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## Significant ESG Movement on the ERISA Front

Legislation is afoot that would amend ERISA to expressly permit fiduciaries to account for environmental, social and governance (ESG) factors as part of their fiduciary duties. The proposed legislation, the Financial Factors in Selecting Retirement Plan Investments Act, was introduced by Senator Tina Smith (D-MN). It expressly permits, but does not compel, fiduciaries to "consider" ESG and similar factors when selecting investments or strategies on behalf of an ERISA-covered retirement plan. The legislation also permits fiduciaries to consider "collateral" factors "as tie-breakers when competing investments can reasonably be expected to serve the plan's economic interest equally well with respect to expected return and risk over the appropriate time horizon." Under either scenario, the fiduciary need not "maintain any greater documentation, substantiation, or other justification" when considering the ESG or similar factors. Notably, the bill provides that an investment selected based on ESG or similar factors (*including such factors used as a tie-breaker*) may be a permissible default investment option (a "qualified default investment alternative" (QDIA)) for a plan that uses a default investment option as part of its menu. Lastly, the US Department of Labor's (DOL) 2020 *Financial Factors* rule would cease to have force or effect upon the enactment of the legislation.

Meanwhile, President Joe Biden just issued an Executive Order on Climate-Related Financial Risk, in which he directed the DOL to consider proposing by September 2021 a rule that would suspend, revise or rescind the *Financial Factors* and proxy voting rules promulgated under the Trump Administration. The Executive Order further directed the DOL to consider taking any other action under ERISA "to protect the life savings and pensions of Unites States workers and families from the threats of climate-related financial risk."

Should the legislation pass, it could provide fiduciaries limited additional comfort that the incorporation of ESG factors in their investment decision-making complies with ERISA's fiduciary duties. The trend is toward incorporating ESG factors into an investment process for their effect on investment performance, and existing guidance, including the *Financial Factors* rule, should *already* provide fiduciaries enough of a roadmap to do so in accordance with ERISA. The legislation also seeks to dial back the documentation requirements of the *Financial Factors* rule, which may indeed ease some of the angst over foot faults and the resulting liability exposure. Though the DOL removed all references to "ESG" in the final *Financial Factors* rule, some argued the rule's aggressive proposal, coupled with the Trump Administration's overall stance on climate change, was designed to curb ERISA fiduciaries' appetite for ESG. Yet, carefully documenting important decisions is already a well-established requirement and technique used by fiduciaries to mitigate their fiduciary duty risk.

It is a big deal that, with a rescission of the *Financial Factors* rule, fiduciaries would seemingly no longer have to comb through a fund's prospectus and marketing materials for references to non-pecuniary factors, nor would the fiduciary need to scrutinize a fund manager's use of screens or ratings. These requirements obviously present legal risk to a fiduciary and, therefore, may deter some fiduciaries from considering ESG products. But they also may serve as useful guideposts for fiduciaries trying to avoid selecting a greenwashed fund. An unintended consequence of the legislation could be that stripping out specific actions a fiduciary must take to navigate the intricate ESG landscape perhaps deters more plan sponsors from adding ESG to their plans than if the guideposts (and associated legal risks) remained.

It is also a big deal that the proposed legislation would allow a fund, which incorporates ESG factors for *non-investment performance reasons*, to serve as QDIA. The *Financial Factors* rule outright prohibited such a result. This change will likely give some plan sponsors comfort in selecting an ESG-themed QDIA that does not base ESG decisions on risk and return criteria, for example. However, the zealous litigation routinely brought against defined contribution plan sponsors over the selection of investment options has largely resulted in playing it safe. Plan sponsors know they will be second-guessed. This change, therefore, is unlikely to dramatically increase the adoption of ESG by ERISA plans, which continue to lag other institutional investors on that score.

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The Executive Order is worth watching. The DOL may opt to impose affirmative obligations on fiduciaries to mitigate climate change risk to the plan. The imposition of any such obligation will likely be litigated.

In sum, ESG is and will remain entirely relevant to ERISA fiduciaries. Under ERISA and existing guidance, fiduciaries may take ESG factors into account when investing plan assets or selecting investment options for a plan lineup. With ESG top of mind for the current Congress and White House, ERISA fiduciaries should continue to evaluate whether taking ESG into account is prudent under the circumstances.