



DOL Releases New ESG Guidance

On October 30, the Department of Labor (DOL) released a final rule under the name Financial Factors in Selecting Plan Investments. This rule amends certain provisions of the investment duties regulation applicable to plans covered by the Employee Retirement Income Security Act (ERISA) by providing guidance for fiduciaries to follow when selecting and monitoring investments. The rule makes it clear that plan sponsors must never subordinate investment returns or increase investment risk due to nonfinancial factors.

The proposed rule, originally issued in June, garnered a lot of attention from asset managers and plan sponsors. While the final text of the rule does not specifically identify environmental, social, and governance (ESG) investments in ERISA-covered plans and instead focuses only on nonpecuniary factors, the DOL's preamble to the final rule makes it clear the intent is to clarify long-standing confusion regarding how fiduciaries can incorporate ESG into their plans and respond to a rise in popularity of ESG-themed investments.

Historically, plan sponsors have relied on numerous pieces of subregulatory guidance on this subject, dating back to 1994. However, the historical guidance became ambiguous and changed with presidential administrations.

The final rule includes the following core additions to the current investment duties regulation:

- A specific provision to confirm that ERISA fiduciaries must evaluate investments and investment courses of action based solely on factors that the responsible fiduciary prudently determines are expected to have a material effect on risk and/or return of an investment based on appropriate investment horizons consistent with the plan's investment objectives and the



funding policy.

- This provision also states that the duty of loyalty prohibits fiduciaries from subordinating the interests of participants to unrelated objectives and bars them from sacrificing investment return or taking on additional investment risk to promote nonpecuniary goals.
- Explicitly requires fiduciaries to consider reasonably available alternatives to meet their prudence duties under ERISA.
- New regulations on required investment analysis and documentation requirements for those limited circumstances in which plan fiduciaries may use nonpecuniary factors to choose between or among investments that the fiduciary cannot distinguish based on pecuniary factors alone.
- States that the prudence and loyalty standards set forth in ERISA apply to a fiduciary's selection of a designated investment alternative to be offered to plan participants and beneficiaries in a defined contribution plan. The rule does not categorically prohibit the fiduciaries of such plans from considering or including, as designated investment alternatives, investment funds, products, or model portfolios that support nonpecuniary goals if the plans allow participants and beneficiaries to choose from a broad range of investment alternatives, as defined in 29 C.F.R. § 2550.404c-1(b)(3). However, the rule makes clear that the fiduciaries must first satisfy the prudence and loyalty provisions in ERISA and the final rule, including the overarching requirement to evaluate investments solely based on pecuniary factors when selecting any such investment fund, product, or model portfolio.
- Prohibits plans from adding or retaining any investment fund, product, or model portfolio as a QDIA (as described in 29 C.F.R. § 2550.404c-5), or as a component of such a default investment alternative, if its objectives or goals or its principal investment strategies include, consider, or indicate the use of one or more nonpecuniary factors.

The final rule will become law 60 days after publishing in the Federal Register. However, the new rule remains subject to the Congressional Review Act, which allows Congress to strike down federal regulations within 60 legislative days.

Importantly, the rule will apply only on a prospective basis, meaning fiduciaries will not have to divest or cease any current investment, even if originally selected using non-pecuniary factors in a manner prohibited by the final rule (with the exception of the prohibition of QDIA investments that use nonpecuniary factors as a primary investment objective, which must be removed from plans by April 30, 2022). However, plan sponsors still maintain responsibility for any actions or decisions made prior to the enactment of this rule and subject to their fiduciary duties of prudence and loyalty in effect at the time.

For more information, please contact your CAPTRUST Financial Advisor at 800.216.0645.