One Minute Memo®

Department of Labor Has More to Say about ESG and Shareholder Rights

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On April 23, 2018, the Department of Labor ("DOL") issued Field Assistance Bulletin No. 2018-01 ("FAB"), which clarifies Interpretive Bulletin 2015-01 (relating to a benefit plan selecting investments to promote social policy goals) and Interpretive Bulletin 2016-01 (relating to a benefit plan exercising its shareholder rights).

Environmental, Social, and Governance ("ESG") Considerations

Interpretive Bulletin 2015-01 provided that "plan fiduciaries are not permitted to sacrifice investment return or take on additional investment risk as a means of using plan investments to promote collateral social policy goals." A fiduciary must determine that an investment is appropriate based on economic factors, and it may only consider ESG factors as tie breakers. ESG may be considered when making an investment if the ESG factors present material business risks or opportunities that bear directly on the economic considerations.[1]

In the FAB, the DOL warns that "fiduciaries must not too readily treat ESG factors as economically relevant to the particular investment choices at issue when making a decision." In other words, fiduciaries must always consider the economic interest of a proposed investment above all else. The FAB analyzes ESG considerations as applied to three specific areas.

- ***Investment Policy Statements.*** Investment policy statements may include policies regarding how ESG factors may be evaluated in selecting investments. However, there is no requirement to address ESG factors in the investment policy statement. Further, even if the investment policy statement addresses ESG, investment managers and/or other fiduciaries are only required to comply with such policies to the extent that they are consistent with the fiduciary obligations under the Employee Retirement Income Security Act of 1974, as amended ("ERISA").

- ***401(k) Plan Investment Alternatives.*** A defined contribution plan that intends to comply with Section 404(c) of ERISA may offer an ESG investment alternative. This investment option may be added to the investment menu without foregoing other non-ESG investment options. The ESG-themed investment option still must be prudently selected.

1. For example, a plan fiduciary may consider whether a particular company complies with federal and state laws and regulations when making an investment decision. Presumably, this not only reduces economic investment risk, but it also shows that the company is a good corporate citizen with strong governance.

- ***Qualified Default Investment Alternatives ("QDIA").*** Selection of an ESG QDIA "is not analogous to merely offering participants an additional investment alternative as part of a prudently constructed lineup of investment alternatives…." The DOL warns against basing the selection of the QDIA on ESG principles, as it could be inconsistent with the fiduciary's duty of loyalty. Specifically, ESG may not be considered with respect to a QDIA if it could potentially result in a lower return or exposure to additional risk.

Shareholder Engagement Activities

The DOL believes that fiduciaries generally should participate in normal proxy voting activities to prudently manage plan investments. Interpretative Bulletin 2016-01 further contemplates that shareholder activities intended to monitor or influence corporations may be permissible under ERISA if such activities are likely to enhance the economic value of an investment after considering the costs to the plan.

The DOL clarified that Interpretative Bulletin 2016-01 was not intended to suggest that individual plans regularly undertake significant expenses to engage in shareholder activism. Also, investment managers and individual plans should not regularly incur significant plan expenses for activist investment activities (including proxy fights on ESG-related issues). If a proposed shareholder engagement activity could result in significant costs, the fiduciary must believe and document accordingly that the potential economic gain exceeds the potential costs.

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