

INTENTIONAL SUSTAINABLE RETIREMENTS INITIATIVE

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GUIDE TO  
**Sustainable  
Retirements**

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**Intentional  
Endowments  
Network**

*An initiative of  
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# GUIDE TO Sustainable Retirements

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## WE THANK

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Hermes** 

  
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# PERFORMANCE MODULE

## Guide to Sustainable Retirements

### — OVERVIEW —

This guide is designed to provide practical information relevant to plan sponsors, human resources and finance officers and personnel, advocates, employees, investment advisors, legal scholars, and others. The guide aims to address misconceptions related to the use of Environmental, Social, and Governance (ESG) funds in retirement plans. In addition, this guide contains modules on fiduciary duty concerns, a how to guide for plan sponsors evaluating the addition of adding ESGs to retirement plans, and steps outlining how to advocate for ESG integration in retirement plans.

**This Performance Module is designed to address the issue of ESG performance in defined contribution retirement plans.**

## Module Summary

Sustainable investing does not sacrifice financial performance. ESG performance should no longer be an issue for retirement plan decision makers if they carefully consider the merits and applicability of each fund and apply the relevant financial and ESG expertise. Any ESG fund that is offered, like all funds considered for inclusion in a retirement plan, should first meet the financial criteria established in the Investment Policy Statement when selecting funds. Hiring advisor firms who understand this process and understand the value of ESG funds, is an important step in evaluating the performance of ESG funds.

This performance module is designed to:

- Answer the question: Does sustainable investing require a tradeoff in performance?
- Provide factual information and aid in examining the issues surrounding the performance of ESG funds in retirement plans to help shape thinking about the efficacy of adding ESG funds to retirement platforms in the future.

This module considers the following for 401(k), 403(b), and other similar defined contribution plans as it relates to **performance**:

- Plan sponsors and other market participants have a misperception that ESG funds have underperformed in comparison to the performance of the general mutual fund marketplace;
  - Studies indicate that ESG performance holds up well against the general mutual fund industry.
  - Studies show that ESG funds actually add value to performance.
- “Over the past several years and especially in 2020, sustainable funds have outperformed their conventional peers,” according to [Jon Hale](#) at Morningstar. However, despite the many studies available, only 3% of 401(k) plans have an ESG fund according to the [Plan Sponsor Council of America](#); a fraction of plan assets (a tenth of 1%) are held in such funds.

Until recently, there has been a common misperception among decision makers and plan sponsors that selecting ESG funds for inclusion in retirement plans risked sacrificing investment performance relative to other mutual funds. Decision makers, CIOs and fiduciaries of 401(k), 403(b), or similar plans, only sought funds they considered “high performers.”

There have been over 2,000 studies designed to understand the relationship between ESG criteria and corporate financial performance. [Based on a review by Sustainable Finance and Investment research](#), “90% of all studies showed a non-negative relationship, indicating that the inclusion of ESG factors did not affect performance. In fact, the majority of the studies reported a positive relationship, indicating that ESG criteria **improved** market performance.”

These misconceptions, coupled with the lack of reliable information, have been major obstacles to the inclusion of sustainable investment options in retirement plans. In many cases, decision makers are not asking their advisors to consider ESG funds. Moreover, inconsistent regulations and guidance from the U.S. Department of Labor (DOL) have further complicated the decision process.

[The Morgan Stanley Study](#) of over 10,000 funds found:

1. There is no financial tradeoff in the returns of sustainable funds and traditional funds. No consistent or statistically significant difference in total returns existed between ESG-focused and traditional mutual funds and ETFs.
2. Sustainable funds may offer lower market risk. Sustainable funds experienced a 20% smaller downside deviation than traditional funds, a consistent and statistically significant finding.

The Morgan study, along with others, indicate that a comparative analysis between ESG Funds and other mutual funds bolsters favorable perceptions of sustainable investing, which are becoming more widely accepted among investors and asset managers, who see potential for sustainable portfolios to yield attractive financial returns, alongside positive environmental or social impact.

#### ***What about during different market cycles? How do ESG funds perform during a recession or long-term volatility?***

The same Morgan Stanley study referenced above found that “in years of turbulent markets, such as 2008, 2009, 2015 and 2018, sustainable funds’ downside deviation (a measure of downside risk that focuses on returns that fall below a

minimum threshold or minimum acceptable return) was significantly smaller than traditional funds.” Based on this information, adding ESG funds to a retirement plan lineup, appears to be financially prudent.

In addition, ESG integration practices are employed by investment managers seeking to broaden the scope of investment analysis to include consideration of material risks not always captured in traditional analysis. Accordingly, the managers are seeking to improve financial outcomes. Appropriately, when funds are being considered in a retirement plan, ESG funds should at least be part of the conversation and analysis, as ESG funds seek to improve financial outcomes with an appropriate risk/return analysis

**The overarching sentiment of note that Green and others point out is that ESG funds are less volatile as originally thought, particularly as **ESG-related strategies are increasingly outperforming the market.****

#### ***What about in 2020, a year with a Pandemic that wreaked havoc on economies across the globe, and had a tremendous first quarter selloff?***

Nigel Green, CEO of financial advisory firm DeVere, found that the [average fund incorporating ESG factors](#) recorded only half the drop experienced by the US S&P 500 Index during the first quarter of 2020. ESG funds are typically less volatile, which is a major reason why they withstood the first quarter drop in 2020. This is true even when you evaluate target date funds. For example, the [Natixis Sustainable Future 2035 Fund](#) returned 15.56% by year end 2020, compared to 12.79% for the S&P 500 Target Date 2035 TR USD Fund.

The overarching sentiment of note that Green and others point out is that ESG funds are less volatile as originally thought, particularly as ESG-related strategies are increasingly outperforming the market. These strategies include carefully selected funds focusing on their core objectives while being less volatile.

Sustainable funds outperformed traditional peer funds and reduced investment risk during coronavirus in 2020.

The [Morgan Stanley Study](#) found that:

U.S. sustainable **equity** funds **outperformed** their traditional peer funds by a median total return of *4.3 percentage points*.

U.S. sustainable **taxable bond** funds **outperformed** their traditional peer funds by a median total return of *0.9 percentage points*.

U.S. sustainable **equity** funds' median **downside deviation** was *3.1 percentage points less* than traditional peer funds.

U.S. sustainable **taxable bond** funds' median **downside deviation** was *0.4 percentage points less* than traditional peer funds.

[Jon Hale's 2021 February blog](#) noted that the better relative performance of ESG funds in 2020 “is tied to their emphasis on companies with better ESG profiles and their thematic alignment with the accelerating transition to a low-carbon economy. In 2020, sustainable funds demonstrated that investing with an emphasis on how a company manages material ESG risks and how it manages key stakeholders can produce better returns in an uncertain economic setting.” In a year like no other, most ESG funds weathered the year better than non-ESG portfolios.

With robust evidence showing the favorable risk-return of ESG funds, sponsors have good reason to consider ESG options to their plans. As the DOL provides more regulatory clarity, employee requests for ESG funds become louder, and plan decision makers become more educated on ESG investing, plan fiduciaries should feel comfortable evaluating ESG options, just as any other plan option, for inclusion in their fund lineups. ■

## FURTHER READING

[It's Time to Think Sustainably](#) ([www.ishares.com](http://www.ishares.com))

[DOL Paves the Way for ERISA Plan ESG Investments in Final “Pecuniary Factor” Rule](#) ([www.natixis.com](http://www.natixis.com))

[Sustainable Signals: Individual Investor Interest Driven by Impact, Conviction and Choice](#) ([www.morganstanley.com](http://www.morganstanley.com))

[The Evolving Defined Contribution Landscape Alternatives & ESG as Long-Term Solutions for Long-Term Challenges](#) ([www.pgim.com](http://www.pgim.com))

[COVID-19 & Its Impact on ESG](#)

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## ESG EXPERTS TO FOLLOW

[Megan Starr](#), the Global Head of Impact for The Carlyle Group

[Marty Walsh](#) as Secretary of Labor

[Brian Deese](#) as the head of the National Economic Council

[Satyam Khanna](#) will serve as Senior Policy Advisor for Climate and ESG (SEC)

[Nigel Green](#), CEO of financial advisory firm DeVere

[Kary A. Moore](#), Senior Corporate Counsel and Senior Vice President

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# PLAN SPONSOR MODULE

## The Guide to Sustainable Retirements

### — OVERVIEW —

This guide is designed to provide practical information relevant to plan sponsors, human resources and finance officers and personnel, advocates, employees, investment advisors, legal scholars, and others. The guide aims to address misconceptions related to the use of Environmental, Social, and Governance (ESG) funds in retirement plans. In addition, this guide contains modules on fiduciary duty concerns, a how to guide for plan sponsors evaluating the addition of adding ESGs to retirement plans, and steps outlining how to advocate for ESG integration in retirement plans.

**This Plan Sponsor module serves as a guide on adding ESG funds to retirement plans.**

## Module Summary

How does an employer begin to evaluate whether the addition of ESG funds in a retirement plan makes sense? In 2015, Maureen Kline, as the Sustainability Officer of Pirelli for North America, faced that very question when a sustainability leader asked, “Does Pirelli have socially responsible funds for investing in the retirement plan? Her first thought was, do I even know? And why have I never thought of that? She approached the head of Pirelli’s Human Resources and raised the question. The head of HR then asked their recordkeeper and eventually their investment advisor firm. The advisor firm was also not familiar with ESG funds and conducted extensive research. During that time, Maureen was added to the Retirement Committee, conducted her own research, and continued to raise questions about the addition of ESG funds. Based on her research, her belief was that ESG funds could provide employees with enhanced retirement outcomes. The advisor firm conducted additional research and found that ESG performance has actually been very strong compared to the general mutual fund industry. After several meetings

evaluating ESG costs and performance, the Committee added one ESG fund to their platform in 2017. Employees were sent messages about the new addition, and the ESG fund at Pirelli was born. Since that time, the fund has been one of the best performing funds on their retirement plan platform.

Maureen’s journey illustrates the challenges many companies face when considering ESG funds in their retirement plans and provides an excellent example of how to overcome them. Pirelli went through a deliberate process to determine how and if ESG funds would be a positive addition to their retirement plan platform. To help you gain a better understanding of how to address the ESG question, this module provides a five-step process on how you can implement ESG funds at your organization; very much like the one followed by Maureen and her colleagues at Pirelli.

