

## Department of Labor Proposes Investment Duties Rule Affecting ESG Investments

June 25, 2020 | Client Update | 3-minute read

The U.S. Department of Labor issued a [proposed rule](#) on June 23, 2020 to clarify how and when ERISA fiduciaries can select and monitor plan investments based on environmental, social or corporate governance (“ESG”) and similar objectives.

### – Who is subject?

The proposed rule would apply to fiduciaries of private-sector retirement plans, such as company-sponsored defined benefit pension plans and 401(k) plans. Fiduciaries of public pension plans are **not** subject.

### – Why was the rule proposed?

The Labor Department believes that the proposed rule will help plan fiduciaries navigate ESG investing and separate the consideration of risk-return factors from investments that may sacrifice investment return, increase costs or assume additional investment risk to promote “non-pecuniary” objectives. The proposed rule would replace previous Labor Department guidance on this topic, with the most recent guidance being Field Assistance Bulletin 2018-01, which we blogged about [here](#).

### – What does the proposal provide?

Plan fiduciaries are subject to duties of loyalty and prudence under ERISA. To discharge its duty of loyalty under the proposed rule, a fiduciary must select “investments and/or investment courses of action” based only on their pecuniary factors. In addition, the proposed rule would require that a fiduciary not act to subordinate the interests of plan participants or beneficiaries to the interests of the fiduciary or another.

Under the proposed rule, fiduciaries may use only “pecuniary factors” to evaluate an investment. The proposed rule does note that ESG factors “and other similar considerations” may be economic considerations, but only if they “present economic risks or opportunities that qualified investment professionals would treat as material economic considerations under generally accepted investment theories.” If these factors are determined to be “pecuniary,” they must be considered alongside other relevant economic factors to evaluate the risk and return profiles of alternative investments.

When fiduciaries consider ESG factors, the proposed rule requires that they examine the level of diversification, degree of liquidity, potential risk-return profile or benchmark, fee structure, performance history and investment strategy of the investment in comparison with available alternative investments.

### – Can ESG factors be considered to break a tie on two “equal” investment options?

Yes, but only if the fiduciary examines the ESG claims carefully and documents the basis for its conclusion. That said, the Labor Department cautions that true ties should be rare and fiduciaries should not look for ties that may not exist to justify their use of non-pecuniary factors.

### – Practical implications if proposal is finalized?

Some fiduciaries may need to change the way they select and monitor plan investments in light of the proposed rule. Some may face additional administrative burdens as a result of the new documentation requirements under the proposed

rule. If the proposed rule is adopted in its current form, it would likely make it more challenging for plan fiduciaries to incorporate ESG factors into their investment decisions.

– **What's next?**

The proposal, which the Labor Department considers to be an Executive Order regulatory action, will be subject to public notice and comment. It is unclear if this rule will be finalized ahead of the November elections.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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