

Battle Over ESG Means Balancing Act For Benefits Plans

By **Kellie Mejdrich**

Law360 (March 3, 2023, 9:57 PM EST) -- Congress recently passed legislation seeking to nix a U.S. Department of Labor rule meant to help retirement plan managers factor things like climate change and social justice into investment decisions, a move that attorneys say highlights the legal risks for plans that offer funds devoted to socially conscious investing.

The House and Senate passed resolutions on Feb. 28 and March 1, respectively, to roll back the Labor Department's **regulations** on environmental, social and governance factors in retirement plan investing. While President Joe Biden has promised to veto the legislation, the resolutions are part of a wave of backlash that includes separate legal challenges from **GOP attorneys general** in Texas federal court and **a conservative group** in Wisconsin.

The Employee Retirement Income Security Act requires those responsible for retirement plans to protect worker-investors' interests, which could be used as the basis for opponents to the ESG rule to argue that a particular plan that used those factors in its strategy unlawfully put ideology above the bottom line.

In light of the conflict between proponents and critics of ESG, and the prospect that federal regulations could change with shifting political winds, attorneys warn that plans shouldn't put too much emphasis on ESG — though they don't have to ignore it, either.

Michael J. Voves, chair of Dorsey & Whitney LLP's benefits and compensation group and head of the firm's executive compensation practice group, said he expects plan participants to sue over ESG. He added that benefits lawyers had to give clients a "road map" — which wasn't forthcoming from the DOL — for incorporating ESG.

"I can see in the future, the DOL saying, as companies get sued, ... 'Well, we told you, you could add ESG-themed funds, but we also expect you to do it right,'" Voves said. "I think the safest thing to do is roll up your sleeves and ask hard questions about how ESG is integrated across the entire platform. Instead of just saying, Oh, let's just drop in an ESG fund."

"I don't think there's litigation risk in saying, 'Hey, we are going to look at ESG factors,'" he added. "But I do think there's litigation risk in saying, 'Hey, we're going to add an ESG-themed fund.'"

Politicians Clash With ERISA

Most benefits attorneys saw a disconnect between how Congress described its actions to revoke Biden's rule and the substance of what lawmakers would actually undo if their legislation was enacted, given that Biden's rule generally reverted to a lighter-touch policy on how ERISA attorneys can consider ESG.

Biden's rule, finalized in November, rolled back rules issued in 2020 under former President Donald Trump that had barred employers from pushing workers' retirement savings toward investments advertised as socially conscious unless those funds were on track to perform well financially, and curbed proxy voting on social or political goals.

Moreover, benefits attorneys said that as lawmakers debated on the two disapproval resolutions, many of the arguments made for or against ESG investing appeared to conflict with how selecting

investments under ERISA works.

For example, Democratic Sen. Joe Manchin of West Virginia, along with many Republicans in both chambers who supported repealing the rule, cited concerns about energy investment as a key reason for their support.

"You can't eliminate something before you have something that will replace it that the American people depend on every day," Manchin said during floor remarks before the Senate's resolution, S. J. Res. 8, passed by a **50-46 vote**.

Manchin and Sen. Jon Tester, D-Mont., were the only two Democrats to support repeal in the Senate, with Tester saying in a statement that he voted for repeal "because I believe it undermines retirement accounts for working Montanans and is wrong for my state."

Josh Lichtenstein, a partner at Ropes & Gray LLP, said "the same way that plan assets are not supposed to be used for the purposes of advancing a political goal, on the pro-ESG side ... having a concern that ERISA plans aren't going to be investing in fossil fuels enough, and it's going to hurt the economies of fossil fuel-based states, is really inconsistent with the idea of ERISA."

Rep. Jared Golden of Maine was the only Democrat to support the House's disapproval resolution, H. J. Res. 30, when it passed **216-204**. A spokesperson for Golden said in a statement to Law360 on Friday that "Jared thinks that working class Mainers' hard earned retirement funds should be invested to maximize positive returns, period."

Adding to the disconnect between the actions from Congress and what attorneys are dealing with on the ground is the fact that regulators already said **they wouldn't enforce** the Trump-era rules before replacing them.

Still, with enactment unlikely in the near future with Biden in charge, benefits attorneys described advising plan sponsors to proceed cautiously on ESG, given shifting political headwinds.

"On both sides, this is being highly politicized," said Anne Tyler Hall, managing partner at Hall Benefits Law, who said the message she got from Biden's rule was that "ESG was a factor — a factor — for consideration. Not the factor, not the only factor, not a required factor."

As for how all the politicization affects her advice, Hall said, "I think plan sponsors at this point stay the course with respect to memorializing investment lineup decisions, having a clear investment policy statement. ... It's an inflection point for plan sponsors: We need to make sure we've got a good robust fiduciary compliance paradigm in place so that we can justify our investment decisions and our investment lineup."

"At this point, I would be careful about ESG," she added. "Because it's just not clear how that's going to land."

Still, some attorneys pointed to aspects of Biden's ESG rule that appeared to do more than simply allow consideration of ESG.

Dorsey & Whitney's Voves pointed to how Biden's rule removed a categorical prohibition on plans choosing an investment fund that pursues collateral benefits as a qualified default investment alternative, or QDIA. That prohibition, first imposed under Trump, had the effect of restricting plan sponsors from choosing an ESG fund as the default investment option in a 401(k) plan when a participant didn't choose where to put their withholdings. That change to prohibitions on the QDIA is also targeted in the Wisconsin conservative group's lawsuit.

"I think if you really get down to it, when you listen to the defenders of the Biden rule, they'd say, 'This is just common sense. We're just saying if these factors are relevant to risk and return, they should be taken into account,'" Voves said.

"That's fair, but I don't think the rule just does that, I think the rule goes further to suggest that you could have an ESG-themed fund be your default. And if you're from Texas, if you're from Montana, or, you know, West Virginia, that's going to rankle you," Voves added.

'Perception Can Be Reality'

Congressional debate over the ESG rule also demonstrated for benefits attorneys that even if a given administration wants to pitch a regulation as leaning one way, public perception can overrule.

Most benefits attorneys agreed that the regulation stepped backward in terms of putting requirements on decisions related to ESG. Still, Andrew Oringer, partner and general counsel at Wagner Law Group, said that in terms of how plan fiduciaries will behave under the new rules given the political activity, "perception can be reality."

"If the perception is that the rule is more flexible to ESG, then at a time when the administration is not going to be antagonistic to ESG... you're going to get more flexibility and more willingness, I think, to go down that road now," Oringer said.

He noted that during the Trump administration, it was the same issue in the opposite direction.

"Regardless of how bad the Trump rule was for ESG, the press on it, the White House statements on it, the coverage of it was that it was extremely negative to ESG — maybe more negative than even it really was, when you actually read the rules," Oringer said.

Voves warned that with the push for ESG coming from all different directions, plans are inevitably putting themselves at risk.

"All these different plan sponsors are just going to cave to the vocal sustainability committee people, and they're going to add an ESG themed-fund," which could potentially open a plan up to an ERISA class action, Voves said.

--Editing by Abbie Sarfo.