

IMPORTANT DATES

October 31:

- Provide notice of benefit restrictions under IRC Section 436 to participants if the AFTAP for a defined benefit plan is less than 60% and notice has not previously been provided

November 15:

- Confirm that 401(k) plan recordkeeper has provided 3rd quarter benefit statements, including fee disclosure information, to participants
- Distribute a Summary of Benefits and Coverage for each group health plan option. Also, provide any documents or notices that have not previously been provided.

DOL PROPOSED REGULATIONS WOULD REVERSE TRUMP-ERA ESG AND PROXY VOTING RULES FOR RETIREMENT PLAN FIDUCIARIES

EXECUTIVE SUMMARY

On October 13, 2021, the Department of Labor released proposed regulations entitled “*Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights*” (the “Proposed Regulations”). The Proposed Regulations focus on the conduct of retirement plan fiduciaries with respect to their evaluation of environmental, social and governance (“ESG”) factors in plan investments, and their exercise of shareholder rights such as proxy voting. The Proposed Regulations represent the latest swing of the regulatory pendulum with respect to the use of ESG factors in making investment decisions for ERISA plans, and effectively reverse the regulations finalized by the Trump administration in November 2020 (the “2020 ESG Regulations”), in three key ways:

- They affirmatively provide that retirement plan fiduciaries making an investment decision may consider ESG factors material to the risk/return analysis of that investment.
- They permit ESG investing to be considered in the selection of which investment option should serve as a retirement plan’s qualified default investment alternative, or “QDIA.”
- They ease the rules of when the so-called “tie-breaker” standard can be used, which permits fiduciaries to consider the collateral benefits of ESG factors, even if they are not material to the risk/return analysis of an investment option.

In addition, the Proposed Regulations remove limitations on the ability of retirement plan fiduciaries to exercise shareholder rights, such as proxy voting, in favor of more general duties of prudence and loyalty when exercising shareholder rights.

Consideration by Plan Fiduciaries of ESG Factors in Investment Decisions

Historic Backdrop to the New Proposed Regulations

One of the core principles under ERISA is that retirement plan fiduciaries must make investment decisions that are prudent, and that are solely in the interests of participants and beneficiaries, for the exclusive purpose of providing them with retirement benefits (and defraying reasonable plan expenses). As a result, retirement plan fiduciaries are not permitted to make investment decisions that sacrifice financial returns for other policy goals.

Over the last few decades, the DOL issued guidance that ESG factors could be taken into account for a retirement plan's investments if the plan fiduciaries found such factors relevant to the risk/return analysis of those investments, or as a "tie-breaker" among investments that were otherwise indistinguishable in terms of risk/return analysis. The 2020 ESG Regulations focused on the importance of pecuniary factors *only* in making investment decisions; prohibited any fund with investment strategies that included ESG factors from being used as a plan's QDIA; and heightened documentation requirements for a plan fiduciary selecting an investment by using ESG factors in a tie-breaker scenario.

Concerned that the 2020 ESG Regulations had created uncertainty and were having a chilling effect on the consideration of ESG factors, the Proposed Regulations authorize plan fiduciaries to consider *all* facts and circumstances of a particular investment that they consider to be material to the investment option's risk/return analysis.

ESG Factors Material to an Investment Option's Risk/Return Analysis

The Proposed Regulations remove the concept of pecuniary factors in making investment decisions, and instead provide that prudent retirement plan fiduciaries may consider any factor that is material to the risk/return analysis of that investment, including the economic effect of climate change, or other ESG factors, on that investment option. In particular, the Proposed Regulations provide a list of three examples of ESG factors that can be considered by plan fiduciaries if they are material to the risk/return analysis:

- *Climate change-related factors*, such as a corporation's exposure to the physical and transitional risks of climate change or from the positive or negative effect of governmental regulations and policies addressing climate change;
- *Corporate governance factors*, such as board composition; executive compensation; transparency and accountability in corporate decision-making; avoidance of criminal liability; and compliance with labor, employment, environmental, tax, and other applicable laws and regulations; and
- *Workforce practices*, including the corporation's progress on workforce diversity, inclusion, and other drivers of employee hiring, promotion and retention; its investment in training to develop its workforce's skill; equal employment opportunity; and labor relations.

While the Proposed Regulations do not have the same emphasis on an investment option's pecuniary factors—which was the focus of the 2020 ESG Regulations—the Proposed Regulations still require that plan investments based on ESG considerations serve the financial interests of the plan and not promote benefits or goals unrelated to the interests of plan participants and beneficiaries in their retirement plan benefits. Thus, plan fiduciaries cannot allow for collateral benefits to be applied that reduce expected investment returns, or increase investment risk.

ESG Considerations for QDIA Investment Options

The Proposed Regulations remove the limitation on the use of ESG factors in the selection of a retirement plan's QDIA that was reflected in the 2020 ESG Regulations. Instead, the Proposed Regulations provide that when selecting a QDIA, plan fiduciaries must focus on material risk/return factors and must not subordinate the interests of participants and beneficiaries to objectives unrelated to the provision of retirement benefits under the plan.

Easing of the "Tie-Breaker" Standard

Previously, two investment options were required to be economically indistinguishable before plan fiduciaries could consider collateral benefits such as ESG factors to serve as a "tie-breaker." The Proposed Regulations ease this standard, providing that the tie-breaker can be invoked when two investments both "equally serve the financial interest of the plan" over the appropriate time horizon, in which case plan fiduciaries can consider collateral benefits such as ESG factors that were not material to the risk/return analysis of the investment option. The Proposed Regulations also remove additional, burdensome documentation when using the tie-breaker provision, although fiduciaries will be required to prominently disclose to plan participants the collateral considerations used as a tie-breaker if they were considered in the selection of the plan's QDIA.

Proxy Voting and Exercising Other Shareholder Rights

Separate regulations issued in December 2020 by the Trump administration took the position that the costs of having retirement plan fiduciaries review proxy materials and exercise shareholder rights might exceed the benefit available to the plan, such that they explicitly provided that plan fiduciaries were not required to vote every proxy or to exercise every shareholder right, especially if the plan's holdings for the investment were determined by the fiduciaries to be too insignificant as to have a material effect on the investment's performance.

However, the DOL under the Biden administration has been concerned that these regulations did not adequately ensure that management is accountable to the shareholders. Consequently, the Proposed Regulations have removed these limitations in favor of more general duties of prudence and loyalty that govern fiduciary conduct when voting proxies or otherwise exercising shareholder rights.

Additional Information

For additional information regarding the Proposed Regulations on ESG factors in retirement plan investing, and on the duties of plan fiduciaries to exercise shareholder rights such as proxy voting, please contact any member of our Employee Benefits and Executive Compensation Group listed below.

Contact Information

1945 Old Gallows Road, Suite 650
Tysons Corner, VA 22182
(703) 748-2690

1111 East Main Street, Suite 1605
Richmond, VA 23219
(804) 489-5507

Andrea I. O'Brien
aobrien@islerdare.com

Jeanne E. Floyd
jfloyd@islerdare.com

Vi D. Nguyen
vnguyen@islerdare.com

Ashley F. Hedge
ahedge@islerdare.com