

MEMO# 33832

October 18, 2021

DOL Proposes Amendments to 2020 Final Rules on ESG Investing and Proxy Voting

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TO: ICI Members
Investment Company Directors
ICI Global Members
ESG Advisory Group
ESG Task Force
Global Retirement Savings Committee
Pension Committee
Pension Operations Advisory Committee
Proxy Working Group
SEC Rules Committee
SUBJECTS: ESG
Pension RE: DOL Proposes Amendments to 2020 Final Rules on ESG Investing and Proxy Voting

On October 13, 2021, the Department of Labor (DOL) released a proposal (the "Proposal") addressing the selection of investments for ERISA plans and proxy voting by plan fiduciaries.[\[1\]](#) The Proposal would amend two rules finalized at the end of the Trump Administration, "Financial Factors in Selecting Plan Investments" ("Current ESG Rule")[\[2\]](#) and "Fiduciary Duties Regarding Proxy Voting and Shareholder Rights" ("Current Proxy Voting Rule") (together, the "2020 Rulemakings").[\[3\]](#) This action represents DOL's response to President Biden's May 20 Executive Order on Climate-Related Financial Risk.[\[4\]](#)

The Proposal would largely retain the basic framework of the investment duties regulation (as adopted by the 2020 Rulemakings), while modifying certain provisions to align more closely with the substance of the sub-regulatory guidance that existed immediately before the 2020 Rulemakings.[\[5\]](#) While the framework of the Proposal is essentially the same as that of the 2020 Rulemakings, the Proposal would include changes that seem likely to not only allow greater flexibility for fiduciaries to include ESG investments in plans but in some cases would arguably *require* consideration of certain ESG criteria as part of a fiduciary's investment analysis.

Comments on the Proposal are due on December 13, 2021.

Background

DOL finalized the Current ESG Rule in October 2020 and the Current Proxy Voting Rule in December 2020. As finalized, both 2020 Rulemakings were substantially improved from their proposed versions, which had each received significant pushback from the asset management industry, the retirement plan community, and climate-focused organizations.[\[6\]](#)

The Current ESG Rule amended the previously existing investment duties regulation and, according to DOL, was intended to provide clear regulatory guideposts for retirement plan fiduciaries in light of recent trends involving environmental, social and governance (ESG) investing. Unlike the proposed version of the Current ESG Rule,[\[7\]](#) the text of the finalized Current ESG Rule contains no specific references to ESG or ESG-themed funds and, instead focuses the relevant analysis on "pecuniary" and "non-pecuniary" factors. The Current ESG Rule accordingly requires that ERISA fiduciaries evaluate investments based solely on pecuniary factors, unless using a tie-breaker test.[\[8\]](#)

The Current Proxy Voting Rule amended the investment duties regulation to address the application of ERISA's fiduciary duties of prudence and loyalty to the exercise of shareholder rights, including proxy voting, proxy voting policies and guidelines, and the selection and monitoring of proxy advisory firms.

The final 2020 Rulemakings became effective on January 12, 2021 and January 15, 2021.[\[9\]](#) On March 10, 2021, DOL issued an Enforcement Policy Statement announcing that it intended to revisit the 2020 Rulemakings and will not enforce the rules while it considered further guidance.[\[10\]](#)

In preamble statements justifying the Proposal, DOL describes its outreach to stakeholders and the concerns conveyed to DOL—concerns for which DOL agrees there is a reasonable basis.[\[11\]](#) DOL explains that—

Many stakeholders have indicated that the rules have been interpreted as putting a thumb on the scale against the consideration of ESG factors, even when those factors are financially material. The Department is concerned that, as stakeholders warned, uncertainty with respect to the current regulation may deter fiduciaries from taking steps that other marketplace investors would take in enhancing investment value and performance, or improving investment portfolio resilience against the potential financial risks and impacts often associated with climate change and other ESG factors. The Department is concerned that the current regulation has created a perception that fiduciaries are at risk if they include any ESG factors in the financial evaluation of plan investments, and that they may need to have special justifications for even ordinary exercises of shareholder rights. [\[12\]](#)

Investment Selection/Consideration of ESG Factors

The Proposal retains the basic structure of the Current ESG Rule. It reiterates the basic requirements that, in selecting plan investments, a fiduciary is subject to ERISA's duties of prudence and loyalty. This includes the requirement that a fiduciary may not subordinate the interests of the participants and beneficiaries in their retirement income or financial benefits under the plan to other objectives and may not sacrifice investment return or take on additional investment risk to promote benefits or goals unrelated to interests of the

participants and beneficiaries in their retirement income or financial benefits under the plan.

