An ESGplanation of ERISA's New Regulation on Social Investing

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The U.S. Department of Labor (the "DOL") on October 30, 2020 released a final regulation (the "Final Regulation") relating to the consideration of non-pecuniary factors by fiduciaries of employee benefit plans ("Plans") that are subject to the Employee Retirement Income Security Act of 1974 ("ERISA"). The Final Regulation is expected to have a pointed impact on the use of environmental, social and governance ("ESG") factors in the context of investment decisions.[1] We previously discussed the DOL's regulatory initiative regarding ESG in our June 2020 OnPoint titled An ESGciting Development - Proposed Regulation on ESG Considerations Under ERISA, which discussed the DOL's proposed regulation regarding the consideration of ESG factors (the "Proposed Regulation").[2]

In our June 2020 OnPoint, we noted that the DOL used what we described as an "arguably skeptical" tone regarding the merits considering ESG factors when investing retirement assets. After the issuance of the Proposed Regulation, the DOL received thousands of submissions, most of which were in opposition to the Proposed Regulation. In response to the comment letters, the DOL made a number of important changes to the Proposed Regulation.

EXECUTIVE SUMMARY

Introduction

For decades, following the enactment of ERISA, the DOL under successive presidential administrations had put forth its own gloss on basic ERISA principles governing social investing. With the Final Regulation, the DOL now uses actual regulatory language to address the current administration's view on taking into consideration non-pecuniary goals when investing on behalf of Plans with the hopes of enshrining those views with greater permanence.

General principles under ERISA have always been clear: a Plan fiduciary may not subordinate economic returns to accommodate collateral goals. This is because ERISA contains bedrock prudence and loyalty provisions that set forth negligence-type duties of care and requires that fiduciaries act solely in the interest of plan participants and beneficiaries and for the "exclusive purpose" of providing benefits and deferring administrative costs.

The Final Regulation works within this existing framework to emphasize the need to focus on pecuniary factors. However, whereas in the past ERISA fiduciaries may have felt comfortable selecting strategies that included ESG factors so long as those factors would not be harmful to economic returns, the Final Regulation likely places more emphasis on requiring fiduciaries to justify the positive economic benefits of such strategies. One key high-level effect of this regulatory initiative will arguably be to increase the focus of Plan fiduciaries and investment

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1 The DOL has also proposed a regulation that would apply to how fiduciaries under ERISA should consider decisions with respect to the voting of proxies and other exercises of shareholder rights associated with investments made by Plans. As we noted in our September 2020 OnPoint regarding the proposal titled A DOL Proxy Vote Against ESG? – New ERISA Proposal May Limit Plans' Exercise of Shareholder Rights, the proposed proxy regulation emphasizes economic value and proscribes subordinating a Plan's interest to any "unrelated goals."

2 Another OnPoint, ERISA's Social Goals? ESG Considerations Under ERISA (May 15, 2020), traces the development of the DOL's ESG-related authority over the years and generally discusses ESG considerations under ERISA.

managers alike on affirmatively identifying the positive economic benefit of ESG-type thinking, as opposed to proceeding on the basis that considering ESG may not be harmful to economic returns.

The Framework of the Final Regulation

The Final Regulation emphasizes the need for fiduciaries to look to pecuniary factors when selecting Plan investments and continues to require that consideration of non-pecuniary factors be empirical and supported by appropriate processes (including documentation in certain instances). It expressly states that Plan fiduciaries are not permitted to sacrifice investment returns or take on additional investment risk to promote nonpecuniary benefits or any other non-pecuniary goals, and that a fiduciary may not subordinate the interests of the participants and beneficiaries in their retirement income or financial benefits under the Plan to other objectives. While references to ESG have been removed from the text of the Final Regulation, it does not specify when ESG-type considerations would be considered pecuniary. In addition, the DOL, in the Preamble to the Final Regulation (the "Preamble"), indicated that the term "pecuniary factor" should be judged by generally accepted investment theories that a fiduciary could consider in making a prudent judgment. In so doing, the DOL specifically stated that it did not intend to foreclose ERISA fiduciaries from considering emerging theories regarding investment practices.

