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Department of Labor Liberalizes Rules for Socially Responsible Investments

On October 22, 2015, the Department of Labor (DOL) issued new guidance on socially responsible investments or economically targeted investments (ETIs), which are investments chosen, at least in part, for reasons other than their expected investment return to the plan. While ETIs are not defined by ERISA, they are commonly understood to cover a broad array of arrangements, such as union plans investing only in unionized companies or funds that invest only in "green" or "sustainable" investments.

ETIs have long been controversial because they may be viewed as inconsistent with ERISA fiduciary standards. ERISA requires plan fiduciaries to act solely in the interest of participants and beneficiaries, and for the exclusive purpose of providing benefits to participants and beneficiaries. Selecting investments for reasons other than their investment return to the plan may be viewed as subordinating the economic interests of participants and beneficiaries to other interests of the fiduciary.

During the Clinton administration, the DOL issued Interpretive Bulletin (IB) 94-1, which found that selecting investments for their collateral benefits is not inconsistent with the exclusive purpose rule of ERISA as long as the investment's expected return is commensurate with alternative investments with similar risks. However, in the last months of the Bush administration, the DOL issued IB 2008-1, providing a more rigid view of ETIs. Under IB 2008-1, investments in ETIs are prohibited unless the fiduciary has first come to a conclusion that alternative investments are truly equal based on economic criteria. Now, with IB 2015-1, the DOL under the Obama administration has repealed this more restrictive position and restored the position of IB 94-1.

IB 2015-1 reflects that the DOL of the Obama administration believes the DOL of the Bush administration went too far by suggesting that additional fiduciary processes are required before investing in an ETI. The greater scrutiny applied to an ETI under the Bush DOL regime may dissuade fiduciaries from making investments that are fully consistent with the fiduciary requirements of ERISA because they may come under greater scrutiny. For example, a fiduciary could decide to invest in "green" funds based on purely economic grounds. In this case, an investment in green funds would not technically be an ETI because ETIs are defined with respect to the fiduciary's motive for investing rather than the substance of the investment. Under IB 2008-1, fiduciaries may view green funds as having a greater fiduciary risk (even if not a greater economic risk) because they are susceptible to being challenged.

IB 2015-1 does not greenlight ETIs. Fiduciaries are still prohibited from selecting investments for non-economic reasons when they have lower expected returns than other investments with commensurate risk. But it does make clear that fiduciaries should not be at greater risk for investing in

funds that are constructed by non-economic criteria when the fiduciary has determined the funds are prudent investments under economic criteria.