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Client Alert

Department of Labor Publishes Final Regulations Aimed at ESG Investing by Retirement Plans

November 23, 2022

In response to 2021 executive orders issued by President Biden, the Department of Labor has finalized new rules relating to investment duties for employee benefit plan fiduciaries. In light of these new regulations, now is a great opportunity for employers and retirement plan sponsors to review their plans' investment line-ups, QDIA options, and investment policy statements to determine whether changes to the plans' investment options or strategy may be appropriate.

The Employee Retirement Income Security Act of 1974 ("ERISA") imposes duties of loyalty and prudence on retirement plan sponsors and investment fiduciaries in selecting investment options for the plan. For decades, the Department of Labor signaled in nonregulatory guidance that certain types of investments designed primarily to support social, environmental or corporate governance causes or interests (so-called "ESG investing")–while not necessarily prohibited by ERISA–may run afoul of these duties if financial returns and risks to plan participants are not given sufficient weight.

In 2020, the DOL issued regulations which seemed to formalize that position by requiring plan fiduciaries to select investments and make investment-related decisions based solely on "pecuniary" factors. In particular, the regulations prohibited the inclusion of an investment fund or portfolio in a plan's qualified default investment alternative ("QDIA") that includes even one non-pecuniary objective in its investment strategy. Since ESG investments, by their very nature, are not solely focused on pecuniary goals, many retirement plans avoided ESG investing altogether.

On November 22, 2022, the DOL issued a final rule designed to reverse the "chilling effect" the prior regulations had on ESG investing by retirement plans. The DOL regulations indicate, in particular, that the prior restrictions should be eased in order to promote climate change efforts often supported by ESG investing. As a result, the pecuniary/non-pecuniary terminology has been eliminated altogether, and the regulations clarify that the ERISA fiduciary duty of prudence may actually require evaluation of the economic effects of climate change and other ESG factors presented by a particular investment strategy. The rules also take steps to pave the way for additional ESG investing by retirement plans by easing the QDIA rules and making various changes to proxy voting rules for ESG investments. The final rule becomes effective 60 days after publication in the Federal Register.

For more information, please contact the professional(s) listed below, or your regular Crowell & Moring contact.

Kristy J. Wrigley-Durer
Senior Counsel – Washington, D.C.
Phone: +1.202.624.2726

Crowell

Email: kwrigley@crowell.com

Anthony G. Provenzano
Partner – Washington, D.C.
Phone: +1.202.624.2507
Email: aprovenzano@crowell.com

Hillary C. Webb
Associate – Washington, D.C.
Phone: +1.202.624.2644
Email: hwebb@crowell.com