The ESG Updates You Need to Know

So many headlines circling and still feeling lost? The Endeavor Retirement monthly Compass is here to help guide the way.

Here's how it works: each issue will highlight what you need to know about a key topic to help you prepare for your next big meeting. If you want to know more, follow the links for additional resources, see us in action at an upcoming event, or book one-on-one time to discuss.

Let's get to the topic for June – investing based on environmental, social, and governance ("ESG") factors. The past month was full of headlines on ESG, but what does that mean for retirement plans?

In short, this means:

1. Trump-era ESG regulation is on the way out.
2. Rules from the Biden administration's DOL are coming soon.
3. Analysis of ESG investments should be the same as other non-ESG investments.

Let's Dive In...

First interpretive guidance, then rulemaking, and now legislation. Starting in 1994, interpretive guidance was published, which continued for several years until the Trump administration's DOL engaged in formal rulemaking in 2020, resulting in a highly-controversial rule that created undue confusion for participants, plan sponsors, and retirement plan advisors.

Where Do We Stand Today?

On May 20, 2021, the Biden administration issued an Executive Order ("EO") that asked the DOL to:

1. "Suspend, revise, or rescind" the Trump-era rules limiting the use of ESG funds in ERISA-covered retirement plans and discouraging retirement plans from proxy voting; and
2. Assess how the Federal Retirement Thrift Investment Board has taken ESG factors, including climate-related financial risk, into account.

From a practical standpoint, this is not really anything new. The DOL previously issued a non-enforcement policy that said they wouldn't enforce the controversial Trump-era rules. The EO, however, is coming from the administration and supports the expeditious timeline for new rulemaking (though it will likely take some time).

The other component of the EO regarding the Federal Retirement Thrift Investment Board is a nudge to encourage the addition of ESG investment options, including those related to climate. A cursory review of the meeting minutes doesn't scream ESG and given that this is the giant group that oversees the federal employee defined contribution plan, this is an important part of the administration's agenda.

While the EO is positive for incorporating ESG investing into retirement plans, legislation (as opposed to rulemaking) to amend ERISA would provide even more clarity and further aid in creating a framework to withstand the test of time.

Proposed Legislation for ESG

Sen. Tina Smith (D-MN) (along with others) introduced Financial Factors in Selecting Retirement Plan Investments Act. Just three pages, this proposed legislation gets right to the point and would provide more certainty to plan sponsors and advisors to ERISA-covered retirement plans that choose to consider ESG factors in their investment decisions (although it's likely going to be hard to get this bill passed). Specifically, the proposed legislation:

1. Amends ERISA to make clear that the same legal standard applies to the evaluation of both ESG factors and non-ESG factors provided the evaluation is consistent with fiduciary obligations.
2. Amends ERISA to account for the longstanding "tie-breaker" principle which allows plans to consider ESG factors when there is a "tie" between otherwise comparable investment options.
3. Formally repeals the Trump-era rules on ESG and proxy voting.

What Comes Next for ESG?

For ESG, it's a little more wait and see, but that doesn't mean that you shouldn't be taking action now. Here's what we know:

1. The rules put into place during 2020 which were viewed by many as "anti-ESG" are not being enforced by the DOL. Though technically there could still be a private right of action related to the Trump-era rules (i.e. a lawsuit), a well-document prudent process when using ESG factors in the investment process will provide a defense to such lawsuits. And, let's be honest – a claim for ESG seems pretty unlikely when there are a lot of other "easier" litigation targets (think: cybersecurity, share classes, use of participant data)
2. New rules are coming soon, so it's important to understand the language of ESG to be prepared. For example, if you think that divesting (or negative screens for tobacco and firearms) is still mainstream investing, then you have some work to prepare for new rules and how they apply.
3. All signs point to pro-ESG factors. In other words, ESG factors will continue to be afforded the same review process as non-ESG factors so long as a prudent process is met. To make sure you are prepared, work on your fiduciary framework today for selection, monitoring and replacement of investments.