The Final Regulation begins by requiring Plan fiduciaries to consider the risk of loss and the opportunity for gain (or other return) associated with an investment or investment courses of action "compared to the opportunity for gain (or other return) associated with reasonably available alternatives with similar risks." In response to comments received in response to the Proposed Regulation, however, the Final Regulation requires a fiduciary to compare alternatives that are reasonably available under the circumstances, but not to "scour the market" or to consider every possible alternative.

The Final Regulation provides that, if a fiduciary is unable to determine which investment is in the best interest of the Plan on the basis of pecuniary factors alone, the fiduciary may, with appropriate documentation, base the investment decision on non-pecuniary factors. However, the DOL remains skeptical that a situation that would allow ESG-type considerations to be used as a tie-breaker in this way is anything more than theoretical.

The Final Regulation will likely have particular relevance for participant-directed individual account plans (such as participant-directed "401(k)" plans). The new rules generally apply to a fiduciary's selection of designated investment alternatives under the Plan. As a result, when assembling, choosing, or modifying an investment menu for participants' investment choices, a fiduciary must evaluate the designated investment alternatives on the menu based solely on pecuniary factors. However, the DOL noted expressly that it may be consistent with the interests of participants and beneficiaries in their retirement income or financial benefits to respond to participant demand in order to increase retirement plan savings or investments in contribution-creating jobs for current or future plan participants. The Final Regulation generally makes clear that a fiduciary is not automatically prohibited from considering or including an investment alternative merely because it pursues ESG-type goals, if the applicable rules are satisfied. That said, alternatives may be added only if they can be justified solely on the basis of pecuniary factors. Under no circumstances may any investment alternative be included in any qualified default investment alternative ("QDIA") if its investment objectives or goals or its principal investment strategies include, consider or indicate the use non-pecuniary factors.

Effective Date

The Final Regulation will generally become effective sixty days after it is published in the Federal Register. Plan fiduciaries will not be required to divest or cease any existing investment, investment course of action or designated investment alternative, even if originally selected using non-pecuniary factors in a manner prohibited by the Final Regulation.

PRACTICAL CONSIDERATIONS

Generally speaking, the following may be among the practical implications arising out of the Final Regulation:

- Strategies that trade returns for collateral benefits, such as ESG, will continue to face challenges, while strategies that do not feature adverse tradeoffs—and those that are able to demonstrate ESG factors as a positive pecuniary factor—may be better positioned to meet these new requirements.
- Tie-breakers are possible between strategies that incorporate ESG factors and strategies that employ similarly situated alternatives without ESG factors, but only if such strategies are really tied on a pecuniary basis; however, the DOL remains highly skeptical that a true tie-breaker scenario is anything more than a theoretical possibility.
- ESG-centric and -themed strategies may be less likely to be feasible for QDIAs unless the fiduciary can validate the pecuniary benefits of using ESG factors.
- Investment strategies that disclose or discuss risk factors concerning the possibility of tradeoffs in investment returns in exchange for collateral benefits, such as ESG, may face heightened challenges. Investment managers trying to satisfy the ESG demands of different investor constituencies or that need to respond to different legal and regulatory regimes may face additional complexities and challenges—especially where those constituencies (e.g., certain public sector plans not subject to ERISA) and regulatory regimes (e.g., developments in the European Union) come with viewpoints about ESG that are fundamentally different from the perspective of the Final Regulation.

DISCUSSION

Background

For decades, following the enactment of ERISA, the DOL under successive presidential administrations had put forth its own gloss on basic principles governing economically targeted investments ("ETIs") that were first outlined by the DOL in 1994. However, these efforts had been pursued interpretively (i.e., in what has been referred to as "sub-regulatory" authority), and the DOL has never before sought to enshrine the treatment of ESG-type considerations in actual regulatory language. The history of the DOL's treatment of economically targeted investments is reviewed in our June 2020 OnPoint referred to above.

With the Final Regulation, the DOL now uses actual regulatory language to address investing on the basis of non-pecuniary goals, thus allowing for the establishment of new rules that might not have been possible under existing statutory and regulatory language. The Final Regulation also gives greater permanence to the current regulatory perspective relating to ESG under ERISA, as it is more difficult to alter regulatory language than to make iterative interpretations under the statutory and regulatory language in place at any particular time.

