Fact Sheet

U.S. Department of Labor
Employee Benefits Security Administration
October 13, 2021

Notice of Proposed Rulemaking on Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights

On October 13, 2021, the U.S. Department of Labor (Department) released a proposal under the Employee Retirement Income Security Act of 1974 (ERISA) to empower plan fiduciaries to safeguard the savings of America's workers by making it clear that fiduciaries may consider climate change and other environmental, social, and governance (ESG) factors when they make investment decisions and when they exercise shareholder rights, including voting on shareholder resolutions and board nominations.

Background

During the last 30 years, the Department has periodically considered the application of the fiduciary duties of prudence and loyalty under the Employee Retirement Income Security Act of 1974 (ERISA) to plan investments that promote objectives such as furthering environmental, social, or public policy goals. The Department has consistently recognized in its various interpretive guidance that ERISA does not prohibit fiduciaries from making investment decisions that reflect ESG considerations depending on the facts and circumstances. Likewise, the interpretive guidance has recognized that the exercise of voting rights as well as other shareholder rights connected to shares of stock are fiduciary acts subject to ERISA's prudence and loyalty requirements. Differences in the tone and tenor in different Administration's iterations of sub-regulatory guidance during this period, however, have created confusion about these investment issues and have been described by stakeholders as an unhelpful regulatory game of "ping pong."

The 2020 Rules

On November 13, 2020, the Department published a final rule on "Financial Factors in Selecting Plan Investments," 85 Fed. Reg. 72846 (November 13, 2020), which adopted amendments to the "Investment Duties" regulation under Title I of the ERISA. The amendments generally require plan fiduciaries to select investments and investment courses of action based solely on consideration of "pecuniary factors." On December 16, 2020, the Department published a related final rule on "Fiduciary Duties Regarding Proxy Voting and Shareholder Rights," 85 Fed. Reg. 81658 (December 16, 2020), which also adopted amendments to the Investment Duties regulation to address obligations of plan fiduciaries under ERISA when voting proxies and exercising other shareholder rights in connection with plan investments in shares of stock. These two final rules (hereinafter "2020 Rules") purported to address perceived uncertainty in this area and respond to concerns that some investment products may be marketed to ERISA fiduciaries on the basis of purported benefits and goals unrelated to financial performance. The 2020 Rules are codified at 29 CFR 2550.404a-1 and they became effective in January of 2021.

Following publication of the final rules the Department heard from a wide variety of stakeholders, including asset managers, labor organizations and other plan sponsors, consumer groups, service providers and investment advisers that questioned whether the 2020 Rules properly reflect the scope of fiduciaries' duties under ERISA to act prudently and solely in the interest of plan participants and beneficiaries. The stakeholders also questioned whether the Department rushed the rulemakings unnecessarily and failed to adequately consider and address the substantial evidence submitted by public commenters on the use of environmental, social and governance considerations in improving investment value and long-term investment returns for retirement investors. The Department has also heard from stakeholders that the rules, and investor confusion about them, have had a chilling effect on appropriate integration of ESG factors in investment decisions. Some stakeholders further expressed concern that under a special rule, funds could be excluded from treatment as qualified default investment alternatives (QDIAs) solely because they expressly considered climate change or other ESG factors, even though the funds were prudent based on a consideration of their financial attributes alone.

President Biden's Executive Orders

Executive Order (E.O.) 13990 ("Protecting Public Health and the Environment and Restoring Science To Tackle the Climate Crisis"), signed January 20, 2021, directed federal agencies to review regulations promulgated, issued, or adopted between January 20, 2017, and January 20, 2021, that are or may be inconsistent with, or present obstacles to, the policies set forth in the order. Section 2 further provided that for any such identified actions, the head of the relevant agency shall, as appropriate and consistent with applicable law, consider suspending, revising, or rescinding the agency action. The policies set forth in the order include improving public health and protecting our environment; and bolstering resilience to the impacts of climate change.

E.O. 14030 ("Climate-Related Financial Risk"), signed May 20, 2021, set forth policies to mitigate climate-related financial risk and actions to help safeguard the financial security of America's families, businesses and workers from climate-related financial risk that may threaten the life savings and pensions of U.S. workers and families. In furtherance of these policies, Section 4 of the order directed the Department to consider publishing for notice and comment a proposed rule to suspend, revise, or rescind the 2020 Rules.

Department of Labor Enforcement Policy

In March of 2021 the Department issued an enforcement policy statement under ERISA. The statement announces that, until the publication of further guidance, the Department will not enforce the 2020 Rules or otherwise pursue enforcement actions against any plan fiduciary based on a failure to comply with those final rules with respect to an investment, including a QDIA, or investment course of action or with respect to an exercise of shareholder rights.

Overview of Notice of Proposed Rulemaking

The Notice of Proposed Rulemaking (NPRM) would amend the "Investment Duties" regulation currently codified at 29 CFR 2550.404a-1. The "Investment Duties" regulation addresses the duties of prudence and loyalty to selecting plan investments and to the exercise of shareholder rights, including proxy voting. The NPRM retains the core principle that the duties of prudence and loyalty require ERISA plan fiduciaries to focus on material risk-return factors and not subordinate the interests of participants and beneficiaries (such as by sacrificing investment returns or taking on additional investment risk) to objectives unrelated to the provision of benefits under the plan. See Prop. 29 CFR 2550.404a-1(a), (b), (c) and (d). The NPRM, however, addresses the Department's concern that the 2020 Rules have created uncertainty and are having the undesirable effect of discouraging ERISA fiduciaries' consideration of climate change and other ESG factors in investment decisions, even in cases when it is in the financial interest of plans to take such considerations into account. This uncertainty may deter fiduciaries from taking steps that other marketplace investors take in enhancing investment value and performance, or improving investment portfolio resilience against the potential financial risks and impacts associated with climate change and other ESG factors.