Removal of definition of "pecuniary" and inclusion of ESG language.

The Proposal removes the Current ESG Rule's requirement that ERISA fiduciaries must evaluate investments based solely on pecuniary factors. Instead, the Proposal states that "[a] prudent fiduciary may consider any factor...that...is material to the risk-return analysis."[\[13\]](#) The Proposal goes on to explicitly state that such factors "might include, for example" climate change-related factors, governance factors, and workforce practices.[\[14\]](#) The Proposal also adds language that suggests that, in some cases, fiduciaries may be required to consider ESG factors. The Proposal's text provides that a fiduciary's consideration of an investment's projected return "may often require an evaluation of the economic effects of climate change and other environmental, social, or governance factors on the particular investment or investment course of action."[\[15\]](#) DOL explains that the substance of this added text is not new and was included in prior sub-regulatory guidance,[\[16\]](#) adding that

[a]s additional evidence on the materiality of climate change in particular has emerged in the intervening years, the Department believes that consideration of the projected return of the portfolio relative to the funding objectives of the plan not only allows but in many instances may require an evaluation of the economic effects of climate change on the particular investment or investment course of action. [\[17\]](#)

As cited above, in addition to climate-related factors, the Proposal includes two other examples of ESG-related criteria that, depending on the facts and circumstances, may be material to a fiduciary's prudent risk-return analysis. These examples are:

- Governance factors, such as those involving board composition, executive compensation, and transparency and accountability in corporate decision-making, as well as a corporation's avoidance of criminal liability and compliance with labor, employment, environmental, tax, and other applicable laws and regulations.
- 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 skill; equal employment opportunity; and labor relations.

If finalized as proposed, these examples of collateral benefits will likely lead to—if not arguably be considered to require—the incorporation of these and other emerging factors by plan fiduciaries as part of any investment analysis.

Clarification of the tie-breaker test.

The Proposal modifies the tie-breaker test, as articulated in the Current ESG Rule, bringing it more in line with the original test, as articulated in IB 94-1.

As proposed, if a fiduciary prudently concludes that competing investments equally serve the financial interests of the plan over the appropriate time horizon, the fiduciary is not prohibited from selecting the investment based on collateral benefits other than investment returns (as opposed to the Current ESG Rule's focus on whether the competing investments are indistinguishable based on consideration of risk and return, which DOL notes could be interpreted too narrowly).[\[18\]](#) DOL requests input on whether it should include more

specificity on the collateral benefits that may be considered.[\[19\]](#)

The Proposal eliminates the Current ESG Rule's specific documentation requirements for circumstances in which plan fiduciaries consider non-pecuniary factors using the tie-breaker test which DOL says "singled out and created burdens specifically for investments providing collateral benefits."[\[20\]](#) Instead, the Proposal requires that in the case of a designated investment alternative[\[21\]](#) for an individual account plan (e.g., a 401(k) plan), if the plan fiduciary makes a selection using the tie-breaker rule, then the collateral-benefit characteristic of the fund must be prominently displayed in disclosure materials provided to participants and beneficiaries.[\[22\]](#) The Proposal does not require any other special documentation for selections made using the tie-breaker rule.

Removal of restrictions for QDIAs.

