DOL PROPOSED RULEMAKING: "PRUDENCE AND LOYALTY IN SELECTING PLAN INVESTMENTS AND EXERCISING SHAREHOLDER RIGHTS"

On October 13, the Department of Labor (DOL) issued a notice of proposed rulemaking entitled, “Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights”. The proposal clarifies the duties of ERISA-regulated fiduciaries in their consideration of environmental, social and governance (ESG) factors when managing retirement plan assets. The Department's stated purpose for issuing the proposal is "to empower plan fiduciaries to safeguard the savings of America’s workers by making it clear that fiduciaries may consider climate change and other [ESG] factors when they make investment decisions and when they exercise shareholder rights, including voting on shareholder resolutions and board nominations".

The Employee Retirement Income Security Act of 1974 (ERISA) sets minimum standards for private industry retirement and health plans in order to protect market participants by providing plan information, setting standards of participation and setting out fiduciary responsibilities for plan managers. There are approximately 140 million Americans with ERISA-regulated retirement plans controlling an estimated $12.5 trillion in assets.¹ In general, ERISA does not regulate retirement plans maintained by government entities or religious institutions for their employees. However, many non-regulated plans look to ERISA for best-practice and many state fiduciary duty laws are patterned after ERISA and look to DOL guidance in interpreting their laws.

BACKGROUND

In January 2021, two rules from the Employee Benefits Security Administration (EBSA) at the DOL entitled, “Financial Factors in Selecting Plan Investments” and “Fiduciary Duties Regarding Proxy Voting and Shareholder Rights” went into effect.² On January 20, President Biden issued an executive order for the DOL to review the rules.³ In accordance with the order, the DOL announced that until it publishes further guidance, it would not enforce the rules.⁴ On May 20, the Biden administration issued another executive order directing the Secretary of Labor to identify actions that can be taken under ERISA to protect retirees from climate-related financial risk, publish a “proposed rule to suspend, revise, or rescind” the two aforementioned rules by September.⁵

³ https://www.whitehouse.gov/briefing-room/statements-releases/2021/01/20/fact-sheet-list-of-agency-actions-for-review/
⁵ https://www.whitehouse.gov/briefing-room/presidential-actions/2021/05/20/executive-order-on-climate-related-financial-risk/
The DOL’s “Financial Factors in Selecting Plan Investments” rulemaking established additional record-keeping rules, prevented ESG-themed funds from being selected as default investment options, and overall created confusion through contradictory language and requirements around the ability of fiduciaries to utilize ESG factors. During the 2020 comment period, the PRI submitted a public comment to the DOL outlining the confusion the proposed rule would create for fiduciaries in considering ESG factors even when those factors were clearly material and their consideration could very likely assist plan managers to reduce risk and enhance earnings of the fund.

The DOL’s “Fiduciary Duties Regarding Proxy Voting and Shareholder Rights” rulemaking established additional record-keeping rules for fiduciaries engaging in the proxy voting process and created confusion by providing putative safe harbors around proxy voting policies and actions. The PRI submitted a public comment to the DOL detailing how the proposed rule would generally discourage engagement in the proxy voting process and directly prevent shareholders wishing to engage in the proxy process from exercising their rights.

PROPOSED RULE

The proposed rulemaking, “Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights” would amend both of the previous DOL rules listed above in an effort to remove additional barriers to ESG considerations and provide clarity to fiduciaries in how to consider ESG factors in investment decision making and the proxy voting process.

