

MEMO# 35447

September 25, 2023

District Court Upholds DOL Final Rule on ESG Investing and Proxy Voting, Ruling Against Twenty-Five States' Attorneys General

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TO: ICI Members

Pension Committee

Pension Operations Advisory Committee SUBJECTS: ESG

Pension RE: District Court Upholds DOL Final Rule on ESG Investing and Proxy Voting, Ruling Against Twenty-Five States' Attorneys General

On September 21, 2023, a judge for the US District Court in the Northern District of Texas issued its decision in the case filed by attorneys general from 25 states against the Department of Labor (DOL).^[1] The judge granted DOL's cross motion for summary judgment, refusing the states' attempt to invalidate the final rule on "Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights" ("2022 Rule"), which addresses the consideration of environmental, social, and governance (ESG) factors in selecting plan investments and exercising shareholder rights.^[2]

2022 Final Rule

The 2022 Rule amends two rules finalized at the end of the Trump Administration, "Financial Factors in Selecting Plan Investments"^[3] and "Fiduciary Duties Regarding Proxy Voting and Shareholder Rights"^[4] (the "2020 Rules"). In issuing the 2022 Rule, DOL explained that the 2020 Rules "unnecessarily restrained plan fiduciaries' ability to weigh [ESG] factors when choosing investments, even when those factors would benefit plan participants financially."^[5]

Although the 2022 Rule allows greater flexibility for fiduciaries to include ESG investments in plans, it retains the longstanding ERISA core principles, including that the duties of prudence and loyalty require ERISA plan fiduciaries to focus on relevant risk-return factors and not subordinate the interests of participants and beneficiaries (such as by sacrificing

investment returns or taking on additional investment risk) to objectives unrelated to the provision of benefits under the plan.

The 2022 Rule makes the following changes to the 2020 Rules:

- deleting the "pecuniary/non-pecuniary" terminology used in the 2020 Rules, based on concerns that the terminology causes confusion and a chilling effect to financially beneficial choices.
- clarifying that a fiduciary's determination with respect to an investment or investment course of action must be based on factors that the fiduciary reasonably determines are relevant to a risk and return analysis and that such factors may include the economic effects of climate change and other ESG factors on the particular investment or investment course of action.
- removing the 2020 Rules' stricter rules for selecting QDIAs, such that, under the final rule, the same standards apply to QDIAs as to selecting investments generally.
- amending the 2020 Rules' "tiebreaker" test, which imposes a requirement that competing investments be indistinguishable based on pecuniary factors alone before fiduciaries can turn to collateral factors to break a tie and imposes a special documentation requirement on the use of such factors. The final rule replaces those provisions with a standard that instead requires the fiduciary to conclude prudently that competing investments, or competing investment courses of action, equally serve the financial interests of the plan over the appropriate time horizon.

Overview of Court Opinion

To determine whether the 2022 Rule violates ERISA, the court applies the Chevron analysis, which is used to determine whether a court should give deference to an agency's interpretation. That analysis first asks "'whether Congress has directly spoken to the precise question at issue,' in which case courts 'must give effect to the unambiguously expressed intent of Congress'" and if the statute is ambiguous, then the court "may not disturb an agency rule unless it is 'arbitrary or capricious in substance, or manifestly contrary to the statute.'" [\[6\]](#)

The plaintiffs had argued in their complaint that "the plain text of ERISA forecloses any consideration of non-pecuniary factors, including for tiebreakers," but the court disagreed, pointing to the fact that ERISA does not contemplate the possibility of a tie between two financially equivalent investment options. Moving to step two, the court explains that the reasonableness of DOL's interpretation is supported by its prior rulemakings, including the 2020 Rule.

The plaintiffs' complaint emphasized the changes to the tiebreaker test, but the court found that the 2022 Rule "changes little substance" from the 2020 Rules. Comparing the two versions of the tie-breaker test, the court explained:

Where the 2020 Rule explained that collateral factors may be considered when a fiduciary is "unable to distinguish" between two investment options based on financial factors alone, the 2022 Rule allows the same when the two options "equally serve the financial interests of the plan." And while Plaintiffs aver that the 2022 changes loosen restrictions on fiduciaries, there is little meaningful daylight between "equally serve" and "unable to distinguish." [\[7\]](#)

The court parses the language of the two rules, noting their similarities, and noting the requirement throughout both the 2022 Rule and the 2020 Rules that a fiduciary's decision

must be based on an analysis of risk and return factors. The court decides that it cannot conclude that the 2022 Rule is "manifestly contrary to the statute."

