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Updated DOL Guidance Bolsters Support for Socially Responsible Investing

DOL has reinstated the so-called “all things being equal” test, under which fiduciaries can consider socially responsible investment goals as a tie-breaker in choosing among investment alternatives that otherwise feature equal risk and return. Fiduciaries interested in pursuing socially responsible investments now have stronger DOL guidance on which to rely — but still cannot accept lower returns or take on greater risk.

Background

ERISA requires fiduciaries to administer plans prudently according to their terms, and for the exclusive benefit of participants and beneficiaries. In past years, DOL has issued guidance on how these fiduciary standards interact with the selection of economically targeted investments (ETIs), which the DOL describes as investments chosen “because of the collateral economic or social benefits they may further in addition to their investment returns.” This type of investing is also referred to as “environmental, social and governance” (ESG) and “impact” investing.

Specifically, in Interpretive Bulletin 94-1, DOL set forth the so-called “all things being equal” test. While emphasizing that a fiduciary cannot subordinate the interests of participants and beneficiaries, this guidance provided that ERISA’s fiduciary rules allow for investment of plan assets in an ETI so long as the ETI (1) has an expected rate of return commensurate to rates of return of alternative investments with similar risk characteristics that are available to the plan, and (2) is otherwise an appropriate plan investment in terms of factors like diversification and the plan’s investment policy. In other words, under this guidance, fiduciaries could consider ETI goals as “tie-breakers” in choosing among investment alternatives that are otherwise equal in terms of risk and returns.

Beyond Investment Returns

Some examples of ETI collateral benefits include job creation, “clean” energy, and affordable housing.

DOL addressed the issue of ETIs again in Interpretive Bulletin 2008-1, which curtailed the circumstances in which ETIs can be permissible investment options. In IB 2008-1, which modified and superseded IB 94-1, the DOL said that consideration of non-economic factors should be “rare and, when considered, should be documented in a manner that demonstrates compliance with ERISA’s rigorous fiduciary standards.”

Volume 38 | Issue 147 | November 12, 2015

Old Rule Reinstated, and Then Some

Stating in a press release its view that IB 2008-01 has "unduly discouraged fiduciaries from considering ETIs and ESG factors," on October 22, 2015, DOL withdrew that guidance and replaced it with Interpretive Bulletin 2015-01.

Return of "All Things Being Equal" Test

To correct what it described as a misperception that the 2008 guidance set forth a "higher but unclear" standard for fiduciaries considering ESG factors or ETIs, IB 2015-01 reinstated — word-for-word — the language of the "all things being equal" test from IB 94-1.

Changing Guidance on ETIs

In reinstating IB 94-1, the DOL returned to the guidance issued under the administration of President Bill Clinton (D) and repudiated 2008-1, which the agency issued under the George W. Bush (R) administration.

The new guidance confirms that ERISA prohibits a fiduciary from subordinating participants' and beneficiaries' interests in their retirement income to "unrelated objectives," and that an investment is not prudent if it is expected to provide the plan with a lower rate of return than an alternative available investment with a "commensurate" degree of risk, or riskier than an alternative available investment with a "commensurate" rate of return. Tracking the language of IB 94-1, it states that fiduciaries can consider ETIs and ESG factors as tie-breakers when the investment is "economically equivalent, with respect to return and risk to beneficiaries in the appropriate time horizon, to investments without such collateral benefits."

ESG Factors May Have Direct Relationship to Economic Value

Going beyond the scope of IB 94-1, the preamble introducing the new guidance provides that ESG factors can directly relate to the investment's economic value (i.e., their risk and return) — and, in such circumstances, ESG considerations are not merely collateral benefits or tie-breakers. In these cases, ESG factors are part of the fiduciary's "primary analysis of the economic merits of competing investment choices." Said another way, an investment that a fiduciary concludes is economically prudent based on an analysis that includes ESG factors may be selected in the same manner as any other investment; a fiduciary need not apply the "all things being equal" test. For example, a fiduciary assessing a potential investment in a solar energy company could consider projections about the increased need for alternative energy sources as part of the primary economic merits of the investment option.

The DOL also stressed its view that where an investment is appropriate based solely on an economic analysis, a fiduciary need not consider this investment as "inherently suspect" or otherwise in need of closer scrutiny simply because it considers ESG factors.

> **Comment.** This point appears to be a direct repudiation of any suggestion in IB 2008-1 that ETIs require greater evaluation and documentation than other plan investments. Rather, they are to be considered as a part of the general evaluation of the economics of investments.

What's a Fiduciary to Do?

The DOL crafted IB 2015-1 to accommodate fiduciaries' consideration of ETIs and ESG factors, removing aspects of earlier guidance that may have left some fiduciaries unnecessarily wary of such investments. Accordingly, fiduciaries interested in pursuing such investments, and revising investment policy statements to reflect ESG-related strategies, now have stronger footing in doing so.

Volume 38 | Issue 147 | November 12, 2015

Nevertheless, fiduciaries should be mindful that, when considering ETIs, they cannot accept lower returns or take on greater risks in exchange for ETI-related benefits. They should also be aware that identifying an available alternative investment with commensurate risk and/or rate of return itself is an act involving the exercise of fiduciary judgment that can be subject to challenge.

In Closing

It remains to be seen whether this guidance will result in an uptick of interest in ETI-related investments. While it may remove some hesitation, fiduciaries must still make investment decisions — with or without a social investment component — based on the same prudence and exclusive benefit requirements they have always considered.

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