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DOL Releases Final ESG Rule

On November 22, the Department of Labor (DOL) released its final rule designed to clarify a path forward for retirement plan fiduciaries wishing to incorporate environmental, social, and governance (ESG) factors into their investment selection and monitoring process. The long-awaited rule, titled "Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights" was originally proposed in October of 2021, months after an announced non-enforcement policy to the rule issued on October 30, 2020.

Once effective, this final rule will modify and reverse certain amendments to the Investment Duties regulation under the Employee Retirement Income Security Act of 1974 (ERISA). An early read of the final rule should allay the fears of many commenters to the 2021 proposed rule, as the DOL makes clear that fiduciaries *may* consider climate change and other collateral benefits when making investment decisions and exercising shareholder rights. However, there is no requirement to incorporate such considerations, as was the concern by many readers of the proposed rule.

Over the last approximately 40 years, the DOL has periodically provided plan sponsors with interpretive guidance on how ERISA's fiduciary duties of prudence and loyalty apply to the selecting and monitoring of investments that promote ESG goals. The DOL's use of non-regulatory guidance recognized that, under the appropriate circumstances, ERISA did not preclude fiduciaries from making investment decisions that took ESG goals into consideration in connection with an investment's risk and return.

As discussed in a previous Plan Sponsor e.Brief, the October 2020 rule aimed to address perceived confusion about the implications of that guidance. However, in confirming that fiduciaries may only select investments based solely on the consideration of *pecuniary factors*, it discouraged many sponsors' desires to integrate ESG goals.

In its final ruling, the DOL has aimed to reverse what the Assistant Secretary of Labor Lisa Gomez called the "chilling effects" from the previous ruling by creating space for the consideration of relevant collateral factors without tilting the scales in favor of ESG factors.

Among the many modifications and changes to the Investment Duties regulation, this final rule includes the following:

- A restated expression of ERISA's duty of loyalty in the context of investment decisions, removing the previous rule's standard of pecuniary factors only;
- A broader description of what factors a fiduciary may deem as relevant to a risk-return analysis, such as climate change and other ESG factors;
- Changes to the *tie-breaker test*, replacing previous provisions with ERISA's statutory duty to act prudently;
- Clarification, with caveats, that fiduciaries of participant-directed plans do not violate the duty of loyalty because the fiduciary takes into account participant preferences;
- Removal of restrictions that disallowed a fund to serve as a QDIA if it included or considered the use of any non-pecuniary factors in its investment objective; and
- Removal of two previous proxy voting safe harbors that allowed sponsors to refrain from voting if they deemed the item to be immaterial or their plan's position to be below a quantitative threshold.

With the exception of the rule's proxy voting provisions, the amendments set forth will go into effect 60 days after its publication in the Federal Register.

Should you have immediate questions, or for more information, please contact your CAPTRUST Financial Advisor at 800.216.0645.