It remains a fundamental underlying principle of the Final Regulation that, consistent with the DOL's historic position, a Plan fiduciary may not subordinate economic returns to accommodate collateral goals. As the DOL stated in the Preamble: "Providing secure retirement for American workers is the paramount, and eminently worthy, 'social' goal of ERISA plans; plan assets may never be enlisted in pursuit of other social or environmental objectives at the expense of ERISA's fundamental purpose of providing secure and valuable retirement benefits."

As compared with the Proposed Regulation, the Final Regulation works more within ERISA's existing framework to emphasize the need to focus on pecuniary factors. While there is clear substantive impact on the consideration of ESG in connection with fiduciary decision-making, it can be argued that the Final Regulation

generally does not dramatically change the current law's overall approach. In this way, the Final Regulation may be seen as, in some ways, bolstering traditional ERISA safeguards with additional process and documentation.

Changes from the Proposed Regulation

The Final Regulation differs in a number of significant ways from the Proposed Regulation. Among the changes are:

- A basic change in tone, including the elimination of the express questioning of ESG factors as permissible considerations.
- The identification of certain factors as being legitimate considerations in breaking ties between equivalent investments.
- New regulatory text setting forth required investment analysis and documentation requirements for circumstances in which Plan fiduciaries may use non-pecuniary factors to choose between or among investments that the fiduciary cannot distinguish based on pecuniary factors alone.
- Modifications to the text to avoid suggesting that fiduciaries must scour the marketplace or look at an infinite number of possible alternatives as part of their evaluation.

However, certain key aspects of the Proposed Regulation were retained, such as:

- An overall emphasis on pecuniary as opposed to other (including social) considerations.
- A requirement that fiduciaries consider reasonably available alternatives to meet their prudence duties under ERISA.
- Permitting fiduciaries of individual account plans to consider or include, as designated investment alternatives, investment funds, products, or model portfolios that support non-pecuniary goals if the Plans allow participants and beneficiaries to choose from a broad range of investment alternatives.
- A requirement that consideration of non-pecuniary factors be empirical and supported by processes (including, possibly, a need for additional documentation under certain conditions).
- Continued expression of skepticism that two investment strategies may ever be equivalent so as to justify a tie-breaker approach.
- Continued barriers to the use of ESG-weighted funds and ESG-themed funds as default investment alternatives under participant-directed individual account plans' qualified default investment alternatives ("QDIAs").

The Provisions of the Final Regulation

Overview

The Final Regulation sets forth fiduciary standards for selecting and monitoring investments held by Plans, and addresses the scope of fiduciary duties surrounding nonpecuniary issues. Unlike the Proposed Regulation, the text of the Final Regulation does not contain express references to ESG. Instead, the Final Regulation makes reference only to pecuniary and non-pecuniary factors in determining the relevant fiduciary investment duties. The DOL noted in the Preamble that the terms used to describe certain non-pecuniary benefits "do not have a

uniform meaning and the terminology is evolving" and that by "conflating unrelated environmental, social, and corporate governance factors into a single term, ESG invites a less than appropriately rigorous analytical approach in evaluating whether any given E, S, or G consideration presents a material business risk or opportunity to a company that corporate officers and directors should manage as part of the company's business plan and that qualified investment professionals would treat as economic considerations in evaluating an investment in that company." The DOL further noted that adopting ESG terminology "invites the arguments" that "all manner of ESG considerations are always and in every case a pecuniary factor that must be considered as such in all investment decisions, or even that ESG should be a mandatory investment strategy for prudent fiduciaries."

Although the text of the Final Regulation does not mention ESG specifically, the Preamble observes the "steady upward trend" in the use of the term "ESG" by asset managers as well as "an increase in asset flows into ESG funds." The DOL observed that ESG investing has engendered "important and substantial questions" particularly considering the "lack of precision and consistency in the marketplace with respect to defining ESG investments and strategies, as well as shortcomings in the rigor of the prudence and loyalty analysis by some participating in the ESG investment marketplace." The DOL further took note of the fact that ESG funds "often come with higher fees," as well as the Securities and Exchange Commission's recent focus in its examination priorities on "the accuracy and adequacy of disclosures" with regard to ESG strategies.

