SLU Law Journal Online

11-13-2021

ESG Investing: May ERISA Plan Fiduciaries Consider Environmental, Social, and Governance Factors When Making Investment Decisions?

Morgan Fox

ESG Investing: May ERISA Plan Fiduciaries Consider Environmental, Social, and Governance Factors When Making Investment Decisions?

Morgan Fox*

Mindsets have shifted over the last century and more acutely in recent years towards a desire to effect change among business operations that implicate environmental, social, and corporate governance issues. These concerns have increasingly been reflected in investor sentiment. What is termed as "ESG" (environmental, social, and governance) investing demonstrates investors' desire to have a positive impact on society and our small, blue planet.[1] It is an investment strategy utilizing a socially conscious set of standards for a business's operations to screen out potential investments.[2] Generally, the factors evaluate a business's sustainability and its effect on financial performance.[3] More specifically, environmental factors may include climate change, pollution, carbon emissions, biodiversity, wildlife conservation, and waste and energy management.[4] Social factors center around issues such as child labor, forced labor, human rights, poverty alleviation, workforce diversity, employee health and safety, product safety, and consumer protection.[5] Governance issues may involve board

* J.D. Candidate, May 2023, Saint Louis University of Law

[1] Tinglong Dai, *ESG investing has a blind spot that puts the trillion industry's sustainability promises in doubt: Supply chains*, MSN (Nov. 9, 2021), https://www.msn.com/en-us/money/topstocks/esg-investing-has-a-blind-spot-that-puts-the-trillion-industry-s-sustainability-promises-in-doubt-supply-chains/ar-AAQvC1V?ocid=BingNewsSearch&pfr=1.

[2] Kenneth Squire, *The evolution of ESG investing. Here's what's next*, CNBC (Nov. 6, 2021), https://www.cnbc.com/2021/11/06/the-evolution-of-esg-investing-heres-whats-next.html#:~:text=ESG%20investing%20is%20still%20very%20young%20and%20will,requires%20active%20ESG%20investing%2C%20which%20is%20already%20happening.

[3] *ESG Glossary*, BLOOMBERG LAW (2021), https://www.bloomberglaw.com/product/bec/document/X19G3GOS000000/.

[4] *Id.*

[5] *Id.*

structure, tenure, and diversity; shareholder rights, internal controls, accountability, transparency, bribery and anti-corruption, among others.[6]

ESG investing has increased over the years, but the trajectory is quickly accelerating.[7] According to Morningstar, flows into sustainable funds increased nearly fourfold from 2018 to 2019.[8] So far in 2021, ESG assets represent 10% of the overall flow into exchange-trade funds, increasing 125.8% year-to-date.[9] Despite the growth, ERISA plan fiduciaries faced restrictions in making ESG investment decisions beginning in 2020. However, with the change in Administration, the outlook for ESG investing is looking up.

I. Evolution of the DOL Rules Governing ERISA Fiduciaries

Title I of the Employee Retirement Income Security Act of 1974 ("ERISA") governs the operations of private-sector employee benefit plans.[10] An ERISA fiduciary exercises discretionary control over plan management and investment of its assets, provides investment advice, or is responsible for administration of the plan.[11] ERISA requires plan fiduciaries to act prudently and diversify plan investments "so as to minimize the risk of large losses".[12] According to Section 403(a) and 404(a), fiduciaries are to act solely in the interest of the participants and beneficiaries of the plan.[13]

---

[6] *Id.*
[7] Financial Factors in Selecting Plan Investments, 85 Fed. Reg. 72846, 72847 (Nov. 13, 2020) (codified at 29 C.F.R. §2550 (2020)).
[8] John Hale, *The ESG Fund Universe Is Rapidly Expanding*, MORNINGSTAR (Mar. 19, 2020), https://www.morningstar.com/articles/972860/the-esg-fund-universe-is-rapidly-expanding.
[9] Franklin Templeton, *Understanding the Rise of ESG*, INVESTMENT EXECUTIVE (Nov. 1, 2021), https://www.investmentexecutive.com/brand-knowledge_/franklin-templeton/understanding-the-rise-of-esg/.
[10] Employee Retirement Income Security Act, 29 U.S.C. §§ 1001-1461 (1974).
[11] 29 U.S.C. § 1002.
[12] 29 U.S.C. § 1104.
[13] *Id.*

For over 30 years, ERISA fiduciaries sought guidance from the DOL on whether plan investments may be selected based on furthering collateral economic or social benefits in addition to investment returns.[14] During those years, the DOL's non-regulatory guidance allowed ERISA fiduciaries to consider ESG factors in investment decisions in certain situations.[15] In a 2015 Interpretive Bulletin, the DOL maintained that fiduciaries my not accept lower expected returns or increased risk in exchange for promoting social, environmental, or other public policy causes.[16] However, the Department noted that ESG factors may not always be incompatible with ERISA's fiduciary duty.[17] As long as the investment with collateral benefits is economically equivalent in terms of risk, return, and time horizon to available alternatives without collateral benefits, fiduciary duty is not violated.[18] This test was termed the "all things being equal" or "tie-breaker" standard.[19] With that said, fiduciary investment decision-making ultimately depends on all the facts and circumstances of each situation.[20]

