

RETIREMENT

DOL's New ESG Rule 'Unremarkable'

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Two days before Thanksgiving, on November 22, 2022, the Department of Labor (“DOL”) released its much anticipated [“Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights.”](#) Between DOL Bulletins and Rules, this represents the fourth rewriting of the fiduciary definition since

2008. This new rule essentially reverses the longstanding “tiebreaker” test from 1994.

Though not a formal “Rule,” the DOL’s 1994 [Interpretative Bulletin](#) said non-pecuniary issues could only be considered when all other economic assessments are the same. In other words, non-pecuniary issues are limited to situations where they act as tiebreakers.

The new Rule specifically states, “the final rule amends the current regulation’s ‘tiebreaker’ test, which permits fiduciaries to consider collateral benefits as tiebreakers in some circumstances. The current regulation imposes a requirement that competing investments be indistinguishable based on pecuniary factors alone before fiduciaries can turn to collateral factors to break a tie and imposes a special documentation requirement on the use of such factors. The final rule replaces those provisions with a standard that instead requires the fiduciary to conclude prudently that competing investments, or competing investment courses of action, equally serve the financial interests of the plan over the appropriate time horizon. In such cases, the fiduciary is not prohibited from selecting the investment, or investment course of action, based on collateral benefits other than investment returns.”

The Biden administration announced the Rule with much fanfare. Officials also focused on the difference between the newest Rule with the one promulgated under the Trump administration, the latter of which remained consistent with the 1994 Interpretive Bulletin.

“Today’s rule clarifies that retirement plan fiduciaries can take into account the potential financial benefits of investing in companies committed to positive environmental, social and governance actions as they help plan participants make the most of their retirement benefits,” said Secretary of Labor Marty Walsh.

“Removing the prior administration’s restrictions on plan fiduciaries will help America’s workers and their families as they save for a secure retirement.”

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Assistant Secretary for Employee Benefits Security Lisa M. Gomez offered this frank assessment. “The rule announced today will make workers’ retirement savings and pensions more resilient by removing needless barriers, and ending the chilling effect created by the prior administration on considering environmental, social and governance factors in investments. Climate change and other environmental, social and governance factors can be useful for plan investors as they make decisions about how to best grow and protect the retirement savings of America’s workers.”

Despite this partisan vitriol, which was no doubt aimed at pleasing the current administration’s more extreme backers, the letter of the Rule is less provocative than advocates have been implying.

“The remarkable thing about the final regulations is they are so unremarkable,” says Albert Feuer of the Law Offices of Albert Feuer in Forest Hills, New York.

Marcia Wagner, Founder of The Wagner Law Group in Boston, says, “While it is not surprising that the final ESG regulations rejected the Trump administration’s ESG regulations, and made clear that depending upon the facts and circumstances, it would be appropriate for an ERISA fiduciary to take into account ESG factors such as climate considerations, the DOL also sought to make clear,

in both the preamble and the text of the final regulations, that it was not requiring consideration of any ESG factors or seeking to place its thumb on the scale in favor of a fiduciary's obligation to consider such factors."

A simple reading of the Rule will tell you that the DOL appears to have removed a major fiduciary roadblock to including ESG-focused investments on retirement plan menus.

"The DOL is stating that ESG criteria may be considered along with other criteria but the primary consideration for the fiduciary should be to act with care and prudence to choose appropriate investments for the plan," says Peter Nerone, Compliance Officer at MM Ascend Life Investor Services, LLC in Cincinnati.

If you carefully examine the language of the Rule, what some might be promoting as a gusher of definitive change may merely be a trickle of "maybe, if you really want to."

"The operative word here is plan fiduciaries 'MAY'—not 'MUST'—consider ESG factors when determining if a fund should be offered as an investment option within the plan," says David Radoccia, Managing Director at PensionMark in Providence.

With this understanding, does the DOL's new Rule offer enough to encourage plan sponsors to reevaluate their current plan investments?

"The DOL has now opened the door to a conversation among plan fiduciaries," says Michael J. Voves, Chair of Benefits and Compensation Group and Head of the Executive Compensation Practice Group at Dorsey & Whitney in Minneapolis. "The question is, should the conversation be about adding an ESG-labeled fund

choice, or should it be about adopting a risk management process looking at ESG across all choices? Time will tell.”

The door to the conversation may now be open, but the 800-pound gorilla remains in the room. The onus of fiduciary duty continues to restrain plan sponsors.

“It’s important to note that in this final ruling, the DOL did not discharge the principles that mark a fiduciary’s duties, namely that the participants’ best interest in terms of risk-return factors must always be the priority and that the fiduciary must not subject participant investments to additional risk due to unrelated objectives,” says Syed Nishat, Partner at Wall Street Alliance Group in New York City. “Because of this, there may not be a great deal of change for plan sponsors in terms of large-scale investment changes, particularly not at first. Without more data and experience with ESG investments, plan sponsors will maintain the types of investments that have more solid data and less risk to maintain the best interests of the plan participants. This may change in the future, particularly if ESG investments become more mainstream or have a stronger performance in the long-term.”

