

# FINANCIAL FACTORS IN SELECTING PLAN INVESTMENTS

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On June 23, the Department of Labor issued a notice of proposed rulemaking entitled “Financial Factors in Selecting Plan Investments” (“Proposal”) aimed at clarifying the obligations related to consideration of environmental, social and governance (ESG) factors by fiduciaries who oversee private sector pension and defined contribution plans covered by the Employee Retirement Income Security Act (ERISA).

Despite the aim of providing clarity for ERISA fiduciaries, the Proposal creates confusion. This appears to be, in part, because of a failure to distinguish ESG integration and economically targeted investing (ETI). ESG integration is the consideration of ESG factors as part of prudent risk management and a strategy to take investment actions aimed at responding to those risks. ETIs are investments that aim to provide financial returns as well as collateral, non-financial benefits. For example, ETIs often advertise job creation or climate impact as goals of the investment.

## ESG INTEGRATION

The Proposal states that ERISA fiduciaries are obligated to integrate ESG factors into their investment analysis if they determine that those factors are likely to have a material economic impact on the investment. If a fiduciary, however, does not believe that ESG factors will have a material economic impact on the investment, in most circumstances, it will not be permitted to consider those factors.

## INVESTMENTS WITH EQUIVALENT RISK-RETURN PROFILES

The DOL developed the “all things being equal test” in 1994 to define when fiduciaries may make investment decisions based on collateral benefits. Under that test, fiduciaries may select an investment that provides collateral benefits only after they have determined that the risk and return profile of that investment option is substantially similar to that of competing options that would meet the needs of the fund just as well.

The Proposal raises questions about whether fiduciaries would, in reality, ever have the opportunity to select between multiple investment options that genuinely present the same risk return profile and invites specific comment on that question. It proposes the retention of the “all things being equal” test and **adds new recordkeeping requirements for fiduciaries to document their analysis that multiple options were equal and that it was, therefore, appropriate to make a decision based on collateral benefits.**

The Proposal's discussion of the all things being equal test is cause for confusion because, while the test was originally developed to guide the consideration of ETIs and the discussion in the Proposal appears to envision the selection of an ETI investment, the language of the Proposal does not distinguish the application of this test from the broader discussion of ESG integration.

## **DEFINED CONTRIBUTION PLAN INVESTMENT OPTIONS**

The Proposal clarifies that ERISA fiduciaries may select "ESG-themed funds" as an investment option for a participant-directed plan but that an "ESG-themed fund" cannot be selected as the default investment option (the investment fund in which beneficiaries' assets are automatically invested should they choose not to select from among the options offered).

The Department's stated rationale for prohibiting an "ESG-themed fund" from being selected as the default investment option is that it is not appropriate to select "investment funds whose objectives include non-pecuniary goals." This statement shows a fundamental misunderstanding of the purpose of ESG integration, which is to integrate all material factors into investment decision-making. In addition, it is likely to cause confusion for fiduciaries as they attempt to rationalize the Department's statements earlier in the Proposal that ESG factors are likely to have a material economic impact with the discussion of ESG factors in this context, in which the Department has deemed them "non-pecuniary."

## **NEXT STEPS**

Once the Proposal is published in the Federal Register, which could happen any day but could also take weeks, we will have 30 days to submit comments. It is not published at time of writing (30 June 2020).

The PRI has submitted a letter to the DOL asking for an extension so that comments are due in 90 days and we will notify you if an extension has been granted. We should assume, however, that comments are due 30 days after publication in the Federal Register.

The PRI will also submit a response to the consultation, which we will make available to PRI signatories. Further resources – for example, an information webinar – will be set out in the coming days.

## **CONCLUSION**

The Proposal mischaracterizes ESG integration and fails to distinguish between ESG integration and economically targeted investing. This is likely to lead to confusion for ERISA fiduciaries and cost to plan savers. If the Proposal is finalized in its current form, we are concerned that fiduciaries will struggle to fulfil their obligations to integrate all financially material risk factors while also trying to respond to the language in the Proposal that appears aimed at preventing fiduciaries from taking account of these same risks.

This Proposal has no impact on ERISA fiduciaries unless and until it becomes final. There are likely to be significant changes before the rule is finalized and it is possible that the DOL will decide not to issue a final rule. PRI signatories have an opportunity to influence the outcome.

## **We recommend**

- In the first instance, PRI signatories write to the DOL requesting an extension to the consultation period.
- And, PRI signatories prepare to respond to the consultation.

Written correspondence should be sent to:  
Office of Regulations and Interpretations  
Employee Benefits Security Administration  
Room N-5655  
U.S. Department of Labor  
200 Constitution Avenue NW  
Washington, DC 20210

Comments may be submitted electronically [here](#) or at [https://www.regulations.gov/document?D=EBSA\\_FRDOC\\_0001-0210](https://www.regulations.gov/document?D=EBSA_FRDOC_0001-0210).

For questions or comments, email [policy@unpri.org](mailto:policy@unpri.org) and to Heather Slavkin Corzo, Head of US Policy, at [heather.slavkin.corzo@unpri.org](mailto:heather.slavkin.corzo@unpri.org).