

Memorandum

DOL Finalized Rule Continues to Impose Limitations on the Use of ESG Considerations (and Other Non-Pecuniary Factors) in Selecting ERISA Plan Investments

November 18, 2020

On October 30, 2020, the Department of Labor (“DOL”) issued a final rule¹ (the “Final Rule”) clarifying its position on when and how plan fiduciaries may consider non-pecuniary factors, such as environmental, social and governance (“ESG”) factors, in making investment decisions under the Employee Retirement Income Security Act of 1974, as amended (“ERISA”). The Final Rule, which amends a regulation from 1979, is similar to the rule that the DOL proposed on June 23, 2020 (the “Proposed Rule”), with the main difference being that the DOL removed all references to ESG and instead focused more broadly on a fiduciary’s consideration of pecuniary versus non-pecuniary factors under a duty of loyalty.² In short, the Final Rule requires that fiduciaries evaluate and select investments based on pecuniary factors and only allows consideration of non-pecuniary factors, such as ESG, in the rare circumstance where all else is equal.

Summary of the Final Rule. The Final Rule revises the 1979 regulation on fiduciary responsibility by expanding upon the duty of prudence and incorporating guidance on the duty of loyalty. Further, the Final Rule provides specific instructions on when and how non-pecuniary factors may be considered and how this analysis should apply to investment alternatives for individual account plans.

- **Fiduciary Duty of Prudence.** The Final Rule clarifies the duty of prudence by providing that the duty of prudence requires a fiduciary to only compare “reasonably available alternatives with similar risks” when making investment-related decisions. In other words, a fiduciary does not have to search for and/or consider every available alternative- just those that are reasonably available.
- **Fiduciary Duty of Loyalty.** The Final Rule adds guidance regarding the fiduciary duty of loyalty, explaining that “[a] fiduciary’s evaluation of an investment or investment course of action must be based only on pecuniary factors.” A pecuniary factor is a factor that “a fiduciary prudently determines is expected to have a material effect on the risk or return of an investment based on appropriate investment horizons consistent with the plan’s investment objectives and funding policy....” The Proposed Rule specifically

¹ See 29 CFR 2550.404a-1.

² See our prior alert on the Proposed Rule [here](#).

addressed ESG considerations in connection with the duty of loyalty, but, as described above, this was removed from the Final Rule.

- **Tie Breaker Test.** Non-pecuniary factors may be considered when the “plan fiduciary is unable to distinguish [investment options] on the basis of pecuniary factors alone.” This is a change from the Proposed Rule that only allowed non-pecuniary factors to be considered when investment options were “economically indistinguishable.” The DOL continues, however, to note in the preamble that the use of the tie breaker test should be rare. In such cases where a plan fiduciary uses the tie breaker test, the plan fiduciary must document:
 - why the pecuniary factors were not sufficient to select the investment option;
 - how the investment option compares to the alternatives with respect to certain pecuniary factors; and
 - how the chosen non-pecuniary factor or factors are consistent with the interests of the participants in their retirement income or financial benefit under the plan.
- **Investment Alternatives for Individual Account Plans.** The Final Rule makes clear that the fiduciary duties of prudence and loyalty apply equally to the selection or retention of investment alternatives for individual account plans (*e.g.*, 401(k) plans). However, a fiduciary is not prohibited from including an investment alternative that promotes a non-pecuniary goal if the fiduciary otherwise satisfies its fiduciary duties and such investment alternative is **not** the qualified default investment alternative.

Effective Date. The Final Rule is applicable to all investments made and investment courses of action taken after January 12, 2021. This gives fiduciaries a chance to amend any investment policy statements and/or take any other actions to comply with the regulation. With the exception of qualified default investments alternatives, which must be brought into compliance with the Final Rule by April 30, 2022, the Final Rule does not otherwise require fiduciaries to divest of investments or make changes to investments that were made prior to the effective date that would now be prohibited under the Final Rule.

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