

CLIENT MEMORANDUM

DOL Clarifies Guidance on Economically Targeted Investments

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AUTHORS

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I. Background

On October 22, 2015, the Department of Labor (the “Department” or the “DOL”) issued Interpretive Bulletin 2015-01 (“IB 15-01”), which clarifies the circumstances under which a fiduciary of a plan that is subject to the fiduciary standards of the Employee Retirement Income Security Act of 1974 (“ERISA”) may invest plan assets in economically targeted investments (“ETIs”). ETIs are generally defined by the DOL as investments that are selected for both their investment returns and collateral (i.e., economic or social) benefits. The new guidance withdraws Interpretive Bulletin 2008-01 (“IB 08-01”), which is the bulletin that had provided the most recent guidance on investing in ETIs, and reinstates the investment standards first announced by the Department in Interpretive Bulletin 94-01 (“IB 94-01”). This new guidance is intended to make clear to plan fiduciaries that there are no specific or additional considerations that fiduciaries must examine when contemplating ETIs.

II. Summary of New Guidance

The ERISA fiduciary rules governing ETIs are the same as the rules governing plan investments generally. Sections 403 and 404 of ERISA require a plan fiduciary to act prudently, and to diversify plan investments so as to minimize the risk of large losses unless it is clearly not prudent to do so under the circumstances. Additionally, a fiduciary must act solely in the interests of the plan’s participants and beneficiaries and for the exclusive purpose of providing benefits to them.

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Under these standards, a fiduciary is prohibited from making investment decisions that subordinate the interests of participants and beneficiaries, with respect to plan assets, to unrelated objectives. As provided in IB 94-01, the focus of plan fiduciaries on the plan's financial returns and risk to beneficiaries must be paramount.

These fiduciary requirements under ERISA are interpreted to mean that a fiduciary is permitted to invest plan assets in ETIs, but only when the ETI would bring at least as much economic value to the plan's portfolio as other available investments. Stated another way, fiduciaries may not accept lower expected returns or take on greater risks in order to secure collateral benefits. However, a fiduciary may consider an ETI's collateral benefits as a "tiebreaker" between two economically equivalent investment choices. Except in these cases, a plan fiduciary may not select an ETI in part because of the collateral social benefits of the investment.

The new guidance also clarifies the Department's position on the environmental, social and governance factors (the "ESG factors") that may inform a fiduciary's investment decisions. Under IB 15-01, a fiduciary may consider ESG factors when investing plan assets, but only as part of a purely economic analysis of the merits of competing investment choices. To the extent that ESG factors directly impact the economic value of an investment, the consideration of such factors in evaluating the investment is part of a prudent analysis under ERISA.

The new guidance also makes clear that fiduciaries are not required to maintain any special or additional documentation to demonstrate compliance with ERISA's fiduciary rules when considering ETIs or ESG factors. As with any other investments, the level of documentation necessary to satisfy the fiduciary requirements depends on the facts and circumstances.

According to the DOL, the principal reason for its decision to reinstate the language of IB 94-01 is that the guidance from IB 08-01 may have unduly discouraged fiduciaries from investing in ETIs and considering ESG factors. According to the now-withdrawn language of IB 08-01, fiduciaries who base their investment decisions on ESG factors and subsequently find their decisions challenged "will rarely be able to demonstrate compliance with ERISA absent a written record demonstrating that a contemporaneous economic analysis showed that the investments were of equal value." Some fiduciaries were concerned that this language required them to provide additional documentation to support any consideration of ETIs or ESG factors. This potential for additional documentation could have caused a chilling effect on ETIs in the context of plan investments.

Another reason given for the new guidance is that, in the Department's view, investors are better equipped to analyze ETIs today than they were in 2008 when the previous guidance was issued. In the Department's news release regarding the new bulletin, U.S. Secretary of Labor Thomas E. Perez states that "[c]hanges in the financial markets since [2008], particularly improved metrics and tools allowing for better analyses of investments, make this the right time to clarify [the Department's] position." If fiduciaries are better equipped to analyze investments than they were in 2008, then they may be more able to accurately evaluate the relative economic value of ETIs as compared to other investments and therefore could be better equipped to select an ETI on the merits of the investment.

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