Included at the end of the module is a summary appendix summarizing the five-steps, along with definitions of terms to aid you in your review.

The following is a five-step process that you can follow to add ESG funds to your retirement plan line-up.

## 1 Gain a Basic Understanding

The first step is to gain an understanding of the benefits of ESG funds in retirement plans and increase your knowledge of ESG investing by asking some of these questions.

Based on your level of knowledge about ESG funds, there are various questions to ask:

- Why should ESG funds be considered for your retirement plan?
- What is the current regulatory environment regarding ESG funds?
- Are socially responsible funds the same as ESG funds? Are they inherently riskier?
- Should I be concerned about the performance and fees of ESG funds?
- Is it feasible to use ESG funds as a Qualified Default Investment Alternative (QDIA)?

The first step in addressing these questions is to increase your knowledge of the benefits of ESG funds. As noted in the introduction, Maureen did her own initial research. The best way to start is to identify existing resources within your firm. Is there an investment committee or Chief Financial Officer who can provide perspectives and feedback? Have any senior management staff worked at other organizations where ESG funds were offered? Has the ESG question been raised in prior Committee meetings? Are there any prior minutes on ESG discussions? Looking inward is a good place to start your quest for information.

If you have an outside investment advisor, you should involve them in your plans, and ask them to research ESG funds that may be appropriate for your retirement plan. If you do not have an investment advisor firm, then this may be the time to hire one. Even once you hire a firm, if you do not raise the ESG question, it may never come up. A recent [Cerulli report](#) notes that more than half of U.S. advisors, say they do not bring up ESG investment options unless prompted by their clients.

If you decide to hire an advisor firm, make sure you focus on issues of importance to your organization. Inquire about

their investment expertise and their ESG experience, as well as any research they may have conducted on ESG and sustainable funds. You can also look into their process for evaluating ESG funds and the success they've had in conducting searches for ESG managers. As you evaluate advisors, be sure to consider other qualities, such as their qualitative and quantitative approach to monitoring investment options, as well as their fees.

In terms of the regulatory environment, there has been a lot of discussion about the confusion caused by the Department of Labor (DOL) in terms of guidance. This of course has caused plansponsors to take a wait and see approach on how things are going to evolve. However, at the time of this writing, a [report by Federated Hermes](#) released in May of 2021, written by Brad Campbell from Faegre Drinker Biddle & Reath LLP, makes it clear that, the "DOL is purposefully sending a clear signal that ESG investing can be appropriate for ERISA plans, and that fiduciaries should not avoid prudent investments utilizing ESG factors." This guidance does send a message that plansponsors should not be afraid to consider adding ESG funds to their retirement platform.

### The best way to start is to identify existing resources within your firm.

As a starting point for implementation, it is important to have a baseline level of understating of ESG terminology as noted below:

- **Socially Responsible Investing (SRI)** was the most popular approach earlier in the decade and is now really considered the "old school" approach. SRI takes an avoidance or elimination approach, as these are portfolios that do not allow alcohol or tobacco companies, or companies that produce guns. They are generally not viewed as the best choice in the ESG universe.
- **ESG Integration** is the analysis of all material factors in investment review and decisions, including environmental, social, and governance (ESG) factors.
- **Impact Investing** places an emphasis on selecting investments that will have a positive impact on a specific environment or social issue.



- **Proxy Voting** allows investors to voice their values by exercising shareholder rights. Funds that bring an ESG methodology to their voting practices can help steer the companies they invest in towards more sustainable practices.
- **Engagement** is active dialogue which allows investors to understand risk and advocate positive change at the company/issuer level

In a [recent study conducted by PGIM](#), plan sponsors were asked about use of ESG investments in their plans. The study found that nearly a quarter of plan sponsors indicated they have not taken action to incorporate ESG approaches into the plan over the past three years, while more than half said they have. There was greater interest in incorporating ESG approaches for mid-sized plans with \$500 million to \$999 million in assets under management.

This Toolkit has a separate section on the performance of ESG funds that you should review, to address common misperceptions around performance tradeoffs. It's a good place to gain some additional knowledge that should be helpful in your journey.

The main objective is to do your homework and gain enough of an understanding to ask the right questions.

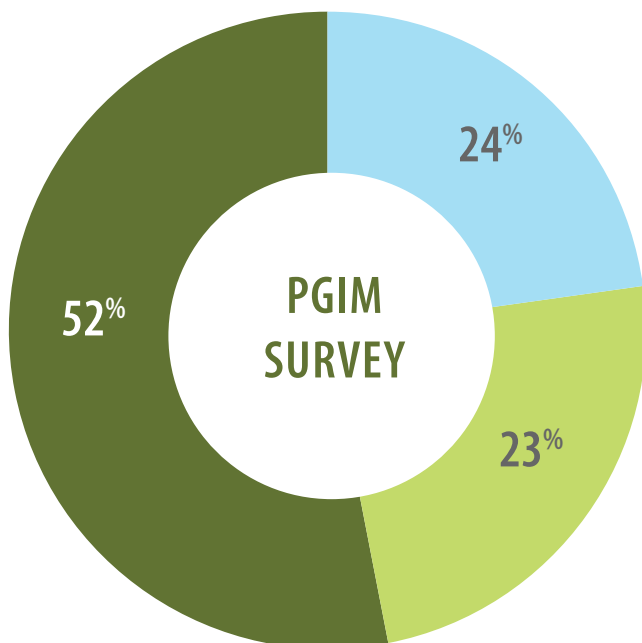
The survey results highlighted the demand from employees to invest in **retirement options that aligned with their values and beliefs.**

## 2 Examine the Interest of Your Employees

How much should employee interest influence fund selection? Would employees use the funds if they were added to the platform?

It is important to determine if employees would be interested in having these funds on the investment platform and determining whether adding to and/or replacing current funds with ESG funds is the way to go. Considering the following options are also a part of this step:

- Adding one ESG fund
- Adding a sleeve of ESG funds
- Adding an ESG default option/QDIA
  - o Model portfolio comprised of other funds
  - o Target date funds



- Plan sponsors who have not taken action to incorporate ESG approaches into the plan over the past three years
- Plan sponsors who have taken action to incorporate ESG approaches into the plan over the past three years
- Neutral

A survey of employees is always an option to consider. Asking such questions as their desire to invest in retirement funds that align with climate or social justice outcomes is a good place to start. In 2019, [Natixis conducted a plan participant study of employees](#) in defined contribution retirement plans. The survey revealed that adding an ESG fund can be a major incentive to boost plan participation. Sixty-one percent (61%) of participants indicated they would be more likely to contribute, or increase contributions, if they knew their investments were doing social good. The survey results highlighted the demand from employees to invest in retirement options that aligned with their values and beliefs.

As discussed in this [2017 report from AsYouSow](#), a real estate services firm had a low employee participation rate of 14%. The firm discovered (through a survey) that employees did not feel the investment lineup represented their interests. The firm addressed this by adding social and environmental funds. The addition of these ESG funds increased participation from 14% to 95% in two years!

### 3 Implementation (Selecting Funds for Consideration)

Hiring the right investment advisor firm can make a significant difference. Many recordkeepers have open platforms, some with over 10,000 funds to choose from. Finding the right ESG fund(s) to add can be a major task. It helps to have in mind the type of fund(s) you want selected and the costs to add funds based on the fees of the recordkeeper. Too many times, investment menus have 30 or 40 funds, and employees are paralyzed by too many options. [A recent report examines this very problem of “paralysis by analysis”](#) of too many investment options in retirement plans. A more modest selection of 15-20 thoughtfully selected funds can make the process more manageable for your employees and will likely result in a better decision-making experience for them.

As you approach the implementation process, much thought should be given to the selecting of funds. Some things one may want to consider in building a list of candidate funds includes such questions as:

- What if any ESG funds are available on the existing platform?
- What are the available third-party resources available for fund ratings, including ESG scores, Morningstar, AsYouSow, and others?

- What’s the voting record of the fund, or what’s the impact on investing?
- How does the fund fit in your existing menu in terms of style?
- Does the decision of adding a fund come at the expense of deleting another fund?
- What type of outcome would satisfy both fiduciary duties of loyalty and prudence, and participant’s desires?

These are just a few of the type of issues to evaluate as you conduct the implementation process, as you should examine the right mix of adding ESG funds to the platform.

Once the decision is made to move forward, all appropriate documents should be updated including the organization’s Investment Policy Statement (IPS). The IPS serves as the document that guides the investment decisions related to your retirement plan. Plan fiduciaries utilize the IPS for decision making related to the investment lineup, including the use of ESG or sustainable funds that are included in the investment lineup. The IPS serves as a critical part of the compliance process as you build any investment lineup.

### 4 Communicate and Educate Employees

All plans covered by or following ERISA must follow a process to communicate plan changes to employees prior to the change taking place. That process should be followed when offering ESG funds. The education and communication efforts should be especially robust. This education should be married with other information, such as the importance of saving and long-term investing. There have been instances when organizations add new funds, and a brief communication is delivered but employees are left on their own to do their homework. We believe all employee communication on funds offered in a retirement plan should have education included about the fund. That communication should come from the employer as employees typically pay more attention to communication that comes from their employer. For example, communication about a new growth fund should include communication on the type of investments in the portfolio, or how the fund is designed to include companies who are positioned for future growth. If it happens to also be an ESG fund, an additional comment can be included that the fund is also

focused on environmental issues and is considered an ESG fund. When employees have better communication and understanding about their investment options, it allows them to make better personal decisions.

## 5 Monitor the Funds

All funds in your investment menu should be monitored for performance, strategy adherence and fees on an ongoing basis. There should be benchmarks for each investment, and a process should be followed in each case to mitigate risk for the organization and for the participants. ESG funds should be subject to the same performance review and benchmarking as other funds on your platform. You may also wish to review these ESG funds in your plan for their adherence to the environmental, social, and governance objectives they outline in their prospectuses and marketing material. Analysis of the investments should be documented and provided to an internal committee that provides oversight of the plan.

