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ERISA Allows Plan Fiduciaries to Pursue More Than Just Money

Analysis

The Wagner Law Group's Michael Schloss, who spent more than 30 years at DOL enforcing ERISA, reflects on retirement policies that except ERISA's primary fiduciary requirements for tax-subsidized plan assets while promoting employee stock ownership as well as environmental and social goals, and barring investments in firms tied to U.S. adversaries.

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ERISA Allows Plan Fiduciaries to Pursue More Than Just Money

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In this note, my first since retiring from the Department of Labor five months ago, I would like to think out loud about three policies that provide exceptions to ERISA's primary fiduciary duties of loyalty and prudence (ERISA §404(a)(1)(A) and (B)) with regard to tax-subsidized plan assets. These policies relate to:

- 1. ESOPs, which were added to ERISA to promote employee stock ownership and control (ERISA §407(d)(6)(A) describes ESOPs as plans "designed to invest primarily in qualifying employer securities");
- 2. ESG, recently incorporated into the latest DOL fiduciary regulation (87 Fed. Reg. 73,822 (Dec. 1, 2022) to promote environmental, social and governance goals; and
- 3. PARSA, proposed legislation that would bar ERISA plan investments in "adversary-tied firms."

Each of these policies is fascinating because each shifts the fiduciary focus away from ERISA's basic requirement that fiduciaries act with an "eye single" towards maximizing retiree assets for working Americans and their families.

Control for Workers, After Historic Pension Failure

First, ESOPs. ERISA was enacted, fittingly, on Labor Day, 1974, following years of hearings and debates which, for those who are truly interested in how we got here, are well documented in a thick three-volume legislative history of the act. The legislative history demonstrates that, in light of the disaster suffered by Studebaker retirees, who lost their pensions when Studebaker failed in the 1960s, Congress initially resisted the idea of permitting pension investments in employer stock in the new law.

However, that all changed after Senator Russell B. Long invited worker-capitalism advocate Louis O. Kelso to a meeting where Mr. Kelso convinced the Senator of the benefits of ESOPs and of the importance of ESOPs for the economy. The rest, as they say, is history. Shortly before ERISA was enacted, provisions were added to encourage employee stock ownership through pension plans. ESOPs were exempted from ERISA's diversification requirements.

ESOP purchases and ESOP loans were exempted from ERISA's strict prohibited transaction provisions. Finally, generous tax breaks were added providing tax subsidies which today are valued by the Treasury Department at more than $200 million a year.

Like today's enthusiasm for ESG investing, Senator Long's enthusiasm for ESOPs was not focused solely on improving retirement security in America. Instead, Senator Long had much grander goals which he believed would be advanced through ESOPs. These goals prominently included protecting America's economic and foreign policy future. In Senator Long's view, the employee stock ownership issue went to the heart of what type of economic system Americans want to have, what they intend to leave for future generations and what they want to share with those around the world who would embrace America's democratic vision. As Senator Long explained in Congressional testimony in 1983:

"By encouraging widespread employee ownership in the United States, we would be making good on our promise of a better life for our people and challenging other nations to do likewise. Such an approach could provide the leadership that is needed to encourage other nations to move our way rather than follow the Socialist path."

To his credit, Senator Long understood that the primary purpose of ESOPs—what Congress sanctioned—was a socially improved technique of corporate finance that also serves as a new type of employee benefit, not as a retirement vehicle:

"The ESOP's primary purpose, however, is not to serve as a retirement vehicle but, rather, to serve as an incentive for corporations to structure their financing in such a way that employees can gain an ownership stake in the company for which they work."

Today, we know that ESOPs have not delivered on Senator Long's promises of improving American foreign policy or boosting our economy in the ways envisaged by Senator Long. And as for providing substantial employee benefits to rank-and-file workers … well I wonder if Enron's ex-employees think ESOPs succeeded there?

ESG Investing for 'Collateral Benefits'

Second, ESG considerations have now been included in DOL regulations. The term "ESG" was formally coined in a 2004 United Nations report titled "Who Cares Wins." Today, ESG is a hotly contested issue with one side arguing that ESG factors may improve investment returns and the other side arguing that consideration of "non-pecuniary factors" muddies investment decisionmaking and hurts American workers and their families. The view focusing on "pecuniary factors" was adopted in regulations enacted by the last Republican administration. The view incorporating ESG was later adopted by the current Democratic administration, overriding the prior regulation. The current regulation is being challenged in district court in Texas.

DOL's latest regulation touches on ESG both directly and indirectly. Directly, it posits that ESG factors may be relevant risk-return factors and, therefore, fiduciaries may consider ESG factors in making investment decisions just likely any other risk-return factors. Section (b)(4) of the regulation provides: "Risk and return factors may include the economic effects of climate change and other environmental, social, or governance factors on the particular investment or investment course of action, …."