Prudence/Loyalty – in General

Paragraph (a) of the Final Regulation, after restating the applicable statutory rules, amends the existing regulation by expressly adding a reference to the duty of loyalty that is manifested by ERISA's "exclusive purpose" requirement to the existing duty of prudence with respect to investment duties.

Paragraph (b) contains general rules relating to prudence and the consideration of an investment or investment course of action taken by a Plan fiduciary. In Paragraph (b)(2), where rules relating to "appropriate consideration" are spelled out, the DOL added new language to state that the consideration of risk and loss and the opportunity for gain (or other return) associated with the investment or investment courses of action should take place "compared to the opportunity for gain (or other return) associated with reasonably available alternatives with similar risks."

Under the Final Regulation, a fiduciary is required to compare alternatives that are reasonably available under the circumstances. According to the Preamble, the DOL decided to substitute the "available alternative investments" standard with the phrase "reasonably available alternatives" not only to confirm that the rule does not "require fiduciaries to scour the market or to consider every possible alternative," but also, in what appears to be a softening from the Proposed Regulation, to "allow for the possibility that the characteristics and purposes served by a given investment or investment course of action may be sufficiently rare that a fiduciary could prudently determine, and document, that there were no other reasonably available alternatives for purpose of this comparison requirement."

Pecuniary Factors

Paragraph (c)(1) of the Final Regulation retains the requirement in the Proposed Regulation that fiduciary evaluation of an investment must be focused only on pecuniary factors. Importantly, the Final Regulation's paragraph (c)(1) is a legal requirement and not merely a safe harbor. Of critical importance is that the Final Regulation expressly states that Plan fiduciaries are not permitted to sacrifice investment return or take on additional investment risk to promote nonpecuniary benefits or any other non-pecuniary goals. The Final Regulation's text also importantly states that a fiduciary may not subordinate the interests of the participants and beneficiaries in their retirement income or financial benefits under the Plan to other objectives. The provision continues by stating the general requirement that the weight given to any pecuniary factor by a fiduciary should

appropriately reflect a prudent assessment of its impact on risk and return. It is ultimately the DOL's intention to "separate the legitimate use of risk-return factors from inappropriate investments that sacrifice investment return, increase costs, or assume additional investment risk to promote non-pecuniary benefits or objectives."

In the Proposed Regulation, the DOL provided that "[e]nvironmental, social, corporate governance, or other similarly oriented considerations are pecuniary factors only if they present economic risks or opportunities that qualified investment professionals would treat as material economic considerations under generally accepted investment theories." In contrast to the Proposed Regulation, the Final Regulation does not specify when ESG and "other similarly oriented considerations" would be considered pecuniary. According to the Preamble, the DOL chose not to include a provision in the Final Regulation that further clarifies this term, and elected to "rely on the definition of pecuniary factor as the governor for investment decisions without specifically constraining the criteria that a fiduciary could consider in making a prudent judgment." Nevertheless, in the Final Regulation the DOL stated that it "believes that it would be consistent with ERISA and the Final Regulation for a fiduciary to treat a given factor or consideration as pecuniary if it presents economic risks or opportunities that qualified investment professionals would treat as material economic considerations under generally accepted investment theories."

The Preamble emphasizes that this provision should not be read as "a limitation on the ability of ERISA fiduciaries to consider all relevant factors in evaluating whether factors may have a 'material effect on the return and risk of an investment.'" Rather, according to the DOL, a fiduciary "satisfies its obligations under paragraph (c)(1) by evaluating factors that are expected to result in a material difference among reasonably available alternatives with respect to risk and/or return." Indeed, the DOL noted that a fund manager's "brand or reputation" would be considered "pecuniary" if the fiduciary would prudently conclude that the brand or reputation "will materially affect the expected risk and/or return [of] funds."[3] Preferences as to investment structure (i.e., a mutual fund vs. collective investment fund) may be legitimate considerations "because of the protection the fiduciary believes the particular regulatory regime offers." In addition, the DOL noted that it did not intend "to foreclose ERISA fiduciaries from considering emerging theories regarding prudent investment practices or otherwise freeze investment practice as of the date of the rule."

