

Regulatory Ping Pong: DOL Releases Proposed Rule on Considering ESG Factors in ERISA Plan Investing

A Practical Guidance® Article by Elizabeth S. Goldberg, Michael B. Richman, Julie K. Stapel, Lance C. Dial, Gena Yoo, and Rachel Mann, Morgan, Lewis & Bockius LLP



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The Department of Labor (DOL) released on October 13, 2021, a [Notice of Proposed Rulemaking on Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights](#) (Proposed Rule), which would amend a prior regulation (the 2020 Rule). Overall, if finalized in its current form, the Proposed Rule should provide comfort to ERISA plan fiduciaries seeking to incorporate climate change and other ESG factors into plan investment decision-making and plan fund lineups by (a) treating climate change and other ESG factors like the myriad of other considerations that may be material to investment value/risk-return; (b) allowing investments selected to serve as qualified default investment alternatives (QDIAs) to incorporate climate change and other ESG considerations and (c) expanding the application of the “tie-breaker” doctrine from prior guidance.

This Proposed Rule is the most recent volley in a 25-year-long game of regulatory ping-pong with respect to the use of ESG factors in making investment decisions for ERISA plans and successive DOL administrations altering

interpretations. For instance, the 2020 Rule, released by the DOL under the prior administration, imposed new standards related to the use of ESG by ERISA plans. It was largely seen as cautious (if not negative) on the use of ESG factors in investment decisions by ERISA plan fiduciaries.

The Proposed Rule would amend the 2020 Rule—and the DOL’s legal interpretation—in three important ways:

- First, the Proposed Rule clearly states that a fiduciary making an investment decision may consider ESG factors material to the risk-return analysis, specifically providing a non-exclusive list of three examples that could be considered: climate change, corporate governance factors and workplace factors. This represents a clear departure from language in the preamble to the 2020 Rule, which seemed to take the view that there were only limited circumstances under which a fiduciary could consider ESG factors based on the presumption that they may not be “pecuniary” in nature. The Proposed Rule would provide greater latitude to consider ESG factors even if they would not be “pecuniary” under the definition of the 2020 Rule, although the Proposed Rule still requires that investments based on ESG considerations serve the financial interests of the plan and not promote benefits or goals unrelated to the interests of plan participants and beneficiaries in their retirement income.
- Second, the Proposed Rule would remove the special rules—present in the 2020 Rule—on the use of ESG in the selection of QDIAs. The Proposed Rule departs from

this approach of treating QDIAs differently and instead applies the same standard to QDIAs as is applied to all other investments (subject, in the case of participant-directed plans, to disclosure of the ESG-themed nature of the investment option to the plan participants). If finalized, this should clear the way for climate change and other ESG factors to potentially serve a role in a plan’s QDIA. This would be helpful to fiduciaries because funds that serve as QDIAs may already incorporate ESG factors into their investment decision-making in a variety of ways.

- Third, the Proposed Rule would reduce burdens of the “tie-breaker” standard, which permits fiduciaries to consider collateral benefits (such as ESG factors that aren’t clearly material to the risk-return analysis). Two investments are no longer required to be economically indistinguishable to invoke the tiebreaker; rather, the two investments must both “equally serve the financial interest of the plan.” In a change from the 2020 Rule, no special documentation would be required for the reliance on the tie-breaker provision.

Morgan Lewis partners Elizabeth S. Goldberg, Michael B. Richman, Julie Stapel, and Lance Dial, and associates Gena Yoo and Rachel Mann advise employee benefit plan sponsors and administrators on a range of matters related to employee benefits.

Elizabeth S. Goldberg, Partner, Morgan, Lewis & Bockius LLP

Elizabeth (Liz) Goldberg advises employee benefit plan sponsors and service providers to those plans (including financial service firms) on ERISA US Department of Labor (DOL) enforcement investigations, DOL ERISA regulatory matters, and ERISA fiduciary counseling and compliance.

Liz has broad experience representing both plan and service provider clients in DOL ERISA investigations. Liz has worked on more than 30 such DOL investigations including matters that have involved significant monetary disputes or enterprise risk. In assisting in such matters, Liz draws on her prior work experience that includes six years at the DOL’s Office of the Solicitor, primarily as an ERISA litigator. Liz also works with clients to perform internal audits to minimize any potential liability related to DOL investigations or ERISA litigation.

Liz’s experience also includes other matters before the DOL, including prohibited transaction exemption applications and representing clients in other DOL regulatory processes (such as ERISA rulemaking).