## Qualified Default Investment Alternatives (QDIA) options

QDIAs have become a popular plan feature for plan sponsors to ensure employees are enrolled in plans when they have not finalized their enrollment choices. Typically, these options are target date funds. Target date funds have become a powerhouse in workplace retirement plans and very popular amongst new enrollees. Plan sponsors/fiduciaries should take a hard look at criteria that platforms use to make their own decision. There are only a few ESG focused target date funds, and they should be assessed for performance, fees,

and glidepath, like any other target date funds. You should establish a process to compare and select target date funds based on these type of criterion.

Companies perceive ESG funds as a litigation risk due to so many 401(k) and 403(b) lawsuits that have taken place over the last few years. However, simply adding ESG funds on an investment platform to meet the ESG screening, is not the right approach. Any ESG fund that is offered, should first meet the financial factors established in the Investment Policy Statement when selecting funds through the plan's prudent process.

This all means that a thorough review of funds must always take place when considering ESG funds for a retirement lineup, and that includes target dates funds as well as other investment alternatives.

Finally, Plan Sponsors have the fiduciary duty under Employee Retirement Income Security Act of 1974 (ERISA) to diversify plan investments and administer the plan in the best interest of participants and beneficiaries. Given the significant impact that climate change and social inequity can have on economic outcomes, it can be argued that not considering ESG funds could be a breach of fiduciary duties.

Whether you handle the process internally or in partnership with your investment advisor, the process should be well thought out and recorded in writing for the protection of your plan, participants and organization. Following these steps can help you make good investment decisions for your plan, minimize the risk of regulatory and legal issues, and take real steps to provide retirement security for your employees and a better future for all. ■

## FURTHER READING

[ESG Investing After the New Labor Department Rule on “Financial Factors”](https://clsbluesky.law.columbia.edu)  
(<https://clsbluesky.law.columbia.edu>)

## ESG EXPERTS TO FOLLOW

[Brad Campbell](#) – Partner Faegre Drinker

[Rob Sitkoff](#) – John L. Gray Professor of Law, Harvard Law School

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## APPENDIX A

### Five-Step Process to add ESG funds to your retirement plan line-up.

1. Gain a Basic Understanding
2. Examine the Interest of Your Employees
3. Implementation (Selecting Funds for Consideration)
4. Communicate and Educate Employees
5. Monitor the Funds

## APPENDIX B

### Definitions

**ESG Fund** A Fund that integrates ESG Factors in its portfolio analysis in order to obtain superior returns without undue risk.

**Qualified Default Investment Alternative (QDIA)** QDIA is a default investment used when money is contributed to an employee's retirement account, but the employee has not made their investment election as it is done automatically for them.

**Sustainable Investing** Is described as focusing on impact, or environmental, social, and governance (ESG) factors in its investing. ESG concerns must be central to its investment process and the fund's intent should be apparent from a simple reading of its prospectus. In particular, the Principle Investment Strategies section of the fund's prospectus should contain enough detail to leave no doubt that ESG concerns figure prominently in the fund's investment process.

**The Employee Retirement Income Security Act (ERISA) of 1974** Is a federal United States tax and labor law that establishes minimum standards for pension plans in private industry. It contains rules on the federal income tax effects of transactions associated with employee benefit plans.

# FIDUCIARY DUTY MODULE

## The Guide to Sustainable Retirements

### — OVERVIEW —

This guide is designed to provide practical information relevant to plan sponsors, human resources and finance officers and personnel, advocates, employees, investment advisors, legal scholars, and others. The guide aims to address misconceptions related to the use of Environmental, Social, and Governance (ESG) funds in retirement plans. In addition, this guide contains modules on fiduciary duty concerns, a how to guide for plan sponsors evaluating the addition of adding ESGs to retirement plans, and steps outlining how to advocate for ESG integration in retirement plans.

**This Fiduciary Duty Module is designed to address Fiduciary concerns that have arisen in the consideration of ESG in 401(K) and 403(b) defined contribution retirement plans.**

## Module Summary

The consideration of sustainable investing and potential incorporation of ESG into Defined Contribution plans has created concern on the part of plan sponsors as to the potential fiduciary duty implications. These concerns have been fostered by the perception that the U.S. Department of Labor's position on the Employee Retirement Income Security Act's (ERISA) consideration of environmental, social and governance factors in investing has alternated, depending on the US Presidential Administration.

To address the ramifications of considering ESG on fiduciary duty, the attached analysis was commissioned by CERES, the Environmental Defense Fund and the Intentional Endowments Network.

Its author, Bradford P. Campbell is a partner at Faegre Drinker Biddle & Reath LLP and nationally recognized figure in employer-sponsored retirement plans who served as Assistant Secretary of Labor for Employee Benefits and head of the Employee Benefits Security Administration from 2006-2009 where he operated as the ERISA's primary Federal regulator. He provides his insights on the current state of any duty in the attached analysis.

Please note, we recognize that the DOL is likely to propose new guidance and regulation applicable to ESG-related investments during the Fall of 2021. As such, we will endeavor to update this analysis as warranted.

... concerns have been fostered by the perception that ....  
**environmental, social and governance factors in investing has alternated,** depending on the US Presidential Administration.

## Executive Summary

While global and domestic interest in sustainable investing continues to set new records, private sector retirement plans subject to the Employee Retirement Income Security Act (“ERISA”) have not kept pace. Only a small percentage of ERISA-covered retirement plans are utilizing ESG investments, despite growing interest in sustainable investing from workers participating in retirement plans and employers sponsoring them. Why?

The answer appears to be, in large measure, because many ERISA retirement plan fiduciaries are unsure how ERISA’s fiduciary standards apply to such investments. Even though the U.S. Department of Labor (“DOL”), which regulates and enforces ERISA’s fiduciary requirements, has provided relatively consistent guidance and regulation applicable to ESG-related investments for nearly 30 years, its 2020 regulation, “Financial Factors in Selecting Plan Investments,” muddied the fiduciary waters.

- **Perception and Confusion:** Perceived as an anti-ESG regulation, the Financial Factors rule created a new fiduciary test for all investment factors, including ESG—fiduciaries generally may consider only factors deemed to be “pecuniary” (having a material effect on the investment during the time period the plan will hold the investment). “Non-pecuniary” factors could be considered only when pecuniary factors did not determine a clear outcome. This new test resulted in significant confusion, as ESG factors can be pecuniary or non-pecuniary.
- **Suspension and Replacement:** Citing confusion among fiduciaries—including the false perception that ESG factors present more fiduciary risk—and concern that the new Financial Factors rule was chilling appropriate ESG investing by ERISA plans, DOL took the unusual step of suspending enforcement of the rule in March, only two months after it went into effect. The White House issued an Executive Order in May directing DOL to write a new proposed regulation in September 2021, urging it to “...identify actions that can be taken under...relevant laws to protect the life savings and pensions of United States workers and families from the threats of climate-related financial risk.” While the new proposal is a priority for DOL and very likely will encourage ESG-investing by ERISA plans, the regulatory process takes time, and any new rule will not be finalized until well into 2022.
- **Fiduciaries Do Not Have to Wait for the New Rule:** ESG-related investments can be prudent for ERISA plans now. By employing a thorough, well-documented fiduciary process taking into account all relevant factors, and reviewing ESG-related investments using the same process and criteria as any other investment, fiduciaries may prudently select ESG-related investments (see Appendix).

This white paper examines the history of DOL fiduciary guidance and regulation related to ESG and its predecessors, and addresses how plans may prudently invest in ESG-related investments today.

## **Introduction:**

Global and domestic interest in sustainable investing, including the integration of environmental, social and governance (“ESG”) factors, reached record highs yet again in the first quarter of 2021. Globally, nearly \$2 trillion is invested in sustainable funds, and net inflows to these funds in the United States doubled in the first quarter of 2021 compared to the same period a year ago.<sup>1</sup>

It’s hardly surprising that demand continues to grow. Organizations increasingly desire to match their investment process with their organization’s values. In a recent survey, 57% of institutional investors utilizing ESG strategies in 2020 reported that they do so “to align investment strategies with organizational values.”<sup>2</sup> Further, strong short and long term performance of sustainable funds shows that sustainable investing is delivering real economic value. Sustainable funds outperformed their non-ESG peers in seven of the last ten years, and averaged 4.6% growth compared to 1.1% growth in the first quarter of 2021.<sup>3</sup>

U.S. institutional investors have been slower to embrace ESG than their European counterparts, but that trend is reversing—a recent survey found that 42% of U.S. institutional investors incorporated ESG factors into investment decisions, and 30% of those that had not were considering doing so.<sup>4</sup>

The notable exception, however, is private sector retirement plans. According to the *63rd Annual Survey of Profit-Sharing and 401(k) Plans* by the Plan Sponsor Council of America, less than 3% of surveyed retirement plans included ESG-related investment options for their participants.<sup>5</sup> This low take-up rate persists despite significant participant interest—another recent survey found that 9 out of 10 defined contribution retirement plan participants who were aware of their plan’s ESG options invested in those funds, and of those participants who did not have access to ESG options, 69% said they would or might increase their overall contribution rate if offered ESG options.<sup>6</sup>

*“...less than 3% of surveyed retirement plans included ESG-related investment options for their participants...despite significant participant interest—another recent survey found that 69% [of plan participants] said they would or might increase their overall contribution rate if offered ESG options.”*

Why are private sector retirement plans lagging so far behind other institutional investors despite the interest of their plan participants in having access to ESG options?

<sup>1</sup> “Sustainable Fund Flows Reach New Heights in 2021’s First Quarter,” Morningstar, Alyssa Stankiewicz, April 30, 2021. These figures reflect only flows into mutual funds and Exchange-Traded Funds identified as sustainable funds by Morningstar—assets related to other investment vehicles and services not subject to the Investment Company Act of 1940 utilizing ESG-related investment factors and strategies are not included in these reports.

<sup>2</sup> “2021 ESG Investor Insights Report,” Natixis Investment Managers, David Goodsell, April 21, 2021.

<sup>3</sup> “Sustainable fund inflows hit record high in Q1 – Morningstar” (citing Refinitiv Lipper data), by Simon Jessop and Patturaja Murugaboopathy, Reuters, April 30, 2021.