The Current ESG Rule prohibits plans from adding or retaining any investment fund, product, or model portfolio as a qualified default investment alternative (QDIA), or as a component of a QDIA, if its objectives or goals or its principal investment strategies include, consider, or indicate the use of one or more non-pecuniary factors. The Proposal would remove this restriction in the text of the rule. DOL clarifies in the preamble that the same standards apply to QDIAs as apply to other investments. DOL states that "[i]f a fund expressly considers climate change or other ESG factors, is financially prudent, and meets the protective standards set out in [DOL's QDIA regulation], there appears to be no reason to foreclose plan fiduciaries from considering the fund as a QDIA."[\[23\]](#)

DOL provides an example of an investment option chosen under the tie-breaker rule because "it better aligns with the corporate ethos of the plan sponsor or that it improves the esprit de corps of the workforce," and that such feature(s) considered must be prominently disclosed in order to ensure that plan participants are given sufficient information to be aware of the collateral factors used in the investment's selection. In discussing the importance of this disclosure, DOL notes the possibility "that a particular plan participant or a population of plan participants does not share the same preference for a given collateral purpose as the plan fiduciary that selected the designated investment alternative for placement on the menu among the plan's other options."[\[24\]](#)

Shareholder Rights/Proxy Voting

Like the Current Proxy Voting Rule, the Proposal provides that when deciding whether to exercise shareholder rights and when exercising such rights, fiduciaries must carry out their duties prudently and solely in the interests of the participants and beneficiaries and for the exclusive purpose of providing benefits to participants and beneficiaries and defraying the reasonable expenses of administering the plan.

The Proposal makes the following four significant changes to the Current Proxy Voting Rule regarding the exercise of shareholder rights.

Removal of statement regarding requirement to vote every proxy.

The Proposal would eliminate the statement in the Current Proxy Voting Rule that "the fiduciary duty to manage shareholder rights appurtenant to shares of stock does not require the voting of every proxy or the exercise of every shareholder right."[\[25\]](#) DOL explains that the removal of the statement does not mean that fiduciaries must always vote proxies, but rather that DOL was concerned that the statement could be misread as

suggesting that plan fiduciaries should be indifferent to the exercise of their rights as shareholders. DOL's longstanding view "is that proxies should be voted as part of the process of managing the plan's investment in company stock unless a responsible plan fiduciary determines voting proxies may not be in the plan's best interest (e.g., if there are significant costs or efforts associated with voting)."[\[26\]](#)

Modification of requirement to monitor rights delegated to investment manager.

The Proposal would eliminate a provision in the Current Proxy Voting Rule that sets out specific monitoring obligations where the authority to vote proxies or exercise shareholder rights has been delegated to an investment manager or where a proxy voting firm performs advisory services as to voting proxies.[\[27\]](#) Instead, the Proposal includes a more general provision requiring that a fiduciary exercise prudence and diligence in the selection and monitoring of persons selected to exercise shareholder rights or assist with exercise of shareholder rights.[\[28\]](#) DOL explains this change does not represent a change in its view, but rather addresses DOL's concern that the specific requirements in the Current Proxy Voting Rule "may be read as requiring some special obligations above and beyond the statutory obligations of prudence and loyalty that generally apply to monitoring the work of service providers."[\[29\]](#)

Removal of "permitted policies" as safe harbors.

The Proposal would remove the two "safe harbors" from the Current Proxy Voting Rule—permitted policies that are optional means for satisfying a fiduciary's responsibilities regarding determining whether to vote (but not how to vote).[\[30\]](#)

DOL explains that the fact that these examples are characterized as safe harbors may lead them to become widely adopted, and DOL is not confident that it is appropriate to include them because DOL does not have confidence that they adequately safeguard the interests of plans and their participants and beneficiaries.[\[31\]](#)

Instead of the safe harbors, the Proposal includes a provision that fiduciaries may adopt proxy voting policies providing that the authority to vote a proxy shall be exercised pursuant to specific parameters.[\[32\]](#)

Removal of requirement to maintain records.

The Proposal would eliminate the requirement in the Current Proxy Voting Rule that, when deciding whether to exercise shareholder rights and when exercising shareholder rights, plan fiduciaries must maintain records on proxy voting activities and other exercises of shareholder rights.[\[33\]](#)

DOL's reason for this change is because, in context, including this specific requirement "may create a misperception that proxy voting and other exercises of shareholder rights are disfavored or carry greater fiduciary obligations, and therefore greater potential liability, than other fiduciary activities."[\[34\]](#)

Next Steps

As stated above, comments on the Proposal are on December 13. ICI will work with a member working group to develop a comment letter. If you would like to participate in this working group, please contact the undersigned at shannon.salinas@ici.org.