Tie-Breakers

Paragraph (c)(2) of the Final Regulation provides that, if a fiduciary is unable to determine which investment is in the best interests of the Plan on the basis of pecuniary factors alone, the fiduciary may base the investment decision on non-pecuniary factors, provided the fiduciary documents the following: (i) why pecuniary factors were not sufficient to select the investment or investment course of action; (ii) how the investment compares to the alternative investments with regard to diversification, liquidity and current return relative to anticipated cash flow requirements, and the projected return relative to funding objectives; and (iii) how the chosen non-pecuniary factor or factors are consistent with the interests of the participants and beneficiaries in their retirement income or financial benefits under the Plan. With respect to the third documentation requirement, the Preamble cautions that, when a fiduciary makes an investment decision based on non-pecuniary factors as permitted under the Final Regulation, the fiduciary remains subject to ERISA's general loyalty obligation and must act in a manner that is consistent with the interests of participants and beneficiaries in their retirement income or financial benefits.

The Proposed Regulation had used the term "economically indistinguishable" which raised a number of comments and concerns. Many commenters worried that this would require fiduciaries to conclude that competing investment options would need to be identical in each and every respect before the tie-breaker provision would be available. The DOL, in the Final Regulation, does not demand that investments be "identical in each and every respect before the tie-breaker provision would be available"; rather, the tie-breaker test

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[3] Similarly, net expenses incurred by the Plan (for example, for plan administration or plan disclosures) would be considered pecuniary if they are expected to "materially affect the risk and return of one alternative as compared to another."

focuses on "situations in which the fiduciary is unable to distinguish investment alternatives on the basis of pecuniary factors alone" (provided the fiduciary documents certain specified matters). However, the DOL remains skeptical that a situation that would allow ESG-type considerations to be used to break a tie is anything more than theoretical, and stated in the Preamble that "investment options that cannot be distinguished on the basis of pecuniary factors occur very rarely in practice, if at all."

Participant Directed Individual Account Plans.

Paragraph (d) of the Final Regulation is, again, a legal requirement and not a safe harbor. Paragraph (d)(1) provides that the standards set forth in paragraph (a) (relating to the statutory duties of loyalty and prudence) and paragraph (c) (the pecuniary-only and anti-subordination provisions, including the tie-breaker test) of the Final Regulation apply to a fiduciary's selection of designated investment alternatives that will be made available to participants and beneficiaries for investing their individual accounts. Thus, prudence and loyalty duties that apply generally to evaluating investments under ERISA (such as stock selection) also apply to a fiduciary's evaluation and selection of designated investment alternatives from which participants and beneficiaries select where to direct their retirement assets. As a result, when assembling, choosing, or modifying an investment menu for participants' investment choices, a fiduciary must evaluate the designated investment alternatives on the menu based solely on pecuniary factors, not subordinate the interests of participants to unrelated objectives, and not sacrifice investment returns or take on additional investment risk to promote non-pecuniary objectives or goals.

As an example of meeting the loyalty obligation, the DOL importantly noted expressly that it may be consistent with the interests of participants and beneficiaries in their retirement income or financial benefits to respond to participant demand in order to increase retirement savings or investments in contribution creating jobs for current or future plan participants. Conversely, the Preamble notes that investment decisions based on which investment would bring greater personal accolades to the chief executive officer of the sponsoring employer, or based solely on a fiduciary's personal policy preferences, are expressly identified as not being consistent with the relevant interests of participants and beneficiaries.