I. Proposed Changes to Clarify Permissibility of Consideration of ESG Factors

An important change included in the NPRM is the proposed addition of regulatory text that makes it clear that, when considering projected returns, a fiduciary's duty of prudence may often require an evaluation of the economic effects of climate change and other ESG factors on the particular investment or investment course of action. See Prop. 29 CFR 2550.404a-1(b)(2)(ii)(C).

That proposed change is complemented by three sets of examples that, depending on the facts and circumstances, may be material to the risk-return analysis. See Prop. 29 CFR 2550.404a-1(b)(4).

- The first set of examples includes climate-change related factors, such as a corporation's exposure to the physical and transitional risks of climate change and the positive or negative effect of government regulations and policies to mitigate climate change. See Prop. 29 CFR 2550.404a-1(b)(4)(i).
- The second set of examples includes governance factors, such as those involving board composition, executive compensation, and transparency and accountability in corporate decision-making, as well as a corporation's avoidance of criminal liability and compliance with labor, employment, environmental, tax, and other applicable laws and regulations. See Prop. 29 CFR 2550.404a-1(b)(4)(ii).
- The third set of examples includes workforce practices, including the corporation's progress on workforce diversity, inclusion, and other drivers of employee hiring, promotion, and retention; its investment in training to develop its workforce's skill; equal employment opportunity; and labor relations. See Prop. 29 CFR 2550.404a-1(b)(4)(iii).

II. Changes to Qualified Default Investment Alternative Provisions

The proposal would also remove the special rules for QDIAs that apply under the current rule. The NPRM would instead apply the same standards to QDIAs as apply to other investments. Thus, when selecting a QDIA, a plan fiduciary must, among other things, focus on material risk-return factors and not subordinate the interests of participants and beneficiaries (such as by sacrificing investment returns or taking on additional investment risk) to objectives unrelated to the provision of benefits under the plan. The preamble to the NPRM reaffirms that, in addition to the requirements under the "Investment Duties" regulation, other standards apply to qualified default investment alternatives. See 29 CFR 2550.404a-5.

III. Changes to Improve and Clarify Application of the Tie-Breaker Test

Another important change is a proposed change to the "tie-breaker" standard, which permits fiduciaries to consider collateral benefits as tie-breakers in some circumstances. The existing rule imposes a requirement that the competing investments be economically indistinguishable before fiduciaries can turn to collateral factors as tie-breakers, and imposes a special documentation requirement on the use of such factors. The proposal would replace those provisions with a standard that requires the fiduciary to conclude prudently that competing investments, or competing investment courses of action, equally serve the financial interests of the plan over the appropriate time horizon. In such cases, the fiduciary is not prohibited from selecting the investment, or investment course of action, based on economic or non-economic benefits other than investment returns. See Prop. 29 CFR 2550.404a-1(c)(3). This proposed change also would remove the special documentation requirements that create unnecessary burdens for application of the tie-breaker provision, and that have erroneously suggested to some fiduciaries that they should be wary of considering ESG factors, even when those factors are financially material to the investment decision. To the extent individual account plans use a tie-breaker in the selection of a designated investment alternative, the plans must prominently disclose the collateral considerations that were used as tie-breakers to the plans' participants. See Prop. 29 CFR 2550.404a-1(c)(3).

IV. Changes to Provisions on Shareholder Rights/Proxy Voting Provisions

The NPRM would also make three noteworthy changes to the current rule's provision on exercises of shareholder rights, including proxy voting. First, the NPRM would eliminate the statement in paragraph (e)(2)(ii) of the current regulation that "the fiduciary duty to manage shareholder rights appurtenant to shares of stock does not require the voting of every proxy or the exercise of every shareholder right." Second, the NPRM would remove the two "safe harbor" examples for proxy voting policies permissible under paragraphs (e)(3)(i)(A) and (B) of the current regulation. One of these safe harbors permits a policy to limit voting resources to particular types of proposals that the fiduciary has prudently determined are substantially related to the issuer's business activities or are expected to have a material effect on the value of the investment. The other safe harbor permits a policy of refraining from voting on proposals or particular types of proposals when the plan's holding in a single issuer relative to the plan's total investment assets is below a quantitative threshold. Third, the NPRM would eliminate the requirement in paragraph (e)(2)(ii)(E) of the current regulation that, when deciding whether to exercise shareholder rights and when exercising shareholder rights, plan fiduciaries must maintain records on proxy voting activities and other exercises of shareholder rights.

Similar to stakeholder input on current rule's provisions on investments and investment courses of action, stakeholders expressed concern that these provisions were creating investor confusion and would chill plan fiduciaries from playing a proper role in exercising their ownership rights as shareholders and ensuring that corporate management is properly accountable to shareholders. The proposed rule instead directs fiduciaries to the generally applicable statutory duties of prudence and loyalty set forth in ERISA section 404 for the governing standards in these areas.

Public Comment Period

The comment period runs for 60 days after publication in the Federal Register and the proposal includes instructions on submitting comments through www.regulations.gov. Commenters are free to express views not only on the provisions of the proposal, but on any issues germane to the subject matter of the proposal.

Contact Information

For questions about the proposed rulemaking, contact EBSA's Office of Regulations and Interpretations at 202-693-8500.