course of action compared to the opportunity for gain (or other return) associated with reasonably available alternatives with similar risks…."[57] Further, the fiduciary must consider (i) the composition of the portfolio with regard to diversification, (ii) the liquidity and current return of the portfolio relative to the anticipated cash flow requirements of the plan; and (iii) the projected return of the portfolio relative to the funding objectives of the plan.[58]

Unlike the 1979 Investment Duties Regulation, the Final Rule provides a new section focused on a fiduciary's consideration of "pecuniary factors."[59] The Final Rule states that "[a] fiduciary's evaluation of an investment or investment course of action must be based only on pecuniary factors…"[60] A "pecuniary factor" is defined as "a factor that a fiduciary prudently determines is expected to have a material effect on the risk and/or return of an investment based on appropriate investment horizons consistent with the plan's investment objectives and the funding policy established pursuant to section 402(b)(1) of ERISA."[61] Any other factor, by default, is "non-pecuniary."

In order to meet the "pecuniary-only" requirement, the Department states in the Final Rule that "a fiduciary may not subordinate the interests of the participants and beneficiaries in their retirement income or financial benefits under the plan to other objectives, and may not sacrifice investment return or take on additional investment risk to promote non-pecuniary benefits or goals."[62] The Final Rule goes on to provide that "[t]he weight given to any pecuniary factor by a fiduciary should appropriately reflect a prudent assessment of its impact on risk-return."[63]

The fact that a fiduciary should prudently determine whether a factor is pecuniary in nature allows for the possibility that a fiduciary can establish an ESG factor as pecuniary, i.e., a factor that has material effect on the risk and/or return of an investment based upon a plan's investment horizon or funding policy. Indeed, in the preamble to the Final Rule, the DOL acknowledged that "…there are instances where one or more environmental, social, or governance factors will present an economic business risk or opportunity that corporate officers, directors, and qualified investment professionals would appropriately treat as material economic considerations under generally accepted investment theories."[64] The DOL pointed to "disposal of hazardous waste" and "dysfunctional corporate governance" as examples.[65] However, the regulatory language emphasizes that it is incumbent on the fiduciary to make the connection between an ESG factor and a pecuniary factor in order to meet his or her duty of prudence. The DOL prescribes a certain level of diligence by fiduciaries that requires reviewing relevant investment disclosures and marketing materials for references to non-pecuniary-driven investment strategies and objectives.[66] Further, the regulatory language cautions that fiduciaries, in reaching the conclusion that an ESG factor is pecuniary, give such factor appropriate weight when evaluating an investment option or investment course of action.[67] The implication is that, in the view of the DOL, some fiduciaries may give too much weight to ESG factors over other factors, e.g., investment risk, investment costs, and portfolio diversification.

56. *Id*.
57. *Id*.
58. *Id*.
59. *Id*.
60. *Id.* (as amended, paragraph (c)(1) of 29 CFR 2550.404a–1).
61. *Id.* (as amended, paragraph (f)(3) of 29 CFR 2550.404a–1).
62. *Id.* (as amended, paragraph (c)(1) of 29 CFR 2550.404a–1).
63. *Id.* (as amended, paragraph (c)(1) of 29 CFR 2550.404a–1).
64. *Id.* at 72848.
65. *Id*.
66. *Id.* at 72864.
67. *Id.* at 72884.

The Final Rule, unlike the Proposed Rule, does not specifically require that the fiduciary apply the "pecuniary-only" provisions of the Final Rule to comply with ERISA's duty of loyalty. Nonetheless, the Department in the Final Rule reiterates in the introductory section of the regulation that "a fiduciary shall discharge that person's duties with respect to the plan solely in the interests of the participants and beneficiaries, for the exclusive purpose of providing benefits to participants and their beneficiaries and defraying reasonable expenses of administering the plan."[68] Therefore, from a practical standpoint, a fiduciary may not consider any factor, including ESG factors, in making investment decisions if the consideration of such factors is not made for the "exclusive purpose" of benefiting the plan participants and beneficiaries.

Consideration of Non-Pecuniary Factors as Tie-Breaker

As discussed, the Final Rule requires that the fiduciary only consider pecuniary factors. However, the Final Rule provides that if a fiduciary identifies two or more investment options or investment courses of action that are indistinguishable based upon pecuniary factors, "the fiduciary may use non-pecuniary factors as the deciding factor" in selecting the investment option or investment course of action.[69] This provision is similar to the "tie-breaker" test first established in IB 94-1 and articulated in subsequent DOL guidance.