After years of riding a wave of popularity and seemingly high returns, the ESG investment movement has come crashing down to earth in 2022. Complicating matters, there is no consistent definition of what “ESG” means. This latter issue is so concerning the [SEC is looking into](#) strengthening mutual fund disclosure regulations. Indeed, state regulators have begun to aggressively question the validity of investments purporting to include ESG criteria. Bear in mind the DOL’s new Rule pertains only to ERISA plans, not to retail accounts or non-ERISA state-sponsored retirement plans.

“The ESG claims are unreliable, and the performance of funds that promote their ESG standards has not been encouraging,” says Nerone.

You may not have noticed what the SEC is doing, but you’ve likely seen the not-so-complimentary headlines regarding the recent performance of ESG funds.

“ESG investments have been a disaster since 2021,” says Atlanta-based Mark Neuman, Founder of Constrained Capital which launched the ESG Orphans ET. “The bubble is unwinding. ESGU ESGU +0.7%, Blackrock’s ESG ETF, has lost 18% year to date. ESGV ESGV +0.8%, Vanguard’s ESG ETF, is down 22% year to date, and ESGG ESGG +0.7%, a STOXX Global ESG fund, has fallen 18% year to date. These are in line to be worse than the SPX and Russell 2000. Everyone was shepherded into the same stocks under false ESG promises and failed objectives. Too many of the stocks in these funds look the same and fail on many ESG metrics. The explosion in ESG assets has herded investors all into the same stocks. These are too crowded; they all move together and, in this case, have moved down. Too many investors don’t know what they own while believing they own ‘ESG.’”

If this sounds like a classic class action opportunity waiting to happen, you’re one step ahead of yourself. The past two attempts to update the Fiduciary Rule by the two previous presidential administrations have ended up stillborn, either by court action or by political action. So, the first question to ask is whether this new Rule is vulnerable to a successful court challenge.

“Those looking for reasons to challenge the rule in court wouldn’t have to look very far at all,” says Kit Gleason, VP/Sr. Relationship Manager at First Bank & Trust in Sioux Falls, South Dakota. “The DOL is suggesting fiduciaries considering ESG investments can

project the economic effects of climate change and other ESG factors on future risks and returns. If sponsors are having a difficult time documenting their prudent process for selecting a family of target-date funds, for example, why would we think they will be more qualified or skilled at estimating the long-term economic impacts of climate change, social norms or corporate governance?”

The weakness of the Rule may not be in the success, or lack thereof, in correctly predicting the future but in the fuzziness of the definition of “ESG.” The SEC is currently reviewing its own ESG disclosure rules. As a result of the DOL moving ahead of the SEC, there’s a good chance the lack of harmonization between the SEC and the DOL may result in conflicts between the two regulators’ rules. Ironically, the legal risk of this is not borne by the regulators but by those being regulated.

“Rather than aiming directly at the rule in terms of the offering, it may be likely that the rule is challenged in terms of how public companies disclose their climate impacts,” says Nishat. “The SEC has recently issued a rule proposal for just that, as it would question how ESG investments are judged and what qualifies them under that name. As an example, a recent U.S. Supreme Court case, *West Virginia vs. Environmental Protection Agency (EPA)* ruled against the EPA in terms of the agency having the ability to regulate the emissions from power plants already in existence due to the generational requirements. This, of course, has implications concerning the EPA’s power to regulate in the future, as well as raising questions about governmental agencies’ power to regulate in areas as diversified as the tech industry and the internet. This has implications for ESG offerings, as, without standardized definitions and regulations applied to various industries, it would be a challenge for compliance to make decisions about these investments and their application to investor accounts.”

Unfortunately, it is transparently apparent, especially given the public statements presented by DOL officials, this new Rule has been couched in political overtones. This suggests we may not have seen the end of “new” Fiduciary Rules.

“While the DOL’s new ESG rule should open the door for adding ESG-related investments to many retirement plan investment menus, fiduciaries may only add these types of funds if they can be confident that rules will not continue to change from one Administration to the next,” says Jeff Coons, Chief Risk Officer for High Probability Advisors in Pittsford, New York. “Retirement investing and fiduciary decision-making should transcend the 4-to-8-year presidential election cycle, so the DOL’s rules around the use of ESG factors will need to show some stability before we are likely to see widespread adoption of such investments in plan menus.”

Those closest to where these rules are crafted may have the best seats in the house when it comes to determining the tenacity of this new Rule.

“For many plan sponsors, yet another regulatory rewrite only serves to further reinforce the partisan politics surrounding ESG,” says Christopher Jarmush, Area Sr. Vice President, Director of Defined Contribution at Gallagher Fiduciary Advisors, LLC in Washington, DC. “To assume this is the DOL’s final, final say on the matter is an absurdly naïve notion.”

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