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DOL Move Bodes Well For Socially Conscious 401(k) Investing

By **Emily Brill**

Law360 (March 10, 2021, 1:30 PM EST) -- The U.S. Department of Labor's decision Wednesday to table Trump-era regulations limiting socially conscious investments by retirement plans signals that the Biden administration is considering an embrace of so-called ESG funds, which attempt to advance environmental, social and corporate governance goals.

Such an embrace would allow retirement plan managers to breathe a "collective sigh of relief" in a world in which socially conscious funds are becoming an ever-larger fixture of the financial landscape, benefits attorneys said. A record-setting $51 billion — 25% of all new investments — poured into ESG funds last year, according to the research firm Morningstar.

In that context, some benefits attorneys said, the Trump DOL's regulations — which seemed to discourage ESG investing by telling plan managers to focus only on funds' financial performance when stocking retirement plans — seemed out of step with new norms. Others said the regulations weren't as dramatic as they seemed, and the companies that paused new investments in ESG funds after the regulations went into effect Jan. 12 simply overreacted.

In either case, the DOL's announcement Wednesday that it will suspend enforcement of the Trump-era policy while crafting new regulations that "better recognize the important role" of socially conscious investments in retirement plans speaks volumes about what the Biden administration's stance on this practice will be, benefits attorneys say.

"I will be surprised if whatever comes out [of the Biden administration] isn't expressly more permissive about the consideration of ESG factors," said Joshua Lichtenstein, a benefits partner at Ropes & Gray LLP. "It's very clear that they don't want this rule to be decreasing the role of ESG in [Employee Retirement Income Security Act] plan considerations."

Erin Turley, a benefits partner at McDermott Will & Emery LLP, said the DOL's news provides "a welcome respite" to her clients, who paused new investments in ESG funds after the Trump regulations went into effect and considered dropping existing funds from their plans' lineups.

Tabling the Trump-era regulations brings "the Department of Labor into alignment with the desire of not just plan fiduciaries, but more notably, the actual plan participants to use their retirement assets in a socially conscious manner," Turley said.

"Given that, for many Americans, their employer-sponsored retirement account constitutes their only investable asset, this may be the only way many Americans can wield their investor strength," she said.

Turley said she anticipates the Biden DOL will adopt a more permissive attitude toward ESG investing, "in line with the theme of the current administration, versus the prior one."

But even if the new administration smiles upon ESG investing by retirement plans, there's only so far it can go under the Employee Retirement Income Security Act, said Steven Rabitz, a benefits partner at Dechert LLP. Plan managers will still have to ensure that ESG funds constitute a good financial investment for the plan.

"It's not like the DOL can say, 'By the way, we love ESG so much that you can sacrifice returns,'" Rabitz said. "You can't sacrifice returns on ERISA investments, end of story. Republican administrations have said that, Democratic administrations have said that."

Ali Khawar, who's heading up the DOL's benefits unit until President Joe Biden appoints an assistant secretary for the Employee Benefits Security Administration, acknowledged as much in a statement released with the administration's announcement Wednesday.

He said EBSA plans to release new regulations that allow plan managers to consider ESG factors "in the financial evaluation of plan investments … while continuing to uphold fundamental fiduciary obligations," like ensuring plans' investments are good.

Attorneys said they weren't surprised to see the old regulations dropped, given that Biden placed them on the chopping block on his first day in office, **identifying them** among the Trump-era policies he intended to review.

But some in the financial services industry hoped to see the regulations dropped a little sooner, given that they've "driven a lot of disruptive behavior in the market" since they went into effect in January, Lichtenstein said.

"The ESG rule has had a very big impact on the market. Funds have been getting dropped from platforms based on the degree to which they mention ESG factors," Lichtenstein said. "It took longer to put on this piece of guidance on non-enforcement than was expected. People were getting a little more nervous than they might have otherwise."

The DOL also tabled enforcement of another **Trump-era benefits policy** on Wednesday, saying retirement plan managers can ignore a 2020 ban on proxy voting to advance social or political goals.

That policy caused much less disruption than the ESG investing rule, given that plan managers often cast proxy votes on "housekeeping issues, rather than substantial issues," Turley said, and given that it didn't disrupt investing patterns.

"The proxy rule isn't driving as much behavioral shifts right now as the ESG investing rule," Lichtenstein said. And because the proxy voting rule was seen as of a piece with the ESG investing rule — part of a **Trump-era strategy** to limit retirement plans' ability to advance social and political goals — it wasn't surprising to see it tabled alongside the investing rule, he said.

"Reevaluating the ESG rule was always likely to involve reevaluating the proxy rule as well," he said.

--Editing by Robert Rudinger and Haylee Pearl.

Update: This story has been updated with more information and commentary about the regulations.
