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## Benefits Update

### **Final Rule on Financial and ESG Factors in Plan Investing**

November 16, 2020

The Department of Labor (“DOL”) recently released a final rule that provides guidance for employee benefit plan fiduciaries on their investment duties under Title I of the Employee Retirement Income Security Act of 1974, as amended (“ERISA”). The final rule softens some of the limitations in the proposed rule released by the DOL in June 2020, and amends existing regulations on plan fiduciaries’ investment responsibilities under ERISA. The final rule will be effective 60 days after publication in the Federal Register and will apply prospectively to investments made and investment actions taken on existing investments after that date.

The final rule requires fiduciaries to base investment decisions solely on financial factors, specifically preventing them from making such decisions based on “non-pecuniary” factors. The rule limits plan fiduciaries from investing on the basis of environmental, social, and governance (“ESG”) factors out of concern that the consideration of these factors may result in fiduciaries making investment decisions that are not for the exclusive benefit of participants and beneficiaries. As background, the proposed rule had explicitly limited the use of ESG-focused investments, and commenters expressed concern that this could be interpreted as an attempt to chill or even prohibit consideration of ESG factors in investment decisions, even if relevant to the financial evaluation of an investment. In response to this feedback, the final rule does not specifically reference ESG factors, and instead frames the distinction as between pecuniary and non-pecuniary factors. Even with this change, the final rule appears to limit the extent to which fiduciaries may consider ESG factors when making investment decisions on behalf of plans, although it does leave open the option of including an otherwise appropriate ESG fund as an investment option for a participant-directed individual account plan.

The rule makes five key clarifications to the fiduciary duties relating to investments:

- Fiduciaries must base decisions on investments and investment courses of action solely on pecuniary factors. Pecuniary factors are financial factors that materially impact the risk and/or return of an investment, “based on appropriate investment horizons consistent with the plan’s investment objectives and funding policy.”
- In addition, the final rule provides that fiduciaries are prohibited from subordinating participants’ interests to “unrelated objectives” or from sacrificing investment return or taking on additional risk in favor of non-pecuniary goals.
- The rule clarifies that, while fiduciaries are required to consider “reasonably available alternatives” to a proposed investment decision in order to meet their duties of loyalty

and prudence under ERISA, they are not required to “scour the marketplace or look at an infinite number of possible alternatives” in making their investment decisions.

- Where plan fiduciaries consider non-pecuniary factors when choosing between investments that are not distinguishable on the basis of pecuniary factors alone, the final rule sets forth the investment analysis and documentation requirements. The documentation requirement is intended to prevent fiduciaries from “improperly finding economic equivalence” or basing investment decisions on non-pecuniary benefits without being appropriately careful in their analysis and evaluation.
- However, in its selection of the investment alternatives for participant-directed individual account plans, a fiduciary is not prohibited from considering or including an investment fund, product, or model portfolio simply because it “promotes, seeks, or supports” a non-pecuniary goal, provided there are a sufficiently broad range of investment alternatives and the fiduciary otherwise complies with ERISA’s duties of prudence and loyalty, as modified by the final rule.
- For participant-directed individual account plans, fiduciaries are prohibited from using an investment fund or model portfolio as a qualified default investment alternative (“QDIA”) or as a component of a QDIA if the investment objectives, goals, or principal strategies “include, consider, or indicate the use” of at least one non-pecuniary factor, although the guidance leaves open the possibility that ESG factors may form part of a QDIA’s investment strategy to the extent they are “pecuniary.” Plans have until April 30, 2022 to make any necessary changes for compliance with the QDIA selection requirements of the final rule.

Please contact Slevin & Hart for more information about how this guidance affects your plan.

### Attorneys



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