In the event the fiduciary decides that one or more investment options or courses of action are indistinguishable based upon pecuniary factors and chooses to rely upon non-pecuniary factors to select an investment option or course of action, the fiduciary must document the following:

1. why pecuniary factors were not sufficient to select the investment or investment course of action;

2. how the investment compares to the alternative investments with regard to (i) the composition of the portfolio with regard to diversification, (ii) the liquidity and current return of the portfolio relative to the anticipated cash flow requirements of the plan, and (iii) the projected return of the portfolio relative to the funding objectives of the plan; and

3. how the chosen non-pecuniary factor or factors are consistent with the interests of the plan's participants and beneficiaries in their retirement income or financial benefits under the plan.[70]

Notably, the Department states in the preamble to the Final Rule that situations in which a fiduciary cannot distinguish between alternatives based on pecuniary factors are "…discrete (and likely rare) situations…"[71]

Participant-Directed Defined Contribution Plans

The Department noted that in general the above-discussed regulatory requirements also apply to a fiduciary's selection of the "designated investment alternatives" made available under a participant-directed defined contribution retirement plan.[72] A "designated investment alternative" is an "…investment alternative designated by the plan into which participants and beneficiaries may direct the investment of assets held in, or contributed to, their individual accounts…", but does not include a brokerage window or self-directed brokerage account.[73] Therefore, the fiduciary must select the investment alternative on the basis of pecuniary factors. If one or

68. *Id.* at 72883. (as amended, paragraph (a) of 29 CFR 2550.404a–1).
69. *Id.* at 72884. (as amended, paragraph (c)(2) of 29 CFR 2550.404a–1).
70. *Id.*
71. *Id.* at 72876
72. *Id.* at 72884. (as amended, paragraph (d)(1) of 29 CFR 2550.404a–1).
73. *Id.* (as amended, paragraph (f)(5) of 29 CFR 2550.404a–1).

more possible alternatives are indistinguishable based upon pecuniary factors, the fiduciary may consider non-pecuniary factors so long as it meets the above-described documentation requirements. However, like the Proposed Rule, the Final Rule provides that under no circumstances may non-pecuniary factors be the basis for selecting a QDIA.[74] In this regard, the DOL pointed to "screening strategies" that exclude certain companies or sectors that are based upon non-pecuniary factors.[75]

Next Steps for Advisers

The Final Regulation became effective on January 12, 2021, during the Trump Administration's lame duck period. On January 20, 2020, immediately after the Biden Administration took office, the new President's transition team released its Fact Sheet: List of Agency Actions Review, which included the DOL's Final Rule. This comes as no surprise given the stance taken by prior Democratic Administrations with respect to ESG investing. Nonetheless, the Final Regulation is current law and, even if the DOL is not inclined to enforce the regulation as written, an Adviser or other fiduciary who failed to comply could be exposed to allegations of breach of fiduciary duty by participants and other parties with standing to bring suit under ERISA.

Based upon the forgoing, Advisers and other fiduciaries should review their practices and procedures to determine whether their current activities appropriately consider pecuniary factors as required by the Final Regulation. Such fiduciaries would, of course, include Advisers who invest ERISA-covered assets on a discretionary basis. However, Advisers who make recommendations to named fiduciaries and participants with accounts in participant-directed account plans should also take such measures because such parties will rely on their Advisers to provide advice consistent with ERISA and its regulations – including the Final Regulation. For example, increasingly, Advisers will often offer plans and plan participants "ESG screens." Such screens are subject to the Final Regulation and may expose an Adviser to ERISA liability if they do not comply with the regulation. Similarly, a plan's investment policy requiring the Adviser to manage assets or make recommendations in a manner inconsistent with the Final Regulation may also expose the Adviser to ERISA liability.

Advisers should determine whether they can establish that ESG or other factors they consider in making investment decisions or in making investment recommendations are "pecuniary" as described in the Final Regulation and otherwise meet the fiduciary duties of prudence and loyalty as required by the Final Regulation. As discussed, Advisers should take care to consider whether ESG factors that are otherwise pecuniary are given appropriate weight when compared against other factors such as investment risks, performance, and costs.

To the extent that investments or investment courses of action are indistinguishable based upon pecuniary factors and the Adviser wishes to apply non-pecuniary factors, the Adviser should consider whether its policies and procedures properly reflect the "tie breaker" concept and provide for the above-discussed required documentation. Further, the Adviser should consider the impact of the Final Regulation on any QDIA offered in a participant-directed defined contribution plan, as non-pecuniary factors – which may include ESG or other factors —may no longer be considered in managing an investment alternative intended to be a QDIA or in recommending the QDIA as an investment alternative under the plan. ■

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74. *Id.* (as amended, paragraph (d)(2)(ii) of 29 CFR 2550.404a–1).
75. *Id.* at 72866.