Paragraph (d)(2) of the Final Regulation reinforces the principles in paragraph (d)(1) by providing that a fiduciary is not automatically prohibited from considering or including as an option for an individual account plan an investment fund, product, or model portfolio merely because it promotes, seeks, or supports non-pecuniary goals, provided that the fiduciary satisfies the general requirements of the regulation (i.e., paragraphs (a) and (c)) in selecting any such fund, product or portfolio. This provision makes it clear that fiduciaries are indeed permitted to add, to platforms or menus, designated investment alternatives that may produce collateral benefits or otherwise are viewed as socially desirable. But, importantly, and consistent with the broad themes of the Final Regulation and the DOL's past historical position, these alternatives may be added only if they can be justified solely on the basis of pecuniary factors. Fiduciaries who choose investments with expected reduced returns or greater risks to secure non-pecuniary benefits would be in violation of ERISA. The DOL cautions that fiduciaries who are considering investment alternatives for individual account plans should "carefully review" the prospectus or other investment disclosures for statements regarding ESG investment policies and investment approaches and that fiduciaries should be "particularly cautious" in exercising their diligence obligations under ERISA when disclosures in a fund's investment objectives or goals or its principal investment strategies contain references to non-pecuniary factors or collateral benefits.

Paragraph (d)(2)(ii) of the Final Regulation provides special treatment for QDIAs. QDIAs have become an important feature in the market, especially in light of the flow of assets into QDIAs as a result of the role QDIAs play as default investment alternatives, and in the Preamble the DOL confirms its encouragement of Plans to offer QDIAs.

In the Preamble, the DOL explained that QDIAs warrant special treatment under the Final Regulation because they are “unique arrangements under ERISA that help ensure . . . the retirement savings of plan participants who have not provided affirmative investment directions for their individual accounts.” Paragraph (d)(2)(ii) expressly provides that in no circumstances may any investment fund, product, or model portfolio be “added as, or as a component of, a QDIA if its investment objectives or goals or its principal investment strategies include, consider, or indicate the use of one or more non-pecuniary factors.” Presumably, ESG-centric or ESG-themed strategies that are able to demonstrate valid favorable pecuniary returns would be permitted as a component to a QDIA.

In contrast to the Proposed Rule, the Final Regulation clarifies that the special rule for QDIAs is not focused on whether an investment alternative employs or applies any particular ESG factors in operation. Paragraph (d)(2)(ii) focuses on whether the investment alternative includes, considers, or indicates the use of non-pecuniary factors in its investment objectives or goals or its principal investment strategies. The Final Regulation clarifies that the special rule for QDIAs only prevents an otherwise acceptable designated investment alternative from being selected as a QDIA if it, or any of its components, has investment objectives or goals or principal investment strategies that include, consider, or indicate the use of one or more non-pecuniary factors. In that case, a designated investment alternative could not be a QDIA even if it otherwise could have been permissibly selected as a designated investment alternative looking only at pecuniary factors.[4]

EFFECTIVE DATE

The Final Regulation will generally become effective 60 days after it is published in the Federal Register, and will apply prospectively in its entirety to investments made and investment courses of action taken after such date. Plans have until April 30, 2022 to make any changes to QDIAs, where necessary to comply with the requirements of the Final Regulation. The Final Regulation’s effective date will be before any change in presidential administrations, thus potentially insulating it from being frozen by the type of administrative action that has been taken early in recent prior administrations with respect to still-pending regulatory efforts.[5]

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[4] In the Preamble, the DOL explained its restrictive treatment of QDIAs as follows:

> ERISA is a statute whose overriding concern relevant here has always been providing a secure retirement for America’s workers and retirees, and it is inappropriate for participants to be defaulted into a retirement savings fund that may have other objectives absent their affirmative decision. This is especially true if the default investment alternative, or any of its components, has investment objectives or principal strategies that reflect one or more non-pecuniary factors. The use of nonpecuniary factors, even if co-existing with financially-oriented strategies or goals, raise questions as to the extent to which the QDIA’s managers may be forgoing financial returns in pursuit of non-financial objectives.
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> . . . .
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> [Thus, the DOL] agrees with those commenters who believe a heightened prophylactic approach for QDIAs is the best course of action [because QDIAs] by definition exist for participants and beneficiaries who do not actively direct their investments, and by operation tend to sweep in many participants and beneficiaries with less investment experience and sophistication than more active investors. . . .

