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BLOG

The Department of Labor Again Weighs In on Social Investing

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The U.S. Department of Labor's Employee Benefits Security Administration ("DOL" or "EBSA") recently issued Field Assistance Bulletin No. 2018-01 (the "Bulletin"). The Bulletin is, in part, intended to provide guidance to EBSA national and regional offices on prior DOL Interpretive Bulletins that addressed the appropriate role of environmental, social, and governance ("ESG") factors when making plan investment decisions.

The DOL has been inconsistent in its guidance on how plan fiduciaries should approach ESG factors when making investment decisions. For example, the DOL has taken the position that consideration of ESG-type factors should be rare, later indicated that such factors can be used as tie-breakers, and most recently noted that such factors should be considered where there is a direct relationship to an investment's economic merits. The Bulletin strikes a cautionary tone.

First, the Bulletin reiterates the DOL's position that plan fiduciaries may not sacrifice investment returns or assume greater investment risks as a means of promoting collateral social policy goals. ESG factors can be seen as more than mere tie-breakers in instances when they "present material business risk or opportunities to companies that company officers and directors need to manage as part of a business plan and that qualified investment professionals would treat as economic considerations under generally accepted investment theories." The Bulletin cautions that the weight given to ESG factors should be appropriate to the relative level of risk and return involved compared to other relevant economic factors.

Second, the Bulletin acknowledges that prior guidance permits the inclusion of policies concerning ESG factors in plan investment policy statements, but points out that even if such policies are included in investment policy statements, fiduciaries may not be required to adhere to them. While this seems to contradict fiduciaries' obligation to adhere to the documents and instruments governing a plan under ERISA, the DOL points out that such an obligation applies only insofar as the policy is consistent with Titles I and IV of ERISA.

Third, the Bulletin points out that in the case of plans that allow participants and beneficiaries the opportunity to choose from a broad range of investment alternatives (like most 401(k)-type plans), plan fiduciaries may in response to participant requests for investment alternatives that reflect their personal values add prudently selected, well managed, and properly diversified ESG-themed investment alternatives without requiring the plan to remove or forgo other non-ESG-themed investment options. However, the Bulletin discourages the use of ESG-themed investment options for use as qualified default investment alternatives (QDIA), warning that diverging policy preferences between participants and fiduciaries may raise questions about such fiduciaries' compliance with ERISA's duty of loyalty. Even if this concern is addressed, plan fiduciaries would need to ensure compliance with prior guidance, including ensuring that the ESG-themed QDIA does not provide a lower expected rate of return than available non-ESG alternative target date funds with commensurate degrees of risk, or conversely, that the ESG alternative is not riskier than non-ESG alternative available target date fund with commensurate rates of return.

In light of the Bulletin, plan fiduciaries may want to avoid using ESG-themed funds as QDIAs. To the extent plan fiduciaries consider ESG-factors in determining plan investments, plan fiduciaries may want to restrict the consideration of ESG factors to circumstances where such factors present material business risk or opportunities to companies and that qualified investment professionals would treat as economic considerations under generally accepted investment theories.

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