The proposed rulemaking clarifies that ESG factors can be material and where determined material by the fiduciary, should be treated in the same way as any other investment factor. Specifically, the proposed rulemaking:

- Clarifies that previous staff-level guidance and Department rulemaking has stated ESG factors can be material.
- Removes all uses of the ill-defined term “pecuniary”
- Plainly states the “duty of prudence may often require evaluation of economic effects of climate change and other ESG factors”.
- Cites risks such as “sea level rise, changing rainfall patterns” as well as “imminent or proposed regulations, for example, to reduce greenhouse gas emissions” as potentially material to investment decision making.
  - Provides a non-exclusionary list of example climate change-related factors, governance factors and workforce practices that can be material.
- The proposed rulemaking amends the “tie-breaker” standard, which allowed fiduciaries to select an investment that promotes non-financial “collateral benefits” such as jobs or environmental benefits if it was “economically indistinguishable” from other considered investments. Specifically, the proposed rulemaking:
  - Lowers the bar for usage of the tie-breaker from “economically indistinguishable” to “equally serve the financial interests of the plan”, making it more practical and likely to be used.
  - Removes parameters on the collateral benefits that may be used in a tie-breaker and clarifies that this provision is not only for consideration of collateral ESG factors.
- Removes the additional documentation requirements where collateral benefits are used to choose between two investment options.

The proposed rulemaking removes the restrictions on ESG factors being considered in default investment options, or QDIAs. QDIAs are the investment option used when a plan participant contributes funds without having specified investment preferences. Specifically, the proposed rulemaking:

- Maintains QDIA protection standards and regulations, but rejects the notion that an option that considers ESG or climate-related factors should not be included in QDIAs.
- Adds a disclosure requirement when QDIAs are selected for the collateral benefits they create in addition to investment return.
  - Examples of collateral benefits in line with QDIA inclusion are listed as “better aligns with the corporate ethos of the plan sponsor or that it improves the esprit de corps of the workforce”.

The proposed rulemaking clarifies the duties of fiduciaries in regard to the proxy voting and engagement process. Specifically, the proposed rulemaking:

- Clarifies that fiduciary duties require the conscientious exercise of shareholder rights, including voting and engagement, depending on determined costs and benefits.
- Removes language such as “always” or “never” which created confusion around requirements for shareholder engagement duties.
- Removes specific monitoring obligations where advisory services have been sought or authority to vote proxies or exercise shareholder rights has been delegated, reasoning that such obligations exist for any service provider and proxy voting providers thus should not be singled out.
- Removes two “safe harbor” examples for proxy voting policies that would be deemed ERISA-compliant, including one allowing the plan to vote based solely on management’s recommendations, and clarifies that the maintenance of a statement of investment policy, as currently required, should include a statement of proxy voting policy.
- Removes requirements for fiduciaries to maintain addition records when deciding whether to exercise shareholder rights and when exercising them, relying instead on the standard documentation activities of fiduciaries in their regular practice.

CONCLUSION
The proposed rule is a substantial step forward for ERISA-regulated fiduciaries in considering ESG factors in investment decision making and the proxy voting process. It removes the artificial barriers erected by the prior rulemakings that seemed designed to discourage such consideration and clarifies that ESG factors can and should be considered in the same way as any other potentially material investment factors. The proposed rulemaking establishes, at its core, trust in fiduciaries to act within their duties of prudence and loyalty when considering ESG factors alongside all other investment considerations. If finalized, this rulemaking would give fiduciaries the ability to utilize ESG factors in the same way they perform their fiduciary duty with any material financial information and remove the discriminatory stigma around ESG that is out of touch with the reality of markets and the global economy.
We highly encourage signatories to engage with the DOL through the public comment process to express support, or request clarification, in the final rulemaking on the provisions important to your firm. The PRI intends to express support for many of the provisions within the proposed rulemaking while offering the DOL recommendations on ways to further strengthen and clarify the consideration of ESG factors across ERISA-regulated plans.

**NEXT STEPS**

13 December 2021 is the deadline for submitting comments to the DOL.

Further resources for signatories will be sent out in the coming days. The PRI will submit a response to the consultation, which we will make available to PRI signatories.

We recommend PRI signatories prepare to respond to the consultation no later than the deadline of 13 December 2021.

All submissions must include the agency name and Regulatory Identifier Number (RIN) for this rulemaking, RIN 1210-AC03. Comments may be submitted electronically here: https://www.regulations.gov/commenton/EBSA-2021-0013-0001. 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  
Attention: Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights

For questions or comments, email policy@unpri.org or Greg Hershman, Head of US Policy, at gregory.hershman@unpri.org