[5] See Memorandum for the Heads of Executive Departments and Agencies from Rahm Emanuel (Jan. 20, 2009) (available at: http://media.washingtonpost.com/wp-srv/politics/documents/emanuel-regulatory-review.pdf) (memo from President Obama ordering that effective as of the first date of the administration no new regulation be sent to the Federal Register, all pending regulation be withdrawn, and certain regulation previously published will have their effective date extended); Memorandum for the Heads of Executive Departments and Agencies from Reince Priebus (Jan. 20, 2017) (available at: https://www.whitehouse.gov/presidential-actions/memorandum-heads-executive-departments-agencies/) (providing for similar orders).

Plan fiduciaries will not be required to divest or cease any existing investment, investment course of action or designated investment alternative, even if originally selected using non-pecuniary factors in a manner prohibited by the Final Regulation. However, after the effective date, all decisions regarding such investments, investment courses of action and designated investment alternatives, including decisions that are part of a fiduciary's ongoing monitoring requirements, must comply with the Final Regulation. The DOL noted that, although it believes that much of the Final Regulation "explains pre-existing duties under the statute," it does not intend to pursue enforcement (and does not believe any private action would be viable) pertaining to any action taken with respect to an investment by a Plan fiduciary prior to the effective date of the Final Regulation.

An item to consider is whether the Final Regulation might be reviewed (and potentially overturned) by the Congressional Review Act (the "CRA"), an oversight tool that Congress may use to overturn rules issued by federal agencies. The CRA generally requires agencies to report on their rulemaking activities to Congress and provides Congress with a special set of procedures under which to consider legislation to overturn those rules. Considering the possible upcoming change in administration, it is possible (although, particularly in light of the DOL's changes from the Proposed Regulation, by no means certain) that there may be CRA review of the Final Regulation.[6]

CONCLUSION

The Final Regulation represents the current administration's attempts to address its concerns arising from the growth in ESG and other collateral considerations. While over time the DOL has addressed ESG-type concerns through interpretive sub-regulatory guidance, the new rules are now actually enshrined in regulations.

It remains a fundamental underlying principle of the Final Regulation that, consistently with the DOL's historic position, a Plan fiduciary may not subordinate economic returns to accommodate collateral goals. Nevertheless, the Final Regulation would seem to permit ESG-type factors to be considered to the extent they deliver on pecuniary objectives. If it can be shown empirically that considering ESG factors can actually deliver better returns for Plans, the arguments in favor of considering ESG factors would seem naturally to improve. Under that paradigm, ESG factors could be viewed as positive considerations that are permissibly taken into account. In all cases, the Plan fiduciary will need to reach the appropriate conclusions and document them.

It is also worthy of note that the extent to which the analysis under ERISA will influence or otherwise affect the analysis under state and local law, and in non-U.S. jurisdictions, is unclear. Similar concerns may arise as investment managers work to develop strategies that can simultaneously satisfy the regulatory demands of the Final Regulation and the commercial desires and regulatory needs of competing investor constituencies. To the extent that those dynamics present tensions, it would appear to increase challenges for investment managers in how they describe and present the material terms and risks associated with their strategies. We would expect that this tension will become more pronounced for many.

Ultimately, it can be argued that the Final Regulation generally does not itself dramatically change the current law's overall approach. Indeed, it is fair to say that some observers believe that the Final Regulation is more consistent with ERISA's historical framework. That being the case, the Final Regulation may be seen in some ways as bolstering traditional ERISA safeguards with additional process and documentation requirements.

The Final Regulation is undeniably important, and a key high-level effect of this regulatory initiative will arguably be to increase the focus of Plan fiduciaries and managers on affirmatively identifying the positive economic

[6] As of January 2020, the CRA had been used to overturn a total of 17 rules. Sixteen of those rules were overturned in the 115th Congress (2017-2018).

benefit of ESG-type thinking, as opposed to proceeding on the basis that considering ESG may not be harmful to economic returns.

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If you would like to discuss the Regulation or other ESG considerations under ERISA, or any aspect of ERISA's fiduciary rules, please contact any of the Dechert attorneys listed below or any Dechert attorney with whom you regularly work.

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