Indirectly, ESG factors may be favored because, the regulation says, in situations where competing investments "equally serve the financial interests of the plan," fiduciaries may base their investment decisions on "collateral benefits." Section (c)(2) of the regulation provides: "If a fiduciary prudently concludes that competing investments, or competing investment courses of action, equally serve the financial interests of the plan over the appropriate time horizon, the fiduciary is not prohibited from selecting the investment, or investment course of action, based on collateral benefits other than investment returns. A fiduciary may not, however, accept expected reduced returns or greater risks to secure such additional benefits."

Note that the regulation does not define the term "collateral benefits." And so while the regulation and its introductory language are replete with language relating to ESG factors, nothing in the regulation itself limits "collateral benefits" to ESG factors. So could "collateral benefits" include other considerations? What about support for or opposition to abortion or gun manufacture? Can those also be considered "collateral benefit"? How is a fiduciary supposed to think about those questions? Frankly, I see no limit to the types of things that could be considered a "collateral benefit." What about improving access to Taylor Swift concert tickets? Why not?

And the regulation does not simply open up consideration of non-investment factors to fiduciaries — it also opens consideration of participants' preferences by providing that fiduciaries may "take[] into account participants' preferences" in situations where competing investments equally serve the financial interests of the plan. Section (c)(3) provides, "The plan fiduciary of a participant-directed individual account plan does not violate the duty of loyalty under paragraph (c)(1) of this section solely because the fiduciary takes into account participants' preferences in a manner consistent with the requirements of paragraph (b) of this section."

So, what happens if participants support or oppose pornography or alcohol (thinking about the latest beer controversy)? How are fiduciaries supposed to handle those issues? Should fiduciaries buy or dispose of Bud Light (Anheuser-Busch InBev SA/NV) stock, regardless of their own thoughts about a certain social policy of the company, because the participant wants to do so? The answer would seem to be yes because, as DOL notes, "If accommodating participants' preferences will lead to greater participation and higher deferral rates, then it could lead to greater retirement security, as suggested by the commenters." Again, I see no limits to the types of things that participants could "prefer." And, if my daughters were any barometer, any investment related to Taylor Swift's music would definitely count as a preference.

Not Helping Adversary Countries

Third, Congress is now considering barring tax-subsidized investments in firms tied to "foreign adversaries." On June 12, 2023, Reps. Mike Gallagher (R-Wis.) and Jim Banks (R-Ind.) introduced the Protecting Americans' Retirement Savings Act (PARSA), which would amend ERISA to block pension plans from making new investments in companies controlled by or based in "foreign adversary" countries (Iran, North Korea, Russia, and China) and to require disclosure of existing investments in foreign adversary and sanctioned entities. This law, if enacted, would vastly expand on Executive Orders already barring investments in securities relating to a number of Communist Chinese Military Industrial Companies.

The proposed law absolutely bars a plan from "acquiring an interest" in a sanctioned entity and broadly defines "interest" to include "any interest" (presumably, no matter how small) held directly, indirectly, or derivatively by a plan through a financial instrument or contractual arrangement. So, whether the interest, no matter how minimal, is held as part of a mutual fund investment, through a brokerage window account or through any other investment product, it would be barred. And, if Plan fiduciaries knew, or should have known, of such investments, they would be in violation of ERISA's fiduciary obligations and, presumably, subject to the full range of remedies (losses, attorney's fees, etc.) should participants suffer losses on those investments.

And, the proposed law does not stop at barring plans from obtaining any financial interest in the barred entities. It goes even further by broadly barring fiduciaries from "transferring, directly or indirectly, to or for use by or for the benefit of such an entity" "any data" with respect to any plan participant or beneficiary. So, fiduciaries, your service provider has an agreement to sell participant lists to third-party vendors? Your plan administrator has outsourced your recordkeeping overseas? Double (triple) check your vendors and their subcontractors. Make sure those lists and your plan data aren't going somewhere they shouldn't. Or you may be liable.

The Future of Conscientious Investing?

During my more than 30 years at DOL enforcing ERISA, the plan investment and plan administration universe became larger and more complex and more tied to the changing social fabric of America. I consider myself fortunate to have been a part of DOL's enforcement history and to have been involved in many of its cutting-edge issues and matters (Enron included). Today, ERISA's evolution has not slowed down one bit. DOL is seeking public comment on its proposal. Congress just recently announced its own ESG proposal. More issues will arise. While plan participants want to build their retirement security, they also want to use the economic power they have to influence social policy. Like the issues I have reflected on here, I see many more exciting and interesting areas to explore.

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Author Information

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