This inherently factual "tie-breaker" standard and non-regulatory guidance did little to address confusion and clarify fiduciary obligation. Concern remained as to whether ERISA fiduciaries were making investment decisions that were not in the best interest of plan participants and beneficiaries.[21] In response, the DOL issued a final rule in November of 2020 titled "Financial Factors in Selecting Plan Investments."[22] The rule requires plan fiduciaries to base investment decisions solely on pecuniary factors and financial interests of participants and beneficiaries.[23] Although the rule

---

[14] See, *e.g.*, Interpretive Bulletin 2015-01, 80 Fed. Reg. 65135, 65135 (Oct. 26, 2015).
[15] *Id.*
[16] *Id.* at 63136.
[17] *Id.* at 63135.
[18] *Id.*
[19] Interpretive Bulletin 2021, 86 Fed. Red. 57272, 57273 (Oct. 14, 2021).
[20] 80 Fed. Reg. 65135, 65137 (Oct. 26, 2015).
[21] 86 Fed. Reg. 57272, 57272 (Oct. 14, 2021).
[22] *Id.*
[23] 29 C.F.R. § 2550.404a (2020).

allows fiduciaries to consider ESG factors in narrow situations, the preamble to the regulation cautioned fiduciaries against too readily concluding that ESG factors are economically relevant, pecuniary factors.[24] It also suggested that ESG factors are of little significance to share value.[25] As such, the rule has been interpreted as "putting a thumb on the scale against consideration of ESG factors."[26]

II. The Future of ESG Investing under ERISA

After the change in Administration, the DOL issued a statement that it would not enforce the final rule.[27] In January 2021, President Biden issued Executive Order 13990, titled "Protecting Public Health and the Environment and Restoring Science to Tackle the Climate Crisis."[28] It states the policy of the Administration is to:

> [l]isten to the science; to improve public health and protect our environment; to ensure access to clean air and water; to limit exposure to dangerous chemicals and pesticides; to hold polluters accountable, including those who disproportionately harm communities of color and low-income communities; to reduce greenhouse gas emissions; [and] to bolster resilience to the impacts of climate change.[29]

Subsequently, the order directs agencies to review regulations to ensure consistency with the policy of the order, and suspend, revise, or rescind

[24] 86 Fed. Reg. 57272, 57275 (Oct. 14, 2021).
[25] *Id.*
[26] *Id.*
[27] *U.S. Department of Labor Statement Regarding Enforcement of its Final Rules on ESG Investments and Proxy Voting by Employee Benefit Plans*, U.S. DEP'T OF LABOR (Mar. 10, 2021), https://www.dol.gov/sites/dolgov/files/ebsa/laws-and-regulations/laws/erisa/statement-on-enforcement-of-final-rules-on-esg-investments-and-proxy-voting.pdf
[28] Exec. Order No. 13,990, 86 Fed. Reg. 7037, 7037 (Jan. 25, 2021).
[29] *Id.*

laws that are inconsistent or pose obstacles to adherence of the policy.[30] In March 2021, the DOL in turn announced that it would not enforce the final rule against any ERISA plan fiduciary for failure to comply, pending review of the current regulation.[31]

In October of 2021, the DOL proposed a new set of rules that, if adopted, would provide ERISA fiduciaries more leeway in considering ESG factors.[32] The DOL's hope is to quell the perception that fiduciaries are at risk by taking ESG factors into account.[33] The proposed provision broadens the "tie-breaker" standard and confirms that a fiduciary can consider *any* factors material to risk-return analysis.[34] To provide further clarity, the proposal provides specific ESG factors that fiduciaries may take into account.[35] Additionally, the proposal rescinds a provision of the 2020 final rule that requires additional documentation of ESG-based decisions, viewing it as needlessly deterring fiduciaries from including ESG factors in their analysis.[36]

The DOL urges that if the rules are left unchanged, plan investments may be subject to avoidable climate-change-related risks that negatively impact performance.[37] It should be understood that climate, social, and governance risk is investment risk. As the DOL has explained, "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 tiebreakers, but rather are proper components of the fiduciary's primary analysis of the economic merits of competing investment choices."[38] These issues only continue to escalate and will

[30] *Id.*
[31] U.S. DEP'T OF LABOR, *supra* note 27.
[32] 86 Fed. Reg. 57272, 57276 (Oct. 14, 2021).
[33] *Id.*
[34] *Id.* at 57277.
[35] *Id.*
[36] *Id.* at 57279.
[37] *Id.*
[38] 80 Fed. Reg. 65135, 65136 (Oct. 26, 2015).

undoubtedly have short- and long-term economic impacts that present material risks and opportunities to businesses. Accordingly, the duty of prudence and loyalty should require an ERISA plan fiduciary to evaluate ESG factors in their investment analysis.

Edited by Alex Beezley