MARCH 24, 2021

For more information, contact:

Jeanie Cogill
+1 212 556 2161

David Tetrick
+1 404 572 3526

Darren Shuler
+1 404 572 2790

Ben Watson
+1 404 572 4608

King & Spalding

Atlanta
1180 Peachtree Street, NE
Atlanta, Georgia 30309-3521
Tel: +1 404 572 4600

New York
1185 Avenue of the Americas
New York, New York 10036-4003
Tel: +1 212 556 2100

Enforcement of ESG Rules Restricting ERISA Retirement Plans on Hold

Issue 6: 10 in 10

The U.S. Department of Labor will not enforce two of its final rules, published in November and December 2020, restricting ERISA retirement plans' consideration of environmental, social, and governance ("ESG") factors in the investment of plan assets, according to a March 10, 2021 enforcement policy statement. The move follows President Biden's executive order directing federal agencies to review regulations promulgated during the Trump Administration that may be inconsistent with his administration's policy objectives related to health and the environment. The DOL "intends to revisit the" ESG rules, but provided no timeline for doing so. Plan fiduciaries who want to consider ESG factors when choosing and managing investment options, however, may feel betwixt and between—still subject to a pair of regulations that private litigants may seek to enforce through ERISA breach of fiduciary duty claims.

Investment vehicles and strategies that integrate environmental, social, and governance factors into investment processes and decision-making reportedly make up one-third (33%) of the $51 trillion dollars in total U.S. assets under professional management. Regulators in the United Kingdom and European Union have begun to promote consideration of ESG factors by retirement plans. By contrast, the ESG rules finalized late last year require ERISA fiduciaries to focus solely on "pecuniary factors":

- The "Financial Factors in Selecting Plan Investments" rule says that ERISA's duties of prudence and loyalty require plan fiduciaries to consider only factors expected to have a material effect on an investment's risk or return when selecting and monitoring plan investments, including investment options in a self-directed 401(k) or other individual account plan. While plan fiduciaries are not forbidden from considering ESG factors, the rule prohibits fiduciaries from focusing on "non-pecuniary benefits or goals" at

the cost of diminished investment returns, increased risk, or higher fees. The rule also prohibits the selection of funds as "qualified default investment alternatives" that include one or more non-financial goals in their investment objectives; and

- The "Fiduciary Duties Regarding Proxy Voting and Shareholders Rights" rule reached a similar conclusion with respect to plan fiduciaries' exercise of shareholder rights. The rule says a plan fiduciary must act solely in accordance with the economic interests of the plan and may not subordinate the economic interests of plan participants to non-pecuniary interests when exercising such rights, including proxy voting on shareholder proposals.

The DOL cited criticisms that the rules fail to consider evidence that ESG factors "improv[e] investment value and long-term investment returns for retirement investors," and have a "chilling effect on appropriate integration of ESG factors" into ERISA investment decisions. The DOL's about-face, while not unexpected, is still welcome news to providers of ESG-branded mutual funds and ETFs, which according to Morningstar data saw net inflows of $51 billion in 2020—more than double the total for 2019, and nearly 10 times more than 2018.

Plan fiduciaries who consider (or want to consider) ESG factors when choosing investment options should not be so sanguine. The Biden Administration's ability to protect plan fiduciaries inclined to consider ESG factors may be constrained, at least without action from Congress, by the Supreme Court's ruling that ERISA's duty of loyalty requires fiduciaries to act for the exclusive purpose of providing *financial* benefits to participants. *See Fifth Third Bancorp v. Dudenhoeffer*, 573 U.S. 409 (2014).

For now, plan fiduciaries who wish to consider investments or shareholder initiatives that incorporate ESG factors should proceed cautiously. Until Congress acts or the DOL explains what plan fiduciaries may do with respect to ESG factors, plan fiduciaries should remain familiar with the final ESG rules, base their decisions on the foundational principles that fiduciaries must act prudently and in their participants' best financial interests, and document their decision-making.

ABOUT KING & SPALDING

Celebrating more than 130 years of service, King & Spalding is an international law firm that represents a broad array of clients, including half of the Fortune Global 100, with 1,200 lawyers in 22 offices in the United States, Europe, the Middle East and Asia. The firm has handled matters in over 160 countries on six continents and is consistently recognized for the results it obtains, uncompromising commitment to quality, and dedication to understanding the business and culture of its clients.

This alert provides a general summary of recent legal developments. It is not intended to be and should not be relied upon as legal advice. In some jurisdictions, this may be considered "Attorney Advertising." View our Privacy Notice.

ABU DHABI	CHARLOTTE	GENEVA	MOSCOW	RIYADH	TOKYO
ATLANTA	CHICAGO	HOUSTON	NEW YORK	SAN FRANCISCO	WASHINGTON, D.C.
AUSTIN	DUBAI	LONDON	NORTHERN VIRGINIA	SILICON VALLEY	
BRUSSELS	FRANKFURT	LOS ANGELES	PARIS	SINGAPORE	