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BLOG

Interpretive Bulletin on Social Investing

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In October, the U.S. Department of Labor issued an Interpretive Bulletin on social investing by qualified pension and 401(k) plans, Interpretive Bulletin Relating to the Fiduciary Standard Under ERISA in Considering Economically Targeted Investments. The Bulletin was effective October 26, 2015. This is not exactly an executive compensation issue; however, shareholders and their advisers have focused on corporate governance issues in making investment decisions for some time now. Many of the shareholder proposals and so much of the proxy statement criticism nowadays relates to environmental, social and governance (ESG) issues. Therefore, I thought I would write a short article on it.

The DOL refers to these as “economically targeted investments” (ETIs) because, ostensibly, the investments are selected, in part, for the collateral economic benefits they create apart from their investment return to the employee benefit plan investor. (Other terms used include “socially responsible investing,” “sustainable and responsible investing,” and “impact investing.”) The DOL had previously addressed ETI investment issues with Interpretive Bulletin in 1994 and 2008. Apparently the current regime did not believe that those two Bulletins had pushed enough fiduciaries into ETIs, so it tried again.

Fiduciary Duty and Social Investing

Since Congress passed the Employee Retirement Income Security Act in 1974, the fiduciaries of qualified pension and 401(k) plans have been obligated to make investment decisions “solely in the interests of participants and beneficiaries,” with “an eye single to the interests of participants and beneficiaries.” The DOL has consistently stated, including in the previous Interpretative Bulletins, that the focus of plan fiduciaries on the plans’ financial returns and risk to beneficiaries must be paramount.

Under ERISA, the plan trustee or other investing fiduciary may not use plan assets to promote social, environmental, or other public policy causes at the expense of the financial interests of the plan’s participants and beneficiaries. Fiduciaries may not accept lower expected returns or take on greater risks in order to secure collateral benefits.

The 1994 and 2008 Interpretive Bulletins emphasize what some have referred to as the “all things being equal” test.

At the same time, however, the Department has consistently recognized that fiduciaries may consider such collateral goals as tie-breakers when choosing between investment alternatives that are otherwise equal with respect to return and risk over the appropriate time horizon. ERISA does not direct an investment choice in circumstances where investment alternatives are equivalent, and the economic interests of the plan's participants and beneficiaries are protected if the selected investment is in fact, economically equivalent to competing investments.

Interpretive Bulletin 2015-01

IB 2015-01 withdraws and replaces the 2008 Interpretive Bulletin. It seems to provide that a fiduciary need not consider environmental, social, and governance issues as merely tie-breakers in otherwise equally attractive investments, but a fiduciary may consider these issues as a critical factor.

An important purpose of this Interpretive Bulletin is to clarify that plan fiduciaries should appropriately consider factors that potentially influence risk and return. Environmental, social, and governance issues may have a direct relationship to the economic value of the plan's investment. In these instances, such issues are not merely collateral considerations or tie-breakers, but rather are proper components of the fiduciary's primary analysis of the economic merits of competing investment choices.

At a minimum, this seems to say that not only could a fiduciary consider matters unrelated to investment performance, it could make those the matters the most important factor. Some commenters have suggested that the language could be read to require prudent fiduciaries to consider environmental, social, and governance issues as "[appropriate] factors that potentially influence risk and return." That possibility frightens fiduciaries and their advisers and sounds like a repudiation of 500 years of fiduciary law.

Careful fiduciaries might still avoid investment funds focused on any goal other than investment return. However, those plan fiduciaries that want to apply their notions of the correct approach to environmental, social, and governance matters, now could follow a prudent investment selection process, as required by ERISA, using the cover of IB 2015-01, and most likely satisfy ERISA's duties of loyalty and prudence. Time will tell whether this is good or bad for corporations and the participants in their pension and 401(k) plans.

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