Department of Labor Guidance on ESG and Other Investments

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The Department of Labor released final guidance on October 30, 2020, concerning socially responsible, environmental, corporate governance (ESG) investing, impact investing, and economically targeted investing. The Department of Labor has emphasized the importance of ERISA Section 404 which requires a "fiduciary act solely in the interest of, and for the exclusive purpose of providing benefits to, participants and beneficiaries as prohibiting a fiduciary from subordinating the interests of participants and beneficiaries in their retirement income to unrelated objectives." (U.S. DEPARTMENT OF LABOR ANNOUNCES FINAL RULE TO PROTECT AMERICANS' RETIREMENT INVESTMENTS, 2020). What this means to fiduciaries is that the DOL is cautioning against using these types of funds in a retirement plan.

This does not mean that the plan fiduciaries cannot invest plan assets in these types of investments it just means they have to do their due diligence and document their findings to show that all things being equal these investments perform the same as any other investment. The fiduciary must be careful to determine that the investment has the expected rate of return in line with alternative investments with similar risk characteristics. The DOL did note that an ESG fund cannot be the plan's qualified default investment alternative or a component of the qualified default investment alternative. The reasoning behind that appears to be, if participants are going to be defaulted into an investment, the selection of that investment should be based solely on financial considerations and nothing else. It appears that they have taken the stance that fiduciaries must be focused solely on the plan's financial returns, reasonable expenses and the interests of plan participants and beneficiaries and not push their own personal agendas.

The ruling did not define what constitutes a genuine "ESG" investment or other socially responsible investment funds. Most financial firms that offer these types of funds provide the details on their particular fund. There are some rating systems available to benchmark these funds but they are inconsistent. Provider's use terms such as ESG, impact investing, sustainability, and non-financial performance metrics, to encompass a wide range of considerations without a common definition and can often take on different meanings to different people. These investments are also stated to have both financial and non-financial goals. Historically these investments come with higher fees, due to the additional monitoring and research that are necessary to assess an investment from all perspectives.

Plans who have used one of these investments as their qualified default investment alternative will have until April 30, 2022 to make any changes necessary to comply with the final ruling.