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Department of Labor Warns about Socially Responsible Investing and Shareholder Activism

On April 23, 2018, the Department of Labor (DOL) issued Field Assistance Bulletin 2018-01 (FAB 2018-1) warning its national and regional offices that fiduciaries who invest plan assets based on public policy factors or who engage in shareholder activism in connection with plan investments may violate their fiduciary duties under ERISA.

Background

The DOL has consistently interpreted the fiduciary standards of ERISA to require investment decisions to be based primarily on economic factors, such as risk and return, because ERISA requires fiduciaries to act with the "exclusive purpose" of providing benefits to participants and beneficiaries and paying reasonable expenses of plan administration.[1] But the DOL's guidance on the extent to which fiduciaries may take into account environmental, social or governance (ESG) factors at the margin has varied across administrations. The DOL refers to investments that are chosen for reasons other than the economic return to a plan as "economically targeted investments" (ETIs).

Guidance issued in 2008 generally permitted ESG factors to be used only as a "tiebreaker" among investments that were otherwise determined to be economically equivalent based on a quantitative and qualitative analysis of the investments.[2] Similarly, 2008 guidance found that fiduciaries may violate their duties if they "attempt to further legislative, regulatory or public policy issues through the proxy process."[3]

But in 2015, the DOL found that ESG factors may in fact be part of the economic analysis of investments, and so it may be appropriate to apply ESG factors as more than mere tiebreakers, and that no heightened fiduciary standards apply when investing in ETIs.[4] For example, 401(k) plan fiduciaries may evaluate the prudence of offering an environmentally-friendly or "green" mutual fund using the same criteria that apply to any other plan investment option. In 2016, the DOL found that plan fiduciaries may adopt investment policies requiring ESG factors (including governance issues like board composition, transparency or executive compensation) to be taken into account by investment managers in voting proxies to enhance the long-term economic value of investments.[5]

401(k) Investment Options and QDIAs

FAB 2018-01 again stresses that the economic factors must be paramount in making investment decisions or voting proxies. But FAB 2018-01 does not discourage green mutual funds or other ETIs from being offered under a 401(k) plan because they can be offered without eliminating other investment options. Accordingly, ETIs are not necessarily suspect as investment options in a 401(k) plan that

includes a number of investment options that are not ETIs. But FAB 2018-01 draws the line at offering ETIs as default investments. For example, selecting an ESG-themed target date fund as a qualified default investment alternative (QDIA) would not be prudent unless it could be determined to be economically equivalent to other available target date funds.

Proxy Voting and Shareholder Activism

FAB 2018-01 also recognizes that proxy voting of plan investments is typically performed by institutional investment managers with resources available to assess the economic benefits and costs of proxy voting. Any proxy voting or shareholder engagement policies approved by plan fiduciaries should be intended to enhance the economic return of investments and take into account the costs of exercising shareholder rights. Where plan fiduciaries are considering courses of actions that may involve routine or substantial costs in voting proxies that take into account social factors, fiduciaries should be able to demonstrate that they have analyzed the economic benefit in view of the costs to the plan and that they are not using plan assets to promote public policy preferences. FAB 2018-01 also notes that to the extent it would be imprudent for an investment manager to follow a plan's proxy voting policy, the investment manager's fiduciary duties require it to disregard the policy and to vote shares based on the interests of participants and beneficiaries.

[1] ERISA § 404(a)(1)(A).

[2] Interpretive Bulletin 2008-1.

[3] Interpretive Bulletin 2008-2.

[4] Interpretive Bulletin 2015-1.

[5] Interpretive Bulletin 2016-1.