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endnotes

[1] The Proposal was published at 86 Fed. Reg. 57272 (October 14, 2021), *available at* <https://www.govinfo.gov/content/pkg/FR-2021-10-14/pdf/2021-22263.pdf>. DOL's press release is available at <https://www.dol.gov/newsroom/releases/ebsa/ebsa20211013>, and DOL's fact sheet is available at <https://www.dol.gov/sites/dolgov/files/EBSA/about-ebsa/our-activities/resource-center/fact-sheets/notice-of-proposed-rulemaking-on-prudence-and-loyalty-in-selecting-plan-investments-and-exercising-shareholder-rights.pdf>.

[2] For a summary, see ICI Memorandum No. 32888, dated November 3, 2020, *available at* https://www.ici.org/my_ici/memorandum/memo32888.

[3] For a summary, see ICI Memorandum No. 32984, dated December 15, 2020, *available at* https://www.ici.org/my_ici/memorandum/memo32984.

[4] The Executive Order (EO) directed DOL "to consider publishing, by September 2021, for notice and comment a proposed rule to suspend, revise, or rescind" the 2020 Rulemakings. See Section 4 of EO 14030, dated May 20, 2021, *available at* <https://www.whitehouse.gov/briefing-room/presidential-actions/2021/05/20/executive-order-on-climate-related-financial-risk/>. The EO also directed DOL to consider actions related to the Thrift Savings Plan and the Federal Employees' Retirement System and to submit a report on these actions to the President by mid-November. On October 14, 2021, the White House issued "Roadmap to Build an Economy Resilient to Climate Change Impacts," *available at* <https://www.whitehouse.gov/wp-content/uploads/2021/10/Climate-Finance-Report.pdf>, a comprehensive, government-wide strategy to measure, disclose, manage and mitigate the systemic risks climate change poses to American families, businesses, and the economy. Pages 24-25 of this document highlight DOL's activity and announce that DOL will issue "an RFI soliciting public input on additional actions that could be taken under ERISA, FERSA, or other laws to further protect workers' life savings from climate-related risks." The document also states that the Proposal "would bring the United States closer in alignment with other countries, including the United Kingdom, the European Union (EU), and Japan, that have already taken steps to incorporate climate-related risks into their retirement plan management."

[5] For a summary of the most recent piece of this sub-regulatory guidance, see ICI Memorandum No. 31192, dated May 3, 2018, *available at* https://www.ici.org/my_ici/memorandum/memo31192.

[6] ICI urged DOL to withdraw both proposed rules. For summaries of ICI's comment letters, see ICI Memorandum No. 32652, dated July 31, 2020, *available at* https://www.ici.org/my_ici/memorandum/memo32652 and ICI Memorandum No. 32808, dated October 6, 2020, *available at* https://www.ici.org/my_ici/memorandum/memo32808.

[7] As proposed in 2020, the ESG rule would have broadly treated any fund that includes

environmental or social or corporate governance, or "any similarly oriented assessments or judgments in their investment mandates" (or any combination of these assessments) as "ESG investments." It then would have subjected all such ESG investments to heightened scrutiny and increased administrative burden, even if they are not marketed as ESG funds or named to indicate a focus on ESG.

[8] Pecuniary factor is defined as "a factor that a fiduciary prudently determines is expected to have a material effect on the risk and/or return of an investment based on appropriate investment horizons consistent with the plan's investment objectives and the funding policy established pursuant to [ERISA]."

[9] Both of the 2020 Rulemakings provided delayed applicability dates for certain provisions.

[10] See ICI Memorandum No. 33176, dated March 10, 2021, *available at* <https://www.ici.org/memo33176>.

[11] "That outreach effort by the Department suggested that, rather than provide clarity, some aspects of the current regulation instead may have created further uncertainty surrounding whether a fiduciary under ERISA may consider ESG and other factors in making investment and proxy voting decisions that the fiduciary reasonably believes will benefit the plan and its participants and beneficiaries. ... After conducting a further review of the current regulation, the Department believes there is a reasonable basis for these concerns." 86 Fed. Reg. at 57275.

[12] 86 Fed. Reg. at 57275.

[13] Proposal at section (b)(4).

[14] *Id.* See Proposal at section (b)(2)(ii)(C). DOL explains that the sole purpose of this provision is to provide clarification through examples, that the list is not exclusive, and that DOL would like input on whether other or fewer examples would be helpful. 86 Fed. Reg. at 57276.

