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4 Takeaways From DOL's Socially Conscious Investing Rule

By **Kellie Mejdrich**

Law360 (November 23, 2022, 5:46 PM EST) -- The U.S. Department of Labor's new regulations — intended to allay retirement plans' fears about considering environmental, social and governance factors such as climate change in their investment decisions — will remove some wariness about factoring in ESG.

The massive, 236-page final rule unveiled on Tuesday by the DOL's Employee Benefits Security Administration lays out amendments to regulations under the Employee Retirement Income Security Act's regulations that spell out how managers meet fiduciary duties of prudence and loyalty when it comes to ESG.

Crucially, benefits and ESG attorneys who have been watching the policy develop say the rule lays out the conditions under which a retirement plan manager can consider ESG. That's left many critics of previous Trump administration policy and even the initial 2021 proposal breathing a sigh of relief that there aren't onerous new requirements on managers' ESG-related investment decisions.

Attorneys say the release is part of a broader push by President Joe Biden's administration to advance public policy on climate change. The DOL's rules hit the books just as the U.S. Securities and Exchange Commission is finalizing a climate risk disclosure rule for public companies that could dramatically reshape what kind of information is easily accessible when retirement managers are selecting investments.

"The prior administration's rule put a thumb on the scale, in some cases, against ESG investing by ERISA plans. Some members of the regulated community felt that the current administration's 2021 proposal went too far the other way, in perhaps mandating consideration of ESG … the DOL is making some effort to get back to an equilibrium point," said Alex Ryan, partner at Willkie Farr & Gallagher LLP.

Here, Law360 looks at four takeaways from the DOL's now-final rule.

'Tiebreaker' Regulations Rewind to Pre-Trump Times

A major aim of the final rule was to dispel confusion generated by the 2020 rules regarding what the obligations were under ERISA when it came to choosing between two competing investments when one was ESG.

That's a point the DOL made clear in the preamble to its own final rule, and one the DOL's Assistant

Secretary for Benefits Security Lisa M. Gomez emphasized on a call with reporters Tuesday.

"This is a final rule, but I hope that it is a beginning of a path towards together understanding how this rule can really help both plan fiduciaries and participants achieve their goals and clearing up any misconceptions about the rule," Gomez said.

One key difference for benefits attorneys has to do with changes to a so-called "tiebreaker" option for managers when making a decision between two competing investments. Gomez highlighted that Tuesday's final rule eschewed a Trump-era requirement that managers determine they're "unable to distinguish the investments based on pecuniary factors alone" before being able to access the tiebreaker. Some attorneys were concerned that language raised a barrier to the consideration of ESG factors.

In addition to removing certain documentation requirements the old rule had associated with the tiebreaker, the new rule makes clear that fiduciaries can choose a given investment based on collateral benefits other than investment returns when the two choices are equivalent from a risk-return perspective.

Andrew Oringer, a partner in Dechert LLP's ERISA and executive compensation group, said it was significant that the department reiterated longstanding policy with respect to investment decisions and ERISA.

"They acknowledged that the general state of affairs is not different — you cannot sacrifice returns to collateral goals," Oringer said.

"They can say whatever they want about making it easier to use the tiebreaker and that the rules are different, but it all comes down to … no matter what you do, you cannot sacrifice economics to collateral," Oringer said.

Attorneys said that unlike the Trump-era language, an important factor under the Biden administration is that the replacement language refers back to longstanding guidance under ERISA that had been at the subregulatory level for decades, which explains how fiduciaries could take collateral benefits into account when managers were weighing a choice between economically equivalent investment alternatives.

"The big thing here is that the tiebreaker rule is now back to what the guidance has been consistently for a long time without adding any additional requirements," said Ivelisse Berio LeBeau, partner with the Wagner Law Group.

Specific Examples Got Dropped

Another major change in the final rule that attorneys highlighted was the removal of a set of examples of ESG topics or considerations that retirement managers might include in their analysis when selecting an investment.

Some attorneys said the mere inclusion of those topics had sparked concerns regulators were getting close to mandating something on ESG.

Ryan at Willkie Farr & Gallagher said the removal of those examples was "the most significant,

substantive difference, in my view" between the 2021 proposal and the final product.

