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Social Investing: What the Latest DOL Guidance Means for Plan Fiduciaries

By Joshua J. Waldbeser

When can a plan fiduciary – consistent with its ERISA duties - consider the "social" aspects of competing investment products when making decisions? This is a common question, and one that has languished without a clear answer for decades. New guidance from the DOL provides insight on some key points, but also re-affirms why this issue has proven to be so challenging.

The DOL's recent pronouncement – Field Assistance Bulletin 2018-01 (the "FAB") – is the fourth iteration of guidance issued on this topic over the past 25 years. Throughout, the DOL has never wavered on two key points:

First, fiduciaries **cannot accept lower investment returns or higher risks** for participants in order to serve social policy goals.

Second, fiduciaries **can use factors such as environmental, social and governance (ESG) considerations to "break ties"** between otherwise-equivalent alternatives.

Unfortunately, the DOL's position on the real-world application of these concepts has shifted back and forth -- largely along party lines. Republican administration guidance has adopted a cautionary tone; emphasizing concerns about protecting participants' economic interests, it suggests that competing investments would be "otherwise equivalent" only rarely, and thus consideration of social aspects should be infrequent. Guidance from Democratic administrations has implied a more flexible standard, indicating that consideration of social factors should not be discouraged.

Prior to the FAB, the most recent guidance was Interpretive Bulletin 2015-01 ("IB 2015-01"), issued during the Obama administration. IB 2015-01 not only stated that ESG and similar investments should not be regarded as inherently suspect, but went on to opine that "social" factors could be more than tiebreakers. That is, they could be taken into account as primary economic considerations if they would be expected to influence risk and return.

The recent FAB backpedals on this principle. While it purports to embrace IB 2015-01's conceptual points, it warns that:

> (f)iduciaries must not too readily treat ESG factors as economically relevant to the particular investment choices at issue when making a decision. It does not ineluctably follow from the fact that an investment promotes ESG factors, or that it arguably promotes positive general market trends or industry growth, that the investment is a prudent choice for retirement or other investors.

Thus, the FAB continues the pattern of back-and-forth, with each new administration issuing updated guidance to move the needle back to its side. This portion of the FAB guidance is therefore unsurprising - it cautions against the use of social factors as economic considerations just as past Republican guidance cautioned against their use as "tiebreakers."

However, the FAB does not discourage the use of social considerations entirely. To the contrary, it provides helpful insight as to ESG investments in 401(k) and other participant-directed plans. It points out that the strict prohibition against sacrificing returns (or increasing risk) to serve policy goals is premised on the notion that any investment selected requires a plan to forego other opportunities. However, this dynamic does not exist where participants are offered a broad range of investment options to choose from – thus, the FAB goes on to opine that:

> …in such a case, a prudently selected, well managed, and properly diversified ESG-themed investment alternative could be added to the available investment options on a 401(k) plan platform without requiring the plan to remove or forgo adding other non-ESG-themed investment options to the platform…

This indicates that fiduciaries can offer ESG options where a number of other investment alternatives are also made available to participants, so long as the ESG options are prudent selections (i.e., even if not economically equivalent to available non-ESG products in the strictest sense). This is consistent with DOL guidance issued in the context of investment advice fiduciaries, which confirms that prudence, not an unrealistic and unachievable expectation that the "single best investment" available in the marketplace must be selected, is the standard to which fiduciaries are held.

The FAB indicates, however, that "participant choice" is key – it discourages the use of ESG funds as default investments (QDIAs) for participants who have not made investment elections.

For plans that offer some ESG options, including a significant number of non-ESG options in the menu (particularly if there are options that are economically comparable to the ESG funds) should also enhance a fiduciary's ability to rely on ERISA Section 404(c). For example, if a socially responsible index fund is offered, the fiduciary might consider offering an inexpensive "regular" index fund in the same asset class.

But in all cases, fiduciaries need to ensure that any "social" investment selected for a plan is a prudent offering. Millennials and other employees may desire and even request that ESG options be made available to them, but if the plan sponsor or investment committee (working with its adviser, where applicable) cannot identify ESG options that it would otherwise be comfortable selecting, it should not do so. In such a case, offering a brokerage window or similar feature that provides access to a large number of ESG and non-ESG options alike (which the plan's fiduciaries are not responsible for selecting or monitoring) may be an option worth considering.

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