<sup>4</sup> “Callan’s 8th Annual ESG Survey Shows Record Number Considering ESG in Future Investment Decisions,” Callan, October 6, 2020.

<sup>5</sup> “63rd Annual Survey of Profit-Sharing and 401(k) Plans,” Plan Sponsor Council of America, December, 2020 (surveying 602 plans reporting on their 2019 experience).

<sup>6</sup> “Could ESG Options Boost 401(k) Participation?” NAPA Net Staff, National Association of Plan Advisors Net Daily, May 13, 2021.

A significant factor is likely the lingering concern and confusion regarding whether ESG investments are compatible with the Employee Retirement Income Security Act (“ERISA”),<sup>7</sup> the Federal law governing private sector retirement plans. Though the U.S. Department of Labor (“DOL”), which regulates and enforces the fiduciary provisions of ERISA, issued guidance permitting ESG-like investments as far back as 1994, new regulations promulgated in 2020 under the Trump Administration created concern among some plan fiduciaries that ESG investments increased fiduciary liability risk. In 2021, the DOL under the Biden Administration moved quickly to allay these concerns, suspending enforcement of the 2020 rule and beginning work on a new regulation to replace it. However, despite the clear endorsement of prudent ESG investing by DOL, many ERISA fiduciaries still have questions about whether and how their plans may adopt sustainable investing.

In this paper, we will explain what the ERISA fiduciary duties are, what nearly 30 years of DOL guidance and regulation permitting sustainable investing actually said, and outline how fiduciaries may incorporate ESG into their ERISA plans today through a prudent, thorough, and well-documented investment selection process.

### **What is ERISA, and to Which Investors Does it Apply?**

ERISA is the Federal law governing pension, health and other employee welfare benefits provided by private-sector employers. It was passed with two primary goals—to protect the basic pension benefits of ordinary workers, and to promote the formation of employee benefit plans through a uniform set of Federal rules. ERISA succeeded on both of these fronts.

*“According to DOL data, there are about 722,000 ERISA-covered retirement plans, providing benefits to nearly 140 million people, and holding nearly \$10 trillion in assets...how ERISA applies to sustainable investing is significant to the wider adoption of ESG-integrated investing in the U.S.”*

To protect retirement benefits, ERISA provides favorable tax treatment for “qualified” plans and establishes minimum benefits, vesting rules and other participant rights and remedies. ERISA also created a new type of fiduciary duty, rooted in trust law, to ensure decisions were made solely for the benefit of the participants and beneficiaries of the retirement plan. Courts have described ERISA’s fiduciary duty as “the highest known to law.”<sup>8</sup>

Further, ERISA plans have proliferated since the law’s passage in 1974, and now play a very significant role in U.S. capital markets. According to DOL data, there are about 722,000 ERISA-covered retirement plans, providing benefits to nearly 140 million people, and holding nearly \$10 trillion in assets.<sup>9</sup> As these numbers illustrate, how ERISA applies to sustainable investing is significant to the wider adoption of ESG-integrated investing in the U.S.

<sup>7</sup> 29 U.S.C. §1001 et. seq.—citations to ERISA provisions will refer to the Act, not the U.S. Code (i.e. ERISA §404(a) rather than 29 U.S.C. §1104(a)).

<sup>8</sup> *Donovan v. Bierwirth*, 680 F.2d 263, 272 n.8, (2d Cir. 1982).

<sup>9</sup> “Private Pension Plan Bulletin, Abstract of 2018 Form 5500 Annual Reports” Employee Benefits Security Administration, U.S. Department of Labor, January 2021.



## • **Types of Plans and Employers Covered by ERISA**

ERISA applies to benefit plans offered by private sector employers to their employees—this includes non-profit organizations, such as private charities or private schools and universities.<sup>10</sup> It does not apply to governmental entities, such as state agencies, or public schools and universities.<sup>11</sup> ERISA can apply to employers affiliated with religious organizations (termed “church plans” regardless of creed), but the law allows “church plans” to opt-out from many ERISA provisions, including its fiduciary standards.<sup>12</sup>

Despite the fact that ERISA does not apply to governmental plans, many state laws governing such plans use similar fiduciary standards, and the large body of ERISA law and guidance often influences the behavior of governmental plan boards, trustees and advisors.<sup>13</sup> The National Association of State Retirement Administrators, whose members are the directors of the nation's state, territorial, and largest statewide public retirement systems, noted that “Although public pension plans are not subject to ERISA, many public pension plans rely on ERISA interpretations as a key source of guidance regarding fiduciary standards.”<sup>14</sup> It is not uncommon, in fact, for some governmental and church plans to voluntarily follow ERISA’s requirements as a “best practice” or guide for their own conduct.<sup>15</sup>

Common types of plans covered by ERISA include 401(k) plans, profit-sharing plans, traditional defined benefit pension plans, and some 403(b) plans sponsored by private entities, like private schools and universities (403(b) plans sponsored by governmental entities are not subject to ERISA). Sponsoring an ERISA-covered retirement plan is voluntary, and employers have considerable latitude in deciding what type of plan to offer, as well as its features and benefits beyond the minimum requirements.

### **The Role of the ERISA Fiduciary:**

ERISA protects plan participants by imposing strict legal duties on the plan’s fiduciary—the person (or committee or other entity) who makes decisions for the plan. These fiduciary duties are defined by the ERISA statute, as well as in numerous regulations and guidance documents issued by the Employee Benefits Security Administration (“EBSA”), the agency within DOL charged with regulating and enforcing ERISA.

## • **What Makes You a Fiduciary?**

A person can be a fiduciary either by position or by action. The “named fiduciary” is the person or entity identified and charged with these responsibilities in the plan document. The “plan document” is a

<sup>10</sup> Note that ERISA applies only to the employer’s benefit plans—for example, ERISA likely would apply to the management of assets in a charitable foundation’s retirement plan for its employees, but it would not apply to the management of the assets in the foundation’s endowment.

<sup>11</sup> See., ERISA §3(32).

<sup>12</sup> See., ERISA §§3(33) and 4(b)(2).

<sup>13</sup> State and local government retirement plans are subject to the U.S. Tax Code and to relevant state laws. These laws differ from state to state, and can include state constitutional provisions, specific retirement plan statutes, statutes enacting ERISA-like standards, and statutes enacting the Uniform Trust Code, the Uniform Prudent Investor Act or the Uniform Fiduciaries Act.

<sup>14</sup> See., National Association of Retirement Plan Administrators website, Topics, ESG at [www.narsa.org/esg](http://www.narsa.org/esg), accessed on June 6, 2021.

<sup>15</sup> See., e.g., “Best Practices for Confident Plan Compliance,” TIAA, July 2020; “Although some plans may not be subject to ERISA’s fiduciary requirements, it is widely recognized that satisfying those requirements—even for a non-ERISA plan—is a recommended best practice.”

written document required by ERISA that describes the terms and conditions for administering the plan, as well as participants' rights, benefits, and obligations within the plan. For example, the plan document might identify the CFO or an "investment committee" as the named fiduciary responsible for investment decisions. However, to ensure someone is always responsible for protecting participants, ERISA also imposes functional fiduciary status—any person, regardless of title, becomes a fiduciary to the extent that person exercises discretion over plan assets or plan administration.<sup>16</sup> In other words, the person or entity that actually makes investment decisions for the plan, such as deciding whether sustainable investments are available on the 401(k) plan's menu, is an ERISA fiduciary.

- **Fiduciary Duties and Procedural Prudence**

Fiduciaries must act "solely in the interest" of the plan's participants, and for the "exclusive purposes" of providing benefits and defraying the reasonable expenses of administering the plan.<sup>17</sup> They must also act in accordance with the law and "the documents and instruments governing the plan," and diversify plan investments.<sup>18</sup>

The core of ERISA's fiduciary duty is procedural prudence, often referred to as the "Prudent Man" rule (in 1974, Congress did not use gender neutral terms, and Congress has not updated this portion of the statute). It states that fiduciaries must carry out their responsibilities "with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise with like character and like aims."<sup>19</sup>

*"...fiduciaries are judged not on whether their decision proves to be correct in hindsight, but on the process they used to arrive at a decision. Fiduciaries are not guaranteeing investment performance when they make investment decisions—rather, their responsibility is to gather the necessary information, ask the necessary questions and consider the appropriate issues in making the decision."*

This legal standard means that fiduciaries are judged not on whether their decision proves to be correct in hindsight, but on the process they used to arrive at a decision. Fiduciaries are not guaranteeing investment performance when they make investment decisions—rather, their responsibility is to gather the necessary information, ask the necessary questions and consider the appropriate issues in making the decision.

DOL regulations further interpreting these investment selection duties explain that the fiduciary has met the prudence requirement if the fiduciary "has given appropriate consideration to those facts and circumstances that ... the fiduciary knows or should know are relevant to the particular investment or investment course of action involved ... [and] has acted accordingly."<sup>20</sup> In other words, fiduciaries must consider all relevant factors in making an investment decision.

<sup>16</sup> See., ERISA §3(21).

<sup>17</sup> ERISA §§404(a) and 403(c)

<sup>18</sup> ERISA §404(a)(1)(C) and (D).

<sup>19</sup> ERISA §404(a)(1)(B)

<sup>20</sup> 29 C.F.R. §2550.404a-1(b).

Fiduciaries first need to determine whether they possess the necessary investment expertise, and if not, to seek the assistance of an expert. It is common for ERISA plans to engage investment professionals to either recommend or to directly manage investments.<sup>21</sup> Many plans decide to adopt a voluntary document that describes the process by which that plan will make investment decisions, commonly called the investment policy statement (“IPS”).

Though ERISA does not require a plan to adopt an IPS, many plans work with their advisors or legal counsel to develop one because it becomes the roadmap for the plan’s procedural prudence—it describes how the plan will evaluate, select and monitor plan investments. For example, though it is not necessary that the IPS specifically address ESG issues, a plan could choose to describe the process by which it will consider climate or other kinds of ESG-related factors in making investment decisions.

- ***Fiduciary Issues and ESG: The “Why” and the “How”***

With respect to sustainable investing, the debate about incorporating climate considerations or other ESG factors into ERISA plans has focused on how to meet two key duties: to act solely in the interest of the plan, and to employ procedural prudence. The debate over acting solely in the interest relates to “why” the plan is including ESG—is it for the participants’ benefit or to serve other interests? Can other interests be considered at all? The debate about procedural prudence relates to “how” the plan selects specific investments—can ESG factors be relevant to the economic analysis, and how are they considered?

