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BENEFITS BRIEF

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DOL Announces New Guidance on Social Investments

On October 22, 2015, the U.S. Department of Labor ("DOL" or "Department") issued guidance on the fiduciary duty provisions of the Employee Retirement Income Security Act of 1974, as amended ("ERISA") in the context of Economically Targeted Investments ("ETIs"). An ETI is broadly defined by the DOL, in the preamble to Interpretive Bulletin 2015-01 ("IB 15-01"), as "any investment that is selected, in part, for its collateral benefits, apart from the investment return to the employee benefit plan investors." IB 15-01 rescinds a 2008 interpretive bulletin the DOL issued on the same subject and reinstates guidance originally issued by the Department in 1994.

Announcing the new guidance, Secretary of Labor Thomas E. Perez stated that the 2008 guidance had "unduly discouraged plan fiduciaries from considering economically targeted investments." To address this, IB 15-01 clarifies that factors often associated with ETIs, including environmental, social and governance ("ESG") factors, "may have a direct relationship to the economic value of investments" and therefore may be considered in a fiduciary's primary economic analysis of plan investments. While IB 15-01 may be intended to remove barriers to ETIs, the DOL was also not surprisingly careful to affirm its long-standing position that a "fiduciary may not use plan assets to promote social, environmental, or other public policy causes at the expense of the financial interests of the plan's participants and beneficiaries."

Background

ERISA requires fiduciaries to act with the care, skill, prudence, and diligence a hypothetical prudent person would use. ERISA also requires fiduciaries to act "solely" in the interest of a plan's participants and beneficiaries and for the "exclusive purpose" of providing benefits and paying reasonable administrative expenses. For years, plan fiduciaries have been concerned about whether collateral benefits in addition to investment returns ("Collateral Benefits") can be considered in the decision to invest plan assets while still complying with ERISA's fiduciary duty provisions.

While the DOL had from time to time considered the role Collateral Benefits may play in the investment decision-making process, it formally set forth its view in IB 94-01. IB 94-01 stated that a plan fiduciary could consider such benefits so long as the fiduciary determined, pursuant to the process it would use with regard to any other investment, that the investment was prudent. However, the DOL noted that making an investment for other than economic factors, such as risk, return, liquidity, and diversification characteristics, would not be prudent unless the investment "is expected to provide an investment return to the plan commensurate to alternative investments having similar risks." Thus, the Department observes in IB 94-01 that "an investment will not be prudent if it would be expected to provide a plan with a lower rate of return than available alternative investments with commensurate degrees of risk or is riskier than alternative available investments with commensurate rates of return." This is known as the "everything being equal test." In the introductory background to IB 15-01, the DOL refers to Collateral Benefits as a "tie-breaker."

In 2008, DOL issued Interpretive Bulletin 08-01 ("IB 08-01") to replace IB 94-01. IB 08-01 established an arguably more rigorous view of the "everything being equal test," in which plan fiduciaries would be required to determine in a contemporaneous writing that the investment chosen with regard to economic benefits it creates apart from the investment return to the plan "is truly equal [to alternative options], taking into account a quantitative and qualitative analysis of the economic impact on the plan" before entering into the investment selected on the basis of such additional economic benefits. IB 08-01 stated that plan fiduciaries would only be able to make this determination "rarely" and, as a result, a fiduciary could only consider economic benefits an investment creates apart from the return to the plan in "very limited circumstances."

IB 08-01 has been criticized as setting a higher standard applicable to fiduciaries considering Collateral Benefits than that applicable to fiduciaries considering other types of investments, despite the fact that ERISA sets out a single standard of care for fiduciaries. Others argued that by presuming that consideration of Collateral Benefits is imprudent, IB 08-01 downplayed the long-term benefits that an ETI could provide. Finally, some argued that IB 08-01 was a "solution in search of a problem" because investing in ETIs results in no harm to plan participants and beneficiaries.

Interpretive Bulletin 15-01

The basic text of IB 15-01 is virtually identical to IB 94-01. But the DOL seems to have gone a bit further in the preamble. There, DOL expresses the view that ESG factors are not merely collateral considerations, but can be an integral part of the economic analysis performed by the plan fiduciary when considering an investment. The preamble to IB 2015-01 explains that plan fiduciaries may address ETIs or incorporate ESG factors in investment policy statements and utilize ESG-related tools, metrics, and analyses to evaluate investments. Thus, under IB 2015-01, a plan fiduciary analyzing a potential investment in clean energy may include ESG factors in its analysis of the investment's risk, return, liquidity, and diversification characteristics. And it would seem that under the IB, a fiduciary could also consider other factors relevant to the primary economic analysis the fiduciary is required to conduct under ERISA – even if that factor is typically associated only with ETIs.

Consistent with this approach, the preamble to IB 15-01 also downplayed the suggestion in IB 08-01 that an investment in an ETI would require a higher level of analysis, or contemporaneous written documentation over and above what would normally be produced. In this regard, the preamble states that ETIs are not "inherently suspect" and that the appropriate level of documentation would depend on the facts and circumstances, as it would with any investment. The preamble also clarified that the analysis set out in IB 15-01 would apply to the designation of a socially-responsible fund in a defined contribution plan's investment line-up, as well as the selection of an investment manager who may itself invest with ESG criteria in mind.

However, IB 15-01 reaffirms the "everything being equal test," under which criteria which cannot be shown to primarily enhance the economic value of proposed investment to the plan may only be considered after the plan fiduciary has determined that the investment is expected to provide an investment return to the plan commensurate to alternative investments having similar risks.

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Implications

IB 15-01 clearly removes perceived obstacles contained in IB 08-01. This may embolden some to look into considering ESG factors when making investment decisions for ERISA-governed plans. But we caution that this guidance does not give free reign for plan fiduciaries to make any investment decision based on ESG criteria. Plan fiduciaries must still determine ETIs are prudent, based on the same factors they would apply with regard to any investment, including identification of the ETI's economic value, as opposed to any Collateral Benefit. We also note that plan fiduciaries may wish to review and consider revision of their current investment policy statements to the extent they would like to explore new investment strategies.