Liz advises fiduciaries and related parties and service providers on ERISA fiduciary compliance including on ERISA’s fiduciary rules, governance issues, and prohibited transaction exemptions. This includes her work with fiduciaries on governance issues, such as setting up fiduciary committees and drafting investment policies. She also provides related counseling on general employee benefit plan issues, such as tax qualification rules.

Liz negotiates all manner of benefits contracts on behalf of plans and financial services providers, including investment management agreements, trust agreements, transition management services, administrative service and recordkeeping contracts, and consulting agreements.

Liz has developed a specialization in a number of emerging fiduciary issues including retirement plan missing participant challenges; privacy and cybersecurity risks facing employee benefit plans; the use of environmental, social, and governance (ESG) factors in retirement plan investing; and the offering of proprietary funds in 401(k) plans.

Liz is the deputy of the firm’s Fiduciary Duty Task Force.

Michael B. Richman, Partner, Morgan, Lewis & Bockius LLP

Michael B. Richman counsels clients on the fiduciary responsibility rules under the Employee Retirement Income Security Act (ERISA), including the ERISA prohibited transaction rules. He advises plan sponsors on investment matters for defined benefit and defined contribution plans. He also counsels banks, investment adviser firms, and broker-dealer firms on ERISA compliance for ERISA plan separately-managed accounts, collective investment funds, private funds, and other arrangements. Additionally, he provides guidance to IRA custodians on permissible IRA investments and investment restrictions.

Michael also advises clients on fiduciary governance of ERISA plans, as well as on prohibited transaction and fiduciary responsibility issues in proposed transactions and transactions under government investigation. Michael prepares requests to the US Department of Labor (DOL) for prohibited transaction exemptions and advisory opinions.

Before joining Morgan Lewis, Michael was counsel in the benefits and executive compensation, and investment management groups at one of the world's largest global law firms.

A frequent writer, Michael has authored or coauthored a book, book chapters, and a number of articles on ERISA, benefits, and securities issues.

Julie K. Stapel, Partner, Morgan, Lewis & Bockius LLP

Julie Stapel provides effective and practical solutions to clients' complex ERISA issues. She proficiently steers plan sponsors and investment managers through ERISA's fiduciary and prohibited transaction rules, and negotiates virtually every type of investment-related agreement with employee benefit plans. Julie uses exceptional communication and interpersonal skills to advise clients on a wide range of ERISA topics, including effective fiduciary governance, risk management, the creation of "white label" investment options, and the application of environmental, social, and governance (ESG) factors in plan investment decisionmaking.

Julie is also part of the firm's industry-leading structured transactions practice, applying ERISA's fiduciary and prohibited transaction rules to structuring and offering asset-backed and mortgage-backed securities and collateralized loan obligations. ERISA-governed investors are an integral part of the market for structured transactions. Julie brings the specialized ERISA knowledge to these transactions that allow them to be effectively marketed and sold to ERISA-governed investors.

Leader of the firm's Fiduciary Duty Task Force, Julie also advises on fiduciary governance, including the formation and operation of benefit plan fiduciary committees.

She works with plan fiduciaries to implement ERISA compliance best practices and manage fiduciary risks. She also helps clients remain in compliance with ERISA's ever-changing reporting and disclosure obligations.

Julie speaks frequently on ERISA-related topics. She has spoken before the Committee on the Investment of Employee Benefit Assets (CIEBA), the ERISA Industry Committee (ERIC), the John Marshall School of Law, and at various events sponsored by Pension and Investments magazine. In addition to these speaking engagements, she regularly addresses client fiduciary committees and investment staff, performing fiduciary training and presenting updates on changes in the law.

Julie is a member of the Economic Club of Chicago, a trustee of the Merit School of Music, and a member of Women Investment Professionals (WIP). She is also a past president of the Chicago Chapter of Worldwide Employee Benefits Network (WEB).

Prior to joining Morgan Lewis, she was a partner in the employee benefits and executive compensation department of an international law firm, resident in Chicago. Before that, she served as general counsel to a registered investment adviser, gaining experience with ERISA and its impact on investment managers and collective investment funds.

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With more than a decade of experience as senior in-house counsel with global investment managers, Lance Dial has a deep understanding of mutual fund law and operation and is fluent in the myriad regulations applicable to investment managers. He is well versed in the creation of investment products and environmental, social and governance (ESG) and sustainability matters. Lance works extensively on regulatory policy matters engaging with various financial services regulators, including the US Securities and Exchange Commission, US Department of Labor, Internal Revenue Service, and US Department of Treasury.

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