### **ERISA and Sustainable Investing: Nearly 30 Years of DOL Guidance and Regulation**

For many plan sponsors, plan fiduciaries and plan participants, their first exposure to the issue of prudently selecting ESG-related investments was the flurry of articles and controversy resulting from the Trump Administration’s 2020 regulation, “Financial Factors in Selecting Plan Investments.” As discussed in more detail below, this rule was perceived to be anti-ESG, and caused some fiduciaries to view ESG-related investments with some trepidation. In fact, the Biden Administration cited fiduciary confusion about the rule and the chilling effect it was having on appropriate ESG investing by ERISA plans as reasons for suspending enforcement of the Financial Factors rule, and for announcing DOL’s intention to replace the Financial Factors rule with a new regulation.

The reality, though, is that these issues are not new. DOL actually has a long history of guidance prior to the Financial Factors regulation. In reviewing that history of guidance, an interesting pattern emerges—while there is no doubt that each Presidential Administration had very different concerns about how ESG and similar investments could or should be used by ERISA-covered retirement plans, (Democratic administrations tended to encourage wider use, while Republican Administrations tended to warn against misuse), the actual policy adopted in the various iterations of the guidance was remarkably consistent.

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<sup>21</sup> A non-discretionary investment adviser recommending investments to the plan is often known as a 3(21) investment adviser, while an investment professional to whom discretionary investment authority is formally delegated by the plan is known as a 3(38) investment manager. Either approach is permissible under ERISA—some plan fiduciaries wish to retain final decision-making authority while others prefer to delegate.

- **Three Consistent Themes Described in Inconsistent Tone and Terminology**

Since 1994, DOL has issued four guidance documents and one regulation regarding the prudent selection of ESG-like investments. Part of the confusion regarding this history is that each version had a very different tone, and used different terminology that evolved over time.

For example, the first two documents referred to “economically targeted investments,” a term that includes what later documents called ESG-related investments. Further, guidance documents issued under Presidents Clinton and Obama emphasized that such investments are appropriate for ERISA plans, and focused on how and why ERISA fiduciaries may select them. Documents issued under Presidents Bush and Trump allowed that such investments may be prudent, but emphasized the care fiduciaries should exercise when selecting them, and focused on the documentation required to justify fiduciaries’ actions if they did select such investments.

However, despite these tonal differences, the documents generally agree on three basic points, and arrive at essentially very similar underlying policy positions. Here are the three basic themes:

1. **ESG as a Collateral Benefit:** A particular investment that is prudent based on its non-ESG characteristics may also possess ESG features. These ESG features are a permissible “collateral benefit” that may be used to help decide among otherwise prudent investments, but they are not relevant to the initial fiduciary analysis of the prudence of the investment;
2. **ESG as a Relevant Factor:** Some ESG factors may be directly relevant to the fiduciary analysis of the investment. Rather than its ESG features being only a collateral benefit, a particular ESG investment could be prudent if selected based both on its ESG and non-ESG characteristics where these factors are material to the financial analysis of the investment; and
3. **Regardless, Investments Must Be Prudent:** Any investment has to meet the basic requirements of procedural prudence—when evaluated based on all relevant factors, the investment has to be prudent, regardless of any ESG factors. A particular ESG investment could be imprudent even though its ESG factors were appropriately considered because other factors made it imprudent for the plan (for example, unreasonably high fees or expenses). The investment cannot be selected if it likely would increase risks or reduce returns relative to other options available to the plan.

The final version of the controversial Financial Factors regulation is also consistent with these themes, but the very different rhetoric and tone surrounding the Trump Administration’s rule illustrates why confusion remains.

While the details of the final rule are discussed in more detail below, it is important to understand, that as a purely legal matter, all three of these outcomes are possible under the final Financial Factors rule. An ESG factor could be what the rule calls “pecuniary,” and therefore appropriately be considered as a directly relevant factor in the analysis of the investment. An ESG factor could be what the rule called a “non-pecuniary” factor, and therefore considered only as a collateral benefit, used as a tie-breaker but not otherwise considered in the analysis. And, finally, of course, an investment could fail to be prudent based on ESG and/or non-ESG reasons.

In fact, the final regulation took great pains to avoid mentioning “ESG” specifically—the term does not appear in the operative text of the regulation. Instead, the final Financial Factors rule states that any factor used to make an investment decision must be “pecuniary” (i.e. material to the financial analysis of the investment during the time frame the plan would likely hold the investment). It does not draw a distinction between an ESG factor and any other factor, such as past performance, tenure of the investment manager, fees, etc.

However, the rule was perceived to be anti-ESG because the Preamble (the narrative accompanying and explaining the operative text, providing context for interpreting the rule) focused on applying the “pecuniary” test virtually only to ESG factors. The Preamble uses the term “ESG” 346 times even though the regulatory operative text does not use the term even once. It is this heavy emphasis on ESG factors and the skeptical tone of the Preamble that led DOL to conclude the rule was chilling appropriate ESG investing, creating a false perception that ESG investments have a higher level of fiduciary risk.

As the Biden Administration prepares a new rule that likely will build on these three themes and encourage more ESG investing by plans, it is instructive to review how the evolving guidance addressed these three themes over time.

- ***What is “Sub Regulatory” Guidance?***

First, what is the difference between a sub regulatory guidance document and a regulation? Briefly, when a Federal regulatory agency provides guidance, it is stating its views on a matter under its jurisdiction, but it has not issued a legally binding regulation. The guidance typically has not gone through public notice and comment rulemaking, and is not entitled to the judicial deference afforded a regulation. Due to the legal complexity and procedural requirements of promulgating a binding regulation, many federal agencies, including DOL, issue sub regulatory guidance as a fast way to provide clarity on technical or ambiguous issues. However, because guidance is just a statement of agency views, it also can easily be rescinded or modified by the agency in the future.

The first three guidance documents discussed below are Interpretive Bulletins (“IB”). IB’s are a formal type of guidance document, published in a special section of the Code of Federal Regulations, but despite this formality they are not binding regulations. The first IB was rescinded and replaced by the second, and the second IB was rescinded and replaced by the third. The fourth guidance document, called a Field Assistance Bulletin (“FAB”), is a lesser form of guidance. It did not rescind the third IB, but it sought to interpret its application. A FAB is essentially a publicly-released internal memo from DOL, written by the director of EBSA’s regulatory division to the director of EBSA’s enforcement division, providing an explanation of how to apply the views in the IB for enforcement purposes.

### **Interpretive Bulletin Establishes the “Collateral Benefit” Analysis:**

Since ERISA’s passage, a key issue has been what “solely in the interest” means in practice. Courts generally have interpreted the statute to establish a very high bar for fiduciary conduct. Well-known and often quoted decisions state that a fiduciary must act with “...complete and undivided loyalty to the

beneficiaries,”<sup>22</sup> and “...with an eye single to the interests of the participants and beneficiaries.”<sup>23</sup>

But does this mean that a plan fiduciary is prohibited from making investments that, though otherwise prudent, would offer “collateral benefits”—i.e., benefits to parties other than the plan participants? Or is it sufficient that the investment is prudent for the plan, allowing the fiduciary to consider collateral benefits in selecting from among equally prudent plan investments?

The issue presented itself almost immediately. In 1976, DOL was asked whether multiemployer pension plans (plans that provide benefits to union members in industries like construction) could invest in construction loans. These loan proceeds would fund construction projects hiring union workers, providing a collateral benefit to the union (as well as to plan participants).

Assuming the loans were otherwise prudent, were the plan fiduciaries nonetheless prohibited from making the loans? Or was the collateral benefit permissible if the loans were good investments? In this instance, DOL agreed to permit such loans as plan investments, subject to additional conditions intended to ensure the loans were of sufficient quality that a bank would be willing to engage in the same transaction.<sup>24</sup>

What followed were years of individual requests concerning the same core issue—if the plan is getting a prudent investment, can the investment offer other benefits beyond those accruing to the plan?

- ***Interpretive Bulletin 94-1 (“IB 94-1”) Articulates Collateral Benefit and Reiterates Prudence***

Finally, DOL decided in 1994 to issue the first comprehensive guidance document answering the collateral benefit question. Introducing a new term, “economically targeted investments” (“ETI”), DOL approved the collateral benefit approach as long as the investment was otherwise prudent.

*“...the fiduciary standards applicable to ETIs [a term that includes what is now called ESG] are no different than the standards applicable to plan investments generally.”*  
—IB 94-1

Specifically, DOL defined ETIs as “...investments selected for the economic benefits they create apart from their investment return to the employee benefit plan.”<sup>25</sup> These could include a wide range of “collateral benefits” from investment in the local community to environmental considerations. However, DOL also wrote that the “solely in the interest” fiduciary obligation prohibited, “...a fiduciary from subordinating the interests of participants and beneficiaries in their retirement income to unrelated objectives.”<sup>26</sup> The IB also noted that, “...because every investment necessarily causes a plan to forgo other investment opportunities, an investment will not be prudent if it would be expected to provide a plan with a lower rate of return

<sup>22</sup> *Donovan v. Mazzola*, 716 F.2d 1226, 1238 (9th Cir. 1983) (quoting *Freund v. Marshall & Ilsley Bank*, 485 F. Supp. 629, 639 (W.D. Wis. 1979)).

<sup>23</sup> *Donovan v. Bierwirth*, 680 F.2d 263, 271 (2d Cir. 1982).

<sup>24</sup> See., Prohibited Transaction Exemption 76-1, Part B. While this exemption provided relief for the prohibited transaction of extending credit to a party in interest, the loan had to be prudent under ERISA Sec. 404(a) as well. DOL later cited this as an example of an investment that was prudent despite producing a collateral benefit in Interpretive Bulletin 94-01.

<sup>25</sup> 59 Fed. Reg. 32,607 (June 23, 1994).

<sup>26</sup> *Id.*

than available alternative investments with commensurate degrees of risk or is riskier than alternative available investments with commensurate rates of return.”<sup>27</sup> The guidance concluded by noting that, “the fiduciary standards applicable to ETIs are no different than the standards applicable to plan investments generally.”

