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Memorandum

To:	FCPS 457 Investment Committee and FCPS Staff
From:	Aon Investments Team Greg Fox, Maggie Uhlein
Date:	November 23, 2020
Re:	**Fiduciary Considerations Following the DOL's Final Rule on ESG Investments**

Background

On October 30, 2020, the U.S. Department of Labor (DOL) released its final rule to amend the regulation governing "investment duties" under *the Employee Retirement Investment Security Act of 1974 ("ERISA"). This was following a 30-day comment period, where the DOL received 8,700 public comments from a variety of parties.* In its June 2020 proposed rule, the Department reiterated its view that defined contribution plan fiduciaries must not sacrifice returns, increase risks, or raise costs in order to pursue non-pecuniary objectives or policy objectives, such as environmental, social, and governance (ESG) investing. While there are still questions about how and whether the rule will be implemented in its current form, the "final" guidance reiterates that plan sponsors subject to ERISA have a fiduciary duty of care and adds that, as a minimum requirement to fulfill that duty, fiduciaries must evaluate investments based solely on "pecuniary" or financial factors, and should not sacrifice returns or increase risk to "promote non-pecuniary goals."

Final DOL Guidance

Based upon our initial review of the final rule, we have identified the following four key changes from the *proposed rule*:

1. The text no longer refers explicitly to "ESG" investments. It was determined that, "the lack of a precise or generally accepted definition of "ESG," either collectively or separately as "E, S, and G," made ESG terminology not appropriate as a regulatory standard."

2. The final rule does not explicitly prohibit the selection of a fund that uses ESG factors as a plan's qualified default investment alternative (QDIA). However, the final rule does stipulate that a fund is not appropriate as a QDIA if its stated objectives or its principal investment strategy includes, considers, or indicates the use of one or more non-pecuniary factors. For example, addressing climate change itself, rather than addressing climate change's impact on the financial outcomes of investors.

3. The DOL removed the objective-only criteria and removed the documentation requirement. It is also important to note in the preamble, the DOL states that they doubt the concept of a "tie" is relevant when adding a designated investment alternative to a participant directed plan.

4. Clarification was provided that fiduciaries must give "appropriate consideration" to the facts and circumstances relevant to the particular investment, including how the investment compares to "reasonably available alternatives with similar risks." The DOL wanted to avoid suggesting that fiduciaries must scour the marketplace or look for an infinite number of funds and instead focus on a prudent process where fiduciaries consider a set of options.

Considerations for Fiduciaries

As a result, our understanding is that the final rule requires the following:

1. As a minimum requirement for meeting the standard of loyalty and fiduciary care, fiduciaries must evaluate investments and investment courses of action based "solely on pecuniary factors and based on appropriate investment horizons."

2. Fiduciaries cannot sacrifice returns or increase risk to promote non-financial goals, which might include environmental or social causes.

3. Fiduciaries must consider reasonably available alternatives as part of their duty of fiduciary care.

4. If a fiduciary uses non-financial factors to choose among investments that are otherwise indistinguishable financially, the rule requires documentation proving that such decisions were made with appropriately careful "analysis and evaluation."

5. The rule does not categorically prohibit investments that support non-financial goals if the plans allow participants and beneficiaries to choose from a broad range of investment alternatives. However, fiduciaries still must satisfy the prudence and loyalty provisions in ERISA and in the final rule, which means pecuniary interests must still be served.

6. Qualified default investment alternatives (QDIAs) must be chosen based on financial factors and QDIAs that utilize one or more non-pecuniary factors are prohibited.

7. The final rule also includes a provision that gives fiduciaries until April 30, 2022 to make any changes that are necessary to comply with the requirements related to the selection of qualified default investment alternatives

Conclusion

The final rule has been submitted to the Office of Management and Budget (OMB) and is scheduled to take effect in 60 days. The results of the 2020 election, which currently signal a change in administration, as well as potential legal action, may delay, vacate or otherwise change the ruling.

We will continue to provide updates, as needed.

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