After completing the Chevron analysis, the court turns to plaintiffs' claim that DOL's issuance of the 2022 Rule violated the Administrative Procedure Act (APA). While the APA requires that courts set aside agency actions that are found to be "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law," the opinion explains, "[t]he scope of review under the arbitrary and capricious standard is narrow and a court is not to substitute its judgment for that of the agency."[\[8\]](#)

The opinion considers the plaintiffs' APA arguments that:

- 1) the 2022 Rule does not rebut DOL's prior finding that "strict" regulations are necessary;
- 2) the alleged need for the 2022 Rule is inadequate because DOL never identified "who specifically was confused," the "source of confusion," or that "any such confusion or negative perceptions reduced financial returns for participants and beneficiaries" and
- 3) many of the 2022 Rule's provisions are "unreasonable, internally inconsistent, fail to consider relevant factors," and rely on factors "Congress has not intended it to consider."[\[9\]](#)

The court addressed these arguments by pointing out language in the 2022 Rule itself and DOL's discussion of the comments it received, ultimately finding that each argument failed to establish an APA violation.

Perhaps to deflect suggestions that the court supports ESG investing, the opinion concludes with the following language to the contrary, explaining that the analysis simply did not support vacating the 2022 Rule.

And while the Court is not unsympathetic to Plaintiffs' concerns over ESG investing trends, it need not condone ESG investing generally or ultimately agree with the Rule to reach this conclusion. Rather, "all that is necessary is a 'minimal level of analysis' from which the agency's reasoning may be discerned," "regardless of whether the court finds the reasoning fully persuasive."[\[10\]](#)

Other Litigation

While the lawsuit filed by the 25 attorneys general has a much higher profile, note that a second lawsuit (Braun v. Walsh) against DOL was filed on February 21, 2023 in the US District Court for the Eastern District of Wisconsin and has yet to be decided. The second lawsuit, filed by two individuals who participate in DC plans for their respective employers, generally makes the same arguments against the 2022 Rule.

A related lawsuit (Spence v. American Airlines), filed against a plan sponsor rather than DOL, was filed on June 2, 2023 in the US District Court in the Northern District of Texas. In that complaint, an American Airlines pilot sued American Airlines, Fidelity Investments Institutional and Financial Engines claiming that the fiduciaries breached their fiduciary duties by investing with investment managers and funds that "pursue leftist political agendas through environmental, social and governance (ESG) strategies, proxy voting, and shareholder activism." The complaint lists 25 ESG-branded funds available in the plan and several additional investment managers for non-ESG branded funds available under the plan. It has been reported, however, that all of the listed funds are only available through the plan's brokerage window and not as designated investment options selected by the

plan fiduciaries.

Congressional Activity

In addition to the lawsuits discussed above, the opposition to DOL's 2022 Rule also continues on the Hill. On September 6, 2023, House Education and the Workforce Committee members announced the introduction of four bills to amend ERISA to ensure that financial institutions are focused on maximizing returns in retirement plans rather than on "woke" ESG factors.^[11] The bills include:

- Roll back ESG To Increase Retirement Earnings Act (the "RETIRE Act"), H.R. 5339, introduced by Rep. Rick Allen (R-GA), amends ERISA to specify requirements concerning the consideration of pecuniary and non-pecuniary factors;
- Retirement Proxy Protection Act, H.R. 5337, introduced by Rep. Erin Houchin (R-IN), amends ERISA to clarify the application of prudence and exclusive purpose duties to the exercise of shareholder rights;
- No Discrimination In My Benefits Act, H.R. 5338, introduced by Rep. Bob Good (R-VA), requires ERISA plan decisions in selecting, monitoring, and retaining any fiduciary, counsel, employee, or service provider of the plan to be made without regard to race, color, religion, sex, or national origin; and
- Providing Complete Information to Retirement Investors Act, H.R. 5340, introduced by Rep. Jim Banks (R-IN), amends ERISA to require that plans provide specified disclosures to brokerage window participants.

At a House Education and the Workforce Committee markup on September 14, 2023, all four bills passed on a 23-19 party-line vote.^[12]

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Notes

^[1] For a summary of the complaint, filed on January 26, 2023, see ICI Memorandum No. 34935, dated February 9, 2023, available at <https://www.ici.org/memo34935>.

^[2] For a summary of the final rule, see ICI Memorandum No. 34506, dated December 5, 2022, available at <https://www.ici.org/memo34506>.

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

^[4] For a summary, see ICI Memorandum No. 32984, dated December 15, 2020, available at https://www.ici.org/my_ici/memorandum/memo32984.

^[5] See DOL press release dated November 22, 2022, available at <https://www.dol.gov/newsroom/releases/ebsa/ebsa20221122>.

^[6] Page 6 of Opinion.

^[7] Page 7 of Opinion.

[8] Page 9 of Opinion.

[9] Page 10 of Opinion.

[10] Page 14 of Opinion.

[11] See press release from Education and the Workforce Committee dated September 6, 2023, available at

<https://edworkforce.house.gov/news/documentsingle.aspx?DocumentID=409502>.

[12] See press release from Education and the Workforce Committee dated September 14, 2023, available at

<https://edworkforce.house.gov/news/documentsingle.aspx?DocumentID=409558>.

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