The effect of this guidance was to permit what we would now call ESG considerations as collateral benefits that could be considered, while reminding fiduciaries that investments must otherwise be prudent, and that collateral goals can never be elevated above the participants’ economic interests.

- ***Interpretive Bulletin 2008-01 (“IB 08-1”) Retains Collateral Benefit and Prudence Concepts, But Clarifies Use and Documentation***<sup>28</sup>

In 2008, the Bush Administration became concerned that the guidance in IB 94-1 could be construed too broadly, allowing the desire for the collateral benefits of the ETI to subordinate the interests of the participants in their retirement income. To address this, DOL rescinded IB 94-1 and issued a new

Interpretive Bulletin stating that an ETI should only be permissible if it is economically equivalent to the non-ETI investment option, and plays the same role in the plan’s portfolio. Further, the guidance indicated the Department’s expectation that the fiduciary would document the basis for determining economic equivalence when it chose an investment based on collateral benefits.

*“[IB 08-1] represented a shift in tone and imposed a new documentation requirement [but] nonetheless retained and reinforced the basic holding of IB 94-1—that collateral benefits were appropriate to consider and did not render the investment imprudent.”*

This represented a shift in tone and imposed a new documentation requirement to demonstrate that the ETI investment selected actually was equivalent to the alternative investment it displaced. However, IB 08-1 nonetheless retained and reinforced the basic holding of IB

94-1—that collateral benefits were appropriate to consider and did not render the investment imprudent. The text specifically noted that ERISA does not provide a means for distinguishing between equally prudent investments, and thus collateral benefits were a permissible and reasonable means to do so.

### **Interpretive Bulletin Establishes the “Directly Relevant” Analysis:**

A major shift in DOL’s guidance came in 2015. In addition to adopting a tone more supportive of ESG, the Obama Administration acknowledged for the first time that ESG can be a relevant factor with which to assess the prudence of investments directly.

- ***Interpretive Bulletin 2015-01 (“IB 15-1”)***

DOL explained that it decided to rescind IB 08-1 for a familiar reason—its chilling effect on ESG. DOL wrote that the narrower view of the equivalence standard was “dissuading fiduciaries from...pursuing investment strategies that consider environmental, social, and governance factors, even where they are

<sup>27</sup> Id.

<sup>28</sup> In the interest of full disclosure, the author promulgated IB 08-01 while serving as U.S. Assistant Secretary of Labor for Employee Benefits.

used solely to... identify economically superior investments.”<sup>29</sup>

In IB 15-1, DOL preserved the ETI collateral benefit analysis, and removed the additional document requirement. More importantly, it added the new relevant factor analysis. Finding that ESG factors could be material to the analysis of the investment, DOL wrote, “Environmental, social, and governance issues may have a direct relationship to the economic value of the plan’s investment. In these instances, such issues are not merely collateral considerations or tie-breakers, but rather are proper components of the fiduciary’s primary analysis of the economic merits of competing investment choices.”<sup>30</sup>

*“The effect of [IB 15-1] was that ESG could now be a passenger in the otherwise prudent investment vehicle under a collateral benefit analysis, or be a driver as a material factor in the fiduciary analysis of the investment vehicle.”*

The effect of this guidance was that ESG could now be a passenger in the otherwise prudent investment vehicle under a collateral benefit analysis, or be a driver as a material factor in the fiduciary analysis of the investment vehicle.

- **Field Assistance Bulletin 2018-01 (“FAB 18-1”)**

The first round of DOL guidance during the Trump Administration in FAB 18-1 foreshadowed some of the issues later found in the Financial Factors rule, but did surprisingly little to change the Obama Administration’s guidance. FAB 18-1 did not rescind IB 15-1, but sought to clarify its application on two points.

First, the FAB reiterated that ESG factors can be relevant factors, but its tone suggested skepticism about how often that should occur. It stated that a fiduciary should use “generally accepted investment theories” and determine that the ESG factor likely will have a “material effect on the return and risk of an investment based on appropriate investment horizons consistent with the plan’s articulated funding and investment objectives” before concluding it is a relevant factor.

Second, the FAB suggested (but did not directly state) that “ESG-themed” investments were unlikely to be appropriate for use as Qualified Default Investment Alternatives (“QDIA”). These are investments into which participants are defaulted when they fail to give investment direction, and are widely used in connection with the automatic enrollment of participants. The guidance expressed concern that using collateral benefits to select the QDIA for a participant substitutes the fiduciary’s values and preferences in collateral benefits for the participants’ values, and may therefore “...raise questions about the fiduciary’s compliance with ERISA’s duty of loyalty.”

The effect of this guidance was primarily a shift in tone—it reiterated the underlying principles of IB 15-1 that collateral benefits are permitted and that ESG can be a relevant factor, but warned that ESG factors are not automatically relevant and required more scrutiny of the circumstances in which ESG issues would be considered relevant. The QDIA guidance served more as a statement of concern than actual guidance—the FAB did not actually state that using ESG in a QDIA was inappropriate.

<sup>29</sup> 80 Fed. Reg. 65,136 (October 26, 2015).

<sup>30</sup> Id.



## **The First Regulation—the “Financial Factors” Rule**

The Trump Administration decided that guidance alone was not sufficient to address its concerns about what it saw as the inappropriate use of ESG, so it proceeded to propose an actual regulation addressing ESG in 2020.

- ***A Controversial Proposal Receiving Negative Public Comments***

Promulgated rapidly in 2020, the “Financial Factors in Selecting Plan Investments” rule started as an attempt to regulate ESG-related investments specifically, a break with prior guidance. The proposed regulation did not prohibit ESG factors, but it did single them out for additional fiduciary process and scrutiny not required of other types of investments. It also effectively prohibited ESG-related investments from being used in connection with QDIAs.

Thousands of comments from across the spectrum of interested parties objected to the proposal’s treatment of ESG factors. As a result, the final rule was materially changed. As discussed above, the final regulation was a mismatch of tone and legal effect. Legally, the final rule ended up being reasonably consistent with previous guidance.

Instead of singling out ESG factors for specific scrutiny, the regulatory text required that all factors (ESG or otherwise) used to select an investment must be “pecuniary” (i.e. a fiduciary must determine the factor would have a material effect on the investment during the time period the plan would hold it). “Non-pecuniary” factors could be present in an investment prudently selected based on its pecuniary factors, but could not be the basis for its selection. However, “non-pecuniary” factors could be used break ties between equivalent investments where pecuniary factors alone did not result in a final investment choice, with additional documentation. The final rule did still contain a provision making it difficult to use ESG-related investments as QDIAs.

Thus, the net effect was largely consistent with prior guidance. The “pecuniary” use of ESG was permissible (ESG could be a directly relevant factor), and the “non-pecuniary” use of ESG (as a collateral benefit) was permissible in certain circumstances.

The tone, however, remained very skeptical of ESG. In fact, the tone caused press articles and many observers to perceive the final rule as limiting ESG well beyond its actual legal effect.<sup>31</sup>

## **The Second Regulation—Biden Administration Suspends and Plans to Replace the Financial Factors Rule, Encourages ESG Investing**

The Biden Administration’s response to the Financial Factors rule has been robust, pushing ERISA and ESG investing issues to the forefront of public policy debate about ERISA and the potential financial impact of issues like climate change.

First, the Biden Administration issued a January 20, 2021 Executive Order<sup>32</sup> directing the DOL to review

<sup>31</sup> See., e.g. “Trump Labor Department’s Rule Discouraging ESG Investing in Retirement Plans is Finalized Over Swell of Objections,” by Rachel Koning Beals, Marketwatch, October 30 2020.

<sup>32</sup> “Executive Order on Protecting Public Health and the Environment and Restoring Science to Tackle the Climate Crisis,” January 20, 2021.

the Financial Factors rule as part of a government-wide review of rules related to environmental policy. In response, DOL decided on March 10, 2021 to suspend enforcement of the Financial Factors rule.

Explaining why it suspended enforcement of the rule, DOL reported that a “wide variety of stakeholders, including asset managers, labor organizations and other plan sponsors, consumer groups, service providers and investment advisers” told the agency that even though the Trump rule had only been in effect for two months, it “...already had a chilling effect on appropriate integration of ESG factors in investment decisions...”<sup>33</sup> The acting head of EBSA stated that “These rules have created a perception that fiduciaries are at risk if they include any environmental, social and governance factors in the financial evaluation of plan investments,”<sup>34</sup> and went on state the DOL’s intention “...to conduct significantly more stakeholder outreach to determine how to craft rules that better recognize the important role that environmental, social and governance integration can play in the evaluation and management of plan investments...”<sup>35</sup>

*“[DOL] intend[s] to conduct significantly more stakeholder outreach to determine how to craft rules that better recognize the important role that environmental, social and governance integration can play in the evaluation and management of plan investments...”*  
*—Ali Khawar, Acting Assistant Secretary, EBSA*

Then, on May 20, 2021, the White issued a second Executive Order that directed DOL “...to consider publishing, by September 2021, for notice and comment a proposed rule to suspend, revise, or rescind...” the Financial Factors rule. Part of the motivation for this directive is concern that the Financial Factors rule left some ERISA plan fiduciaries with the false impression that integrating ESG factors into investment decisions is risky or imprudent. In fact, the Biden Administration is quite likely to embrace ESG-related investing in the new rule, as the new Executive Order went even further, asking DOL to “...identify actions that can be taken under...relevant laws to protect the life savings and pensions of United States workers and families from the threats of climate-related financial risk.”<sup>36</sup>

- **Climate-Related Financial Risk, Procedural Prudence and the Proposed Regulation**

While the Trump Administration’s Financial Factors rule sparked debate about whether and how ESG factors could be prudently considered, it is likely that the Biden Administration’s proposed regulation will spark debate regarding whether fiduciaries have an obligation to consider such factors, especially with respect to climate-related financial risk.

During the Financial Factors rule comment period, DOL received many submissions providing articles, papers and studies that argued a favorable correlation between consideration of ESG-factors and investment performance and risk. Since last year, additional reports and studies regarding climate

<sup>33</sup> “US Department of Labor Releases Statement on Enforcement of its Final Rules on ESG Investments, Proxy Voting by Employee Benefit Plans,” Press Release 21-371-NAT, Employee Benefits Security Administration, March 10, 2021.