[15] Proposal section (b)(2)(ii)(C). *Also see* discussion at 86 Fed. Reg. at 57276.

[16] DOL cites language in Interpretive Bulletin (IB) 2015-01 and Field Assistance Bulletin 2018-01 that suggests that in some cases, a prudent fiduciary should consider ESG issues.

[17] 86 Fed. Reg. at 57276. DOL also states that "[c]limate change is particularly pertinent to the projected returns of pension plan portfolios that, because of the nature of their obligations to their participants and beneficiaries, typically have long-term investment horizons" and "[t]aking climate change into account, such as by assessing the financial risks of investments for which government climate policies will affect performance and account for the risk of companies that are unprepared for the transition, can have a beneficial effect on portfolios by reducing volatility and mitigating the longer-term economic risks to plans' assets." 86 Fed. Reg. at 57276-7. DOL requests comment on whether fiduciaries should consider climate change as presumptively material in their assessment of investment risks and returns. 86 Fed. Reg. at 57290.

[18] See Proposal at section (c)(3) and 86 Fed. Reg. at 57278.

[19] 86 Fed. Reg. at 57279.

[20] 86 Fed. Reg. at 57278. DOL adds that it "is concerned that singling out this one category of investment actions for a special documentation requirement may, in practice, chill investments based on climate change or other ESG factors, even when those factors are directly relevant to the financial merits of the investment decision or they are legitimately applied as a tie-breaker" and that "that ERISA general prudence obligation is sufficiently protective in this context and, unlike the heightened documentation requirements in the current regulation, does not tip the scale against the particular investment that offers collateral benefits." 86 Fed. Reg. at 57279.

[21] The Proposal confirms that the term designated investment alternative does not include brokerage windows. Proposal at section (e)(4).

[22] Proposal at section (c)(3). DOL notes that the Proposal "intentionally provides flexibility in how plan fiduciaries may fulfill this requirement" and that the Proposal assumes that the required disclosure under 2550.404a-5 "are, or perhaps with minor modifications or clarifications could be, sufficient to satisfy the disclosure element of the tie-breaker provision..." 86 Fed. Reg. at 57280

[23] 86 Fed. Reg. at 57279-80.

[24] 86 Fed. Reg. at 57280

[25] Section (e)(2)(ii) of the Current Proxy Voting Rule.

[26] 86 Fed. Reg. at 57281. DOL also notes that "abstaining from a vote is not a neutral act" and that "[t]he solution to proxy-voting costs is not total abstention, but is, instead, for the fiduciary to be prudent in incurring expenses to make proxy decisions and, wherever possible, to rely on efficient structures (e.g., proxy voting guidelines, proxy advisers/managers that act on behalf of large aggregates of investors, etc.)." Further, DOL is concerned that the statement "may be construed as little more than regulatory permission for plans to broadly abstain from proxy voting without properly considering their interests as shareholders and without legal repercussions." 86 Fed. Reg. at 57282.

[27] Section (e)(2)(iii) of the Current Proxy Voting Rule.

[28] See Proposal at section (d)(2)(ii)(E).

[29] 86 Fed. Reg. at 57281.

[30] Section (e)(3)(i) of the Current Proxy Voting Rule. The two permitted policies are as follow:

1. A policy to limit voting resources to particular types of proposals that the fiduciary has prudently determined are substantially related to the issuer's business activities or are expected to have a material effect on the value of the investment.
2. A policy of refraining from voting on proposals or particular types of proposals when the plan's holding in a single issuer relative to the plan's total investment assets is below a quantitative threshold that the fiduciary prudently determines, considering its percentage ownership of the issuer and other relevant factors, is sufficiently small that the matter being voted upon is not expected to have a material effect on the investment performance of the plan's portfolio (or investment performance of assets under management in the case of an investment manager)

[\[31\]](#) 86 Fed. Reg. at 57281.

[\[32\]](#) Proposal at section (d)(3)(i).

[\[33\]](#) Section (e)(2)(ii)(E) of Current Proxy Voting Rule.

[\[34\]](#) 86 Fed. Reg. at 57281.

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