"That language has been taken out of this final version, meaning that there's nothing explicit in the language of the regulation now that requires fiduciaries to consider ESG factors in their investment analysis. They can, if they conclude that ESG factors are relevant to the investment risk and return analysis. But ESG factors are to be considered like any other factor that bears on the risk and return of a particular investment," Ryan said.

Berio LeBeau, at Wagner, said she didn't agree that the proposal's examples meant the DOL was requiring something, but she agreed that it was "better not to have that suggestion" in the final rule.

"I think the department saw the point and said, 'OK, we don't need the examples,'" Berio LeBeau said.

House Republicans Will Push Back

Hours after the final rule was unveiled, detractors in the employee benefits industry and the Republican Party laid out pointed criticism for the Biden administration's approach.

Hours after its publication, the top Republicans on the House Education and Labor Committee, who are set to take over control in January, torched the Biden administration's final rule in a joint statement.

Top committee Republican Rep. Virginia Foxx of North Carolina and Rep. Rick Allen of Georgia, the Republican ranking member on a pensions subcommittee, said in a statement Tuesday that the new rule "jeopardizes the financial security of many retirement savers, especially workers and retirees who may be put into ESG investments by default."

"The new rule overturns the strong protections implemented by the Trump administration, which guarded retirement savers from investment managers seeking to advance social and political objectives unrelated to the financial benefits to workers and retirees," the lawmakers said, adding that "the Biden administration is choosing its climate and social agenda over retirees and workers. This is bad news."

Industry stakeholders had some criticisms of their own, although a statement from the ERISA Industry Committee, or ERIC, the top lobbying group for large employers providing ERISA benefits, indicates that regulators allayed some of the group's concerns with the 2021 proposal.

Andy Banducci, ERIC's senior vice president of retirement and compensation policy, said in a statement that the DOL's rule "clarified that the final rule does not establish a mandate to consider any specific factor in every circumstance or put a thumb on the scale when selecting investments, leaving fiduciaries to manage plans for the best interests of workers and retirees."

Banducci added that "While DOL retained the proposal's confusing tiebreaker rule, it removed an unnecessary and burdensome documentation requirement," adding that the group was continuing to review the regulation with member companies and would urge DOL to "further clarify and provide flexibility as necessary."

Keep an Eye on the SEC

Attorneys said the DOL's proposal comes just as the SEC is finalizing a key new set of rules that will dramatically expand the kind of information available to asset managers. When both those regulations

are finalized, investors can start working on the next step of actually weighing ESG factors when they matter and with sufficient information.

Berio LeBeau said she was glad that with additional clarity "fiduciaries can move on to the hard part, which is, do they have the information that they need to properly evaluate all of these ... what we've been calling ESG considerations?"

Jacob Hupart, a member of Mintz Levin Cohn Ferris Glovsky and Popeo PC's ESG practice, said another dynamic he's watching has to do with how the final rule arrives as some conservative states — including Texas, West Virginia, Oklahoma and Florida — are adopting rules that preclude consideration of ESG factors by pension funds and other entities.

Hupart said that in addition to being part of a broader set of policy initiatives related to climate change under Biden, he saw the administration's rule as "pushback against some of the state-level skepticism or promulgation of anti-ESG policies, and effectively making the dividing line perhaps a little bit more clear between these competing policy agendas."

Elizabeth Goldberg, a benefits partner at Morgan Lewis & Bockius LLP, said "I think another next step for ERISA plans is, as they try and figure out how to use this guidance from the DOL, they are looking for things like metrics and disclosures from asset managers that will help them in these evaluations."

That's why all eyes are now on the SEC, attorneys said, with its climate proposal in the final stages after a proposal came out this March.

"It does dovetail with what ERISA plan fiduciaries will be looking for as they move forward with this DOL rule," Goldberg said.

Advocates said the rule sets up clear standards on how retirement plan managers can consider ESG as pressure increases on companies to incorporate the concept into pension and defined contribution retirement plans.

Danielle Fugere, president and chief counsel of As You Sow, a nonprofit shareholder advocacy group that's been deeply involved in the public policy push to get companies to disclose more information about climate change and other sustainability issues, said she hopes that the final rule convinces more companies and plan managers to consider how to take climate into account in their 401(k) plans. She said As You Sow is beginning to track how large public company pension funds take climate risk into account.

"I do think that there has been hesitancy to take climate into account in investing decisions, to the extent that it should be. And I think that this hopefully will start changing the considerations, the risk analysis in 401(k) plans," Fugere said.

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