<sup>34</sup> Id.

<sup>35</sup> Id.

<sup>36</sup> “Executive Order on Climate-Related Financial Risk,” May 20, 2021.

change have been published, and likely will be provided to DOL in the course of considering the new rule proposal.

In addition to the DOL regulation, the SEC will shortly propose regulations likely to mandate and standardize reporting of climate information.<sup>37</sup> As such information becomes more readily available, and as regulatory standards provide some consistency and uniformity in that information, some commenters to the DOL proposal are likely to argue that generally accepted investment theories may require fiduciaries to consider such factors as a standard part of fiduciary investment review.

Other commenters are likely to disagree that climate risk is so broad-based that it is material other than in the case of certain industries or economic sectors, such as energy or heavy industries with regulatory and litigation risks related to pollution.

*“Fortunately, fiduciaries do not have to wait for DOL to complete its rulemaking to prudently consider ESG-related investments. Fiduciaries already have the tools they need to make these decisions...the same prudent, thorough and well-documented fiduciary process they have always used to make plan investment decisions...”*

While the Executive Orders suggest a significant interest by the Biden Administration in the financial risk posed by climate change, it is not clear how this concern would manifest itself in a specific policy position on the scope of fiduciary investment duty in the proposed regulation. Whether the proposal will expand on the principles in the prior guidance, clarifying that ESG factors are appropriate and can be directly material to fiduciary analysis, or whether the proposal will go farther, suggesting that fiduciaries should affirmatively consider such factors, remains to be seen.

It is likely that the new rule will be proposed in September 2021 as scheduled, given the high priority the Administration is placing on the rule. However, the regulatory process takes time, as it involves public notice and comment, revisions to the rule in response to comments, and other procedural steps. As a result, a final rule will likely not be completed until well into 2022.

If enforcement of the old rule is suspended, and the new rule is not yet written, where does that leave ERISA plan fiduciaries today? How can they address sustainable investing and make prudent decisions

about ESG right now?

### **Selecting Sustainable Investments in the Current Environment Using a Thorough, Prudent, and Well-Documented Fiduciary Process:**

There is increasing demand and interest in sustainable investing from both employers and employees. According to a 2020 survey by the Employee Benefits Research Institute, about 1 in 7 workers identified making “more environmentally or socially responsible investment options available” as the “most valuable improvement” their plan sponsor could make in their retirement plan.<sup>38</sup> Fiduciaries are

<sup>37</sup> See., Spring 2021 Unified Agenda of Regulatory and Deregulatory Actions, Securities and Exchange Commission, “Climate Change Disclosure” Notice of Proposed Rulemaking, RIN# 3235-AM87, scheduled for October 2021. (“The Division is considering recommending that the Commission propose rule amendments to enhance registrant disclosures regarding issuers’ climate-related risks and opportunities.”)

<sup>38</sup> 2020 Retirement Confidence Survey Summary Report, Employee Benefits Research Institute, April 23, 2020, pg. 47.

being asked to consider sustainable investing and ESG options in their plans on a regular basis.

Fortunately, fiduciaries do not have to wait for DOL to complete its rulemaking to prudently consider ESG-related investments. Fiduciaries already have the tools they need to make these decisions—ERISA fiduciaries should rely on the same prudent, thorough and well-documented fiduciary process they have always used to make plan investment decisions, and simply incorporate ESG-related investments into that process. Reviewing ESG-related investments with the same process as other types of investments will provide fiduciaries the tools needed to evaluate whether any particular investment—including those with ESG-related factors—can be prudent for their plans.

As this paper discussed above, the history of DOL’s treatment of ESG has, in fact, been very consistent despite differences in tone and terminology. Regardless of whether a particular administration was skeptical of ESG or embracing it, the actual policies promoted were quite similar. They agreed that the primary fiduciary obligation is to make prudent investments for the plan participants. They agreed that participants’ interests cannot be subordinated to other goals. They agreed that fiduciaries must employ a prudent process to evaluate investments taking into account all relevant factors. They agreed that ESG can be a relevant factor where it is material to the analysis of the investment. They agreed that ESG factors can be used to decide among equivalent investments already determined to be prudent.

While the DOL is developing a new fiduciary rule, fiduciaries can apply these principles by employing their normal investment process. The process should include contemporaneous documentation of committee meetings, investment advisor reports and other steps taken to as part of the process. The attached Appendix provides more detail on the fiduciary do’s and don’ts of ESG investing.

However, fiduciaries should remember that the Financial Factors rule still exists, even though it is not being enforced by DOL. Thus, it can be the basis for a private lawsuit by a participant or class of participants. For example, it would not be advisable to exclude from consideration all investments that are not ESG-related. It would be difficult to demonstrate that refusing to consider the majority of the investments available to the plan is a prudent decision.

### **Conclusion:**

Workers and leaders of private sector businesses and charitable organizations want greater access to investments that reflect their values and their commitment to a sustainable economy. The Employee Retirement Income Security Act (“ERISA”) does not stand in the way of adopting such investments—it provides a framework for prudently selecting ESG investments that will meet the needs of the plan as well as our global community. While DOL under the Biden Administration drafts new regulations encouraging ESG investments, plan fiduciaries may consider sustainable investments today by employing a thorough, prudent, and well-documented fiduciary process.

## About the Author

The Hon. Bradford P. Campbell, partner at Faegre Drinker Biddle & Reath LLP, is a nationally-recognized figure in employer-sponsored retirement plans. He counsels his clients in ERISA Title I issues, including fiduciary conduct and prohibited transactions.

Mr. Campbell served as Assistant Secretary of Labor for Employee Benefits and head of the Employee Benefits Security Administration from 2006-2009. As ERISA's former "top cop" and primary Federal regulator, he provides his clients with insight and knowledge across a broad range of ERISA issues, and also serves as an expert witness in ERISA litigation.

Mr. Campbell has been listed as one of the 100 Most Influential Persons in Defined Contribution by *401kWire* and has been listed as one of the top 15 ERISA attorneys in the country by a poll of the National Association of Plan Advisors. He has testified before Congress on employee benefits issues 11 times.



*This paper was commissioned by Ceres, a non-profit organization that works with capital market leaders to develop market-based and policy solutions to global sustainability challenges. Its views are those of the author, and do not necessarily reflect the views of Faegre Drinker or its clients.*

*This paper does not provide legal or investment advice. Plan fiduciaries should seek appropriate legal or other counsel to evaluate their specific circumstances and to determine what investments are prudent for their plans. Fiduciaries should understand the material differences in regulation, transparency, and portability, among other factors, between different types of investment vehicles and investment strategies.*

## Appendix

### Overview of a Prudent Fiduciary Process Considering ESG Investments

While DOL drafts a new regulation to replace the 2020 Financial Factors in Selecting Plan Investments rule, it has suspended enforcement of the Rule. It is not necessary to wait for DOL to complete the new rulemaking (which may not be finished until well into 2022) for ERISA plan fiduciaries to prudently select and monitor sustainable or ESG-related investments.

Though DOL has suspended enforcement of the Financial Factors rule, it still exists as a Federal regulation. In addition, the underlying ERISA statutory obligations of prudence and loyalty continue to apply. However, the good news is that fiduciaries don't need to jump through new hoops to prudently select ESG-related investments. In fact, if fiduciaries have been employing a through, prudent and well-documented investment process, they can prudently consider ESG-related investments by treating them as they would any other investments.

Fiduciaries must carry out their responsibilities “with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent [person] acting in a like capacity and familiar with such matters would use in the conduct of an enterprise with like character and like aims.” Fiduciaries should determine whether they need the expert assistance of investment advisors, and engage those experts as necessary. It is advisable, but not required, to adopt an investment policy statement (“IPS”) that will provide the blueprint for the plan’s prudent investment process.

The investment review process should take into account all relevant factors regarding the available investment alternatives, ESG or otherwise. Common factors a fiduciary should consider include:

- The costs associated with the investment;
- How the investment fits within the plan’s overall investment strategy and criteria;
- How the investment suits the needs of the plan’s participants;
- The past performance of the investment;
- Any restrictions or additional fees the investment imposes when entering or leaving the investment; and
- Whether such an investment is permitted by the plan documents

The fiduciary may also determine that ESG factors are relevant to the analysis and include them, or it may consider those ESG factors as collateral factors used to choose between two equivalent investments.

However, simply because a prudent process may readily consider ESG-related investments does not mean that all ESG-related investments are appropriate for ERISA plans. Here are several considerations that should cause fiduciaries to reassess whether their utilization of particular ESG investment is prudent:

- **Negative Screening**—It is not advisable to apply a broad “negative screen” related to ESG or other factors. The fiduciary has a responsibility to consider all the investments reasonably available to the plan—if the initial review simply excludes entire industry sectors, for example, the fiduciary cannot evaluate the economic impact of the investment opportunities that are being excluded to compare them to the investments the fiduciary may choose. There is a fundamental difference between incorporating ESG investments into the prudent process to be reviewed on the same basis as all other investments, and refusing to consider non-ESG investments.
- **Reviewing Descriptive Language in the Investment Document**—Fiduciaries must review and understand the investments they select. That includes reviewing the prospectus or similar investment disclosure document. If those documents express investment goals and objectives that are not consistent with ERISA’s requirements, they may not be prudent investments. For example, the Department of Labor initiated a series of investigations against plans and advisors in 2019 because they had invested in certain pooled investments. DOL believed the managers of those investments had disclosed that they would sacrifice returns or increase risks to achieve sustainability goals. While these investigations do not appear to have resulted in significant violations, they do illustrate the kind of factors that could support an allegation that the fiduciary subordinated the participants’ interests to collateral goals.
- **Monitoring**—Fiduciaries have a duty to monitor periodically the investments they make. Given that regulators in the United States are only beginning to consider standardizing disclosures related to ESG factors, fiduciaries should ensure they are monitoring their investments to understand any material changes in how the investment is using ESG-related factors. The U.S. Securities and Exchange Commission is taking public comments in preparation of developing a standard on ESG reporting, and officials have indicated that the Commission will move expeditiously on proposing regulations following the comment period.<sup>39</sup>

All investments should be reviewed on their merits to the plan. This permits fiduciaries to include sustainable investing in their process, and to select investments that meet the plan’s criteria for the investment menu. It does not permit prudent fiduciaries to exclusively consider ESG-related investments at the expense of non-ESG options.

