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Citi Blazes New ESG Trails in Boosting Diverse 401(k) Managers

By Austin R. Ramsey 2023-10-12T05:45:04000-04:00

- Labor Department permits Citigroup's Racial Equity Program
- Advisory opinion likely to be caught up in ESG public debate

Multinational investment bank Citigroup Inc. has found a novel way to use its own worker retirement plans to achieve racial diversity objectives without running afoul of strict federal benefits laws.

The Biden administration's chief worker benefits regulator granted Citi a rare advisory opinion (Advisory Op. 2023-01A) last week, the agency's first since January 2020.

It paves a "groundbreaking" path for the company to prioritize diverse asset managers to oversee its workers' 401(k)s, said Dominic DeMatties, a Thompson Hine LLP partner who requested the department's input on behalf of Citi.

Video: ESG Explained

Regulators are already facing criticism from the right over a supposedly pro-ESG investing rule, setting the stage for what could be a new round of GOP challenges to the Labor Department's ability to permit so-called "woke" investment plans. But the department's nuanced approach is grounded in years of subregulatory guidance that distinguishes the roles of those who establish and manage a worker pension.

The DOL's Employee Benefits Security Administration has been fighting back for more than a year now against Republican criticism that it has subverted workers' benefits by favoring environmental, social, and corporate governance investing factors.

The agency has insisted that its new rule actually strikes a neutral tone on ESG considerations, yet mischaracterizations abound. The agency's advisory opinion could be destined for a similar drawn-out, contentious fate, said Allison Wielobob, general counsel of the American Retirement Association.

“The conversation that we’ve all gotten into—the regulated community, financial services industry, and members of Congress—has really run far afield of the weeds of what the DOL does and has done,” Wielobob said. “The real meaning is in the nuances, but I’ve seen more mischaracerizations of what the DOL does than I have accurate characterizations.”

Settlor vs. Fiduciary

Citi sought EBSA’s input on its Racial Equity Program, which covers some or all of the asset management fees more diverse companies would otherwise charge its employee benefit plans.

It’s still up to plan decision-makers called fiduciaries to choose one or more asset managers to oversee plan assets. However, by lowering the costs diverse companies would otherwise charge, Citi would be giving diverse service providers a leg up on the competition.

Fees aren’t the only factor fiduciaries have to consider, and EBSA stressed that the plan fiduciaries must factor multiple considerations into their analysis of investment management professionals.

EBSA relied on other advisory opinions and informational letters issued by Republican and Democratic administrations over the years to paint a clear line between actions taken by an employer to establish and set the confines of a benefit plan and fiduciary decisions to implement and manage a plan under the Employee Retirement Income Security Act of 1974 (Pub. L. No. 93-406).

“The Department has long recognized there is a class of discretionary so-called ‘settlor’ activities that relate to the formation, rather than the management, of plans,” the advisory opinion reads. “These functions include decisions relating to the establishment, design, and termination of plans and, except in the context of multiemployer plans, generally are not fiduciary activities governed by ERISA.”

The money used to prioritize diverse asset managers comes directly from Citigroup as a corporate entity, not plan assets, which are generally at least partially made up of participant contributions. That crucial detail makes a world of difference when determining settlor versus fiduciary action, said DeMatties.

“This is company money, not plan money,” he said. “Just like the department’s ESG rule is not a requirement that any factor be included in the fiduciary process unless that factor is relevant to a risk and return analysis, this letter describes an optional program for how a plan sponsor chooses to use corporate assets. This letter underscores that point."

DEI and ESG

Already, diversity, equity, and inclusion metrics have infiltrated the public narrative on ESG, raising the stakes for the agency's advisory opinion still in its infancy.

The Republican-controlled House Committee on Education and the Workforce advanced a bill last month that would apply the same duties fiduciaries face when selecting and monitoring investments to their choice of 401(k) service providers such as outside counsel and investment managers.

The bill's author, Rep. Bob Good (R-Va.), said "financial management should stay focused on finances," without regard for race, color, religion, sex, or national origin.

Asset managers that employ at least half or are owned by people of color are underrepresented among institutional investors, according to research by the Diverse Asset Managers Initiative. Earlier this year, a handful of Senate Democrats sent a letter to 25 large companies requesting information about the diversity of the asset managers they've hired to oversee their pension plans.

Despite its important role in helping guide and inform employee benefit plan practitioners, EBSA's advisory opinion last week marked the first the agency has issued in more than three years, which could be at least partly due to the specter of even more contentious public debate and litigation surrounding the issue, said Michael Del Conte, a senior counsel at Groom Law Group Chartered.

"It wouldn't surprise me if people would challenge this advisory opinion," he said. "What remains to be seen is on what grounds that litigation would be filed, and who would have standing to sue."

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