EMPLOYEE BENEFITS

DEPARTMENT OF LABOR REISSUES RULES ON FIDUCIARIES INVESTING IN "ECONOMICALLY TARGETED INVESTMENTS"
by Jordan Schreier

The Department of Labor (DOL) has clarified the fiduciary implications of an employee benefit plan investing in so-called "socially responsible investments," sometimes referred to as "impact investments" or "economically targeted investments," in a new Interpretive Bulletin released October 22, 2015. The bulletin refers to investments that are selected not solely because of their risk and return characteristics, but also because of some perceived collateral economic or social benefit the investment will produce. Examples include:

- A multiemployer pension fund investing in a loan to fund a large construction project that would provide jobs to union members
- A plan investing in a bond to finance affordable housing for residents of the local community
- A plan investing in companies that meet certain environmental standards or not investing in companies in socially sensitive industries such as firearms or tobacco or that do business with certain nations based on their internal political positions

The bulletin, IB 2015-1, restates the DOL's views on this category of investment, replacing the previous Interpretive Bulletin 2008-1. In IB 2015-1, the DOL settled on the term "economically targeted investments" (ETIs) for these investments. The DOL said that aspects of the prior IB 2008-1 had unduly discouraged fiduciaries from considering these investments, particularly in two areas: (1) investment strategies that consider environmental, social and governance (ESG) factors where they are used solely to evaluate the economic benefits of investments and identify economically superior investments, and (2) investments in ETIs even where economically equivalent. The agency concluded that the fiduciary standards for ETIs are no different than the standards for plan investments generally.

In the background discussion of IB 2015-1, the DOL articulated some basic principles that might give fiduciaries considering ETIs some comfort. These are:

- Fiduciaries can consider collateral goals to break ties between investment alternatives that are otherwise equal with respect to return and risk over the appropriate time horizon.
- ESG issues may have a direct relationship to the economic value of a plan's investment and if so, such factors may not just be collateral considerations or tie-breakers, but rather are proper components of a fiduciary's economic analysis.
- Fiduciaries do not need to treat commercially reasonable investments as inherently suspect or in need of special scrutiny merely because they take ESG and other such factors into account.
- ERISA does not prohibit a fiduciary from addressing ETIs or incorporating ESG factors in investment policy statements or integrating tools, metrics and analyses in evaluating an investment's risk and return or choosing between equivalent investments.
- ERISA does not prevent fiduciaries from considering whether potential investment managers consider ETIs or ESG criteria in their investment practices.
- Consideration of ETIs or ESG criteria does not presumptively require additional documentation or evaluation.
- These same standards apply to a fiduciary's selection of a socially responsible mutual fund as a plan investment or, for plans with participant directed investments (e.g., 401(k) or 403(b) plans) or other individual accounts, a designated investment alternative.

While the updated DOL guidance provides some helpful principles that fiduciaries considering ETIs or investments with ESG features can consider, fiduciaries should be cautious about placing increased emphasis on such investments. Over the past decade, a significantly increased volume of lawsuits have been filed accusing plan fiduciaries of breaching duties of prudence and loyalty, particularly with participant directed investment plans. These lawsuits place an increased focus on the specific details of investment decision-making and allegations of decision-maker conflict. The risk of significant damages should promote fiduciary practices that take into account only pure risk and return considerations across appropriate time horizons and prudent diversification of assets and investment alternatives, even to the detriment of ETIs and ESG factors.

Please contact the author of this Alert or any member of the Dickinson Wright employee benefits practice team if you would like assistance in reviewing your current fiduciary practices or in implementing a fiduciary best practices program.

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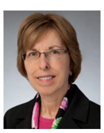

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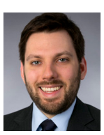

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