ESG-related investments should be subjected to the same fiduciary process as all other plan investments. It would be imprudent to select an investment likely to increase risks or reduce returns regardless of whether it is ESG-related; for the same reasons, an investment favorably reviewed by a prudent fiduciary process is not imprudent simply because it is ESG-related.

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<sup>39</sup> “SEC to Move ‘Promptly’ on ESG Rulemaking in 2021, Official Says,” by Andrew Ramonas, Bloomberg Law, April 30, 2021.

# ADVOCATE MODULE

## The Guide to Sustainable Retirements

### — OVERVIEW —

This guide is designed to provide practical information relevant to plan sponsors, human resources and finance officers and personnel, advocates, employees, investment advisors, legal scholars, and others. The guide aims to address misconceptions related to the use of ESG funds in retirement plans. In addition, this guide contains modules on fiduciary duty concerns, a how-to guide for plan sponsors evaluating the addition of adding ESGs to retirement plans, and steps outlining how to advocate for ESG integration in retirement plans.

**This Advocates Module serves as a guide on how to determine what is in your Defined Contribution Plan and how to advocate for ESG funds inclusion in your retirement plan(s).**

### Module Summary

In the 2019 Natixis Defined Contribution Plan Participant Survey, seventy-five (75%) percent of the participants stated that they believe it is important to make the world a better place while growing their personal assets. In that same study, almost the same number (74%) see a profit motive, saying they believe that companies that provide clean water and clean energy present significant growth opportunities. Can employees truly have it both ways, where investments in companies that take a social stance, or focus on the environment, make for good long-term investments and increase investment portfolios? For years, the answer has been yes. Retirement plans have been adding funds that focus on the environment, social, and governance or ESG issues for many years. The question is:

#### How do You Bake ESG Funds in Your Retirement Plan?

#### Follow this Recipe for Success

In 2014, Professor Erica Frank found herself trying to invest her Emory University pension sustainably. She had served (including being President) on the national and local boards of Physicians for Social Responsibility for

over a decade and wanted to put her money where her mouth was. She created and circulated a [national petition](#) focused on TIAA-CREF, and then went to TIAA-CREF and requested a socially screened and low carbon fund to be made available for retirement investing. TIAA did some research and responded a year later with a [Low Carbon Social Choice Fund](#) that has as of June 2021, an asset value of over 850 million dollars.

**Can employees truly have it both ways, where investments in companies that take a social stance, or focus on the environment, make for good long-term investments and increase investment portfolios?**

She continued her efforts to invest aligned with her (and her institution's stated) philosophies after joining the University of British Columbia (UBC). This change took over a decade, but she remained persistent gathering



advocates and experts to help convince those who could make the decisions to include these funds. She and faculty/student colleagues repeatedly went to the university pension trust board and requested funds from companies that were low in carbon production. UBC returned with a [Fossil Fuel Free Fund](#) that came out in March 2020 that has outperformed the benchmark since inception, and over the last year. Dr. Frank continues to work to include ESG funds and to educate others on what they can do where there are to affect change. Included in Appendix A is a copy of the 2

## 1 Do Your Homework

You should first have a committed understanding as to why you want your employer to add ESG funds to the retirement plan. Is this just a benefit to you, or do you think investing in ESGs funds will have a larger benefit to the greater good? There is a wide range of social issues, including gender pay equity, diversity data disclosure, improving human rights policies, LBGT equality in the workplace, board diversity, and more, that are all characteristics that firms seeking to invest in ESG companies look for. If your desire is to ensure that your retirement portfolio includes companies that take positions in these areas, you need to do your homework. List and have the facts and data that support your commitment and be able to readily share with anyone who asks. And there is abundant [evidence](#) that supports that companies who do better on sustainability metrics also perform as well as, or better than, their peers financially.

## 2 Determine The Players

The key is to evaluate your campus and determine who you can talk to and create a coalition to suggest ESGs options. Gain an understanding of your plan's current fundamentals. If you are at a public university or college, decisions are made at the state level and it may take some time to find the right contact to listen to your request, and even longer to have a committee formed to review the request as legislation may need to be passed to eventually include ESG funds.

Just recently, however, the federal government's employee retirement plan (Thrift Savings Plan) announced that it will add a window for ESG funds in 2022. The push to add ESG funds into the Thrift plan (one of the largest defined contribution plans in the country) has been in the works for years and was finally approved in June of this year.

Today, we are seeing more millennials wanting to align their own values with those of their place of employment.

Therefore, you must have patience and be persistent but know the oven is heating up.

A good starting place is the head of human resources or the college's chief financial officer. One of the main contacts that you can identify, is the plan's investment advisor. The advisor typically works with the institution to evaluate and oversee all the funds on the retirement platform. In cases where there are unions, you need to also identify the head of the union. For some colleges, the Sociology or Law Departments may be a good place to explore other potential allies as these areas of discipline typically address deeper issues and provide a broader view of information. Some colleges also have sustainability and/or climate departments so you should evaluate if they exist at your school.

## 3 Lay Out A Game Plan

Once you have determined the players (step 2), you can start to find alignment with your objective. This is where the homework (step 1) you have done will come in handy. Adding more investments to any retirement plan takes time and is a process. More importantly, the people who oversee the plan are called fiduciaries, and they have a duty to add funds to the plan that will benefit employees and their beneficiaries, so just asking to add ESG funds will not be enough. However, you can impress them with your homework. For example, In June 2017, a Povaddo survey of employees revealed that 74% felt that having socially responsible funds offered in their retirement plan was important.

Today, we are seeing more millennials wanting to work for and align their own values with those of their place of [employment](#).

## 4 Find Responsible Party

Once you've done your homework and identified the players or gained a coalition on campus, now it's time to approach the decision-makers. Here are a sample of the types of the questions to ask the college's personnel who are in charge of the retirement plan:

- Could the institution add ESG options to the plan – particularly for the default option target date funds – in near future? If not, why not?
- Has the college considered adding ESG Funds in the past? If so, what was the outcome?
- What does it take to add ESG funds?
- Has the college surveyed the staff, or be willing to survey the staff, to see if there is an interest in ESG funds?
- Does the college have sustainability objectives related to endowment investments? Why not have them in the retirement plan?

- Are you aware of other colleges that have added ESG funds? What has been their experience?
- Is the college interested in climate or sustainability issues? In particular, has it made public commitments or set goals on issues such as Climate, Gender, Social Equity? If so, doesn't this approach to align values make sense?

## 5 Be Persistent

Be persistent. The process could take some time but you must continue to push your employer.

- Continue to gather data and information that is helpful.
- Continue to build your coalitions and support on campus and in your workplace.
- Continue to share information with the contacts you've made.

However, if you follow the steps we provided, you may be able to get the ESG options integrated into your plan sooner rather than later. ■

For instance, how do you find out who the responsible parties are for your plan?

## FURTHER READING

[Democrats' ESG Drive Fuels Lobbying Bonanza in Washington \(bloomberglaw.com\)](#)

[2020 Proxy Season Will See Heightened Focus On Environmental and Social Factors Amid Regulatory, Market and Economic Uncertainty \(streetinsider.com\)](#)

## ESG EXPERTS TO FOLLOW

[Karina Funk](#), Partner and Co-manager of Brown Advisory Large-Cap Sustainable Growth strategy (LCSG) and chair of sustainable investing

[Katherine Collins](#), Head of Sustainable Investing, Putnam Investors

## APPENDIX A

### How do You Bake ESG Funds in Your Retirement Plan?

**STEP 1:** Do Your Homework

**STEP 2:** Determine the Players

**STEP 3:** Layout a Game Plan.

**STEP 4:** Find Responsible Party

**STEP 5:** Be Persistent

## APPENDIX B

### Example of Correspondence to Colleagues/Professors

**Subject line: We want ESG funds to choose from!**

*Great news! A small group of professors who were frustrated by the lack of ESG funds available in the retirement plan, asked TIAA to provide one several years ago. TIAA listened, added our request to other inputs, and provided the Low Carbon Social Choice fund.*

*In addition to meeting broad environmental, social and governance criteria that are consistent with sustainability principles, ESG funds have demonstrated they are appropriate for retirement plans, and have the performance to prove it. Investment professionals have been tracking ESG funds for years, and many colleges, and other organizations, have added these funds to their retirement lineup.*

*Ask your university HR director to review ESG funds and make them available to you and your coworkers.*

*This approach can make a difference. University employees' retirement funds are typically even larger than universities' endowments. At University of Utah, for example, the university endowment is roughly \$1 Billion, and the employees' retirement funds are worth approximately \$3 Billion – which are heavily invested in [TIAA-CREF](#), the \$866 billion academicians' retirement fund.*

*Please, take a moment now to help your university take this important step to add ESG funds.*

## Example of Correspondence sent to HR Department

Dear \_\_\_\_\_,

*I learned recently that TIAA and other retirement vendors now have ESG funds available for retirement investments. However, I noticed that our plan does not yet offer ESG funds, even though this can happen easily via a request to our retirement plan vendor from our HR/benefits department. We've done some research and ESG funds can have solid performance, while focusing on clean water, energy, and other important environmental issues. The plan's investment advisor should be able to provide good examples of why ESG are viable retirement investment options.*

*I'm eager to see sustainable retirement options available for employees here, too, as it will make a big difference to our campus community, the security of our investments, the integrity of our institution, and the environment.*

*Many of our professor and staff are not aware of these type of investments, so I am more than happy to assist in any way possible, as we ask that you give us the opportunity to invest our retirement money in ESG funds of our choosing.*

Sincerely,

## RESOURCES

<https://humaninterest.com/blog/401k-plan-administrator-and-sponsor-duties/>

<https://www.tnrs.com/blog/what-businesses-need-to-know-about-401k-plan-sponsor-and-plan-administrator-responsibilities>

<https://www.shrm.org/resourcesandtools/hr-topics/benefits/pages/administering-401k-plans-who-does-what.aspx>

<https://5500search.dol.gov/>