March 12, 2021

U.S. Department of Labor Will Not Enforce Final Rules on ESG Investing, Proxy Voting

This client alert, part of a series focused on ESG disclosure and regulatory developments, should be read together with our ESG Lexicon, available here, which provides definitions of some of the key terms used in ESG reports, disclosures and regulations.

Key Takeaways

- The U.S. Department of Labor ("DOL") announced on March 10, 2021 that it will not enforce recently published final rules on "Financial Factors in Selecting Plan Investments" and "Fiduciary Duties Regarding Proxy Voting and Shareholder Rights."
- This shift in enforcement priority will bring a degree of certainty for institutional investors regarding the integration of ESG factors in investment decisions, in the short term, and may presage a return to Obama-era policy with future rulemaking or guidance.

Background

In November and December 2020, the DOL published its final rules on "Financial Factors in Selecting Plan Investments" (the "Pecuniary Factors Rule") and "Fiduciary Duties Regarding Proxy Voting and Shareholder Rights" (the "Proxy Voting Rule"), respectively. The former rule requires fiduciaries under the U.S. Employee Retirement Income Security Act of 1974, as amended ("ERISA"), to consider only so-called "pecuniary factors" when making investment decisions on behalf of employee benefit plans subject to ERISA. "Pecuniary factors" were defined to include only factors that a fiduciary prudently determines are expected to have a material effect on the risk and/or return of an investment, considered within the context of an employee benefit plan's investment objectives and funding policy. The Pecuniary Factors Rule took effect on January 12, 2021; for more on the rule as initially proposed in June 2020, see our prior client alert here. The Proxy Voting Rule similarly requires ERISA fiduciaries, when voting proxies or exercising other similar shareholder rights with respect to the assets of employee benefit plans, to consider only the economic interests of the benefit plans and its beneficiaries – and not to vote proxies or exercise such rights when no such economic interests were at stake. Together, these two rules (the "Rules") represented a move by the Trump administration to curtail the consideration of ESG factors when making key decisions on behalf of employee benefit plans subject to ERISA.

Biden Administration Executive Order and Non-Enforcement Policy Announcement

One of President Biden's first actions in office was to sign an executive order (the "Executive Order") directing all departments and agencies to review and, as appropriate, take action to address federal regulations that conflict with protecting public health and the environment. An associated fact sheet specifically listed the Pecuniary Factors Rule as the lone rule up for review by the DOL (see the Executive Order here and the associated fact sheet here). As a result, it has been anticipated for some time that the Biden administration would take action with respect to the Pecuniary Factors Rule.

On March 10, 2021, the DOL announced that it will not enforce the Rules or otherwise pursue enforcement actions "against any plan fiduciary based on a failure to comply with those final rules with respect to an investment, including a Qualified Default Investment Alternative, or investment course of action or with respect to an exercise of shareholder rights" (see the related press release here).

Looking Ahead

The release does not rescind or otherwise affect the status of the Rules as binding regulations, leaving open the possibility that individuals and other private litigants may still bring claims under ERISA against fiduciaries that do not act in compliance with the Rules. That said, the release provides important clarity for ERISA fiduciaries currently managing the assets of employee benefit plans subject to ERISA and may signal a return to the regulatory *status quo ante* (which permitted some limited consideration of ESG factors when making plan investments) through future rulemaking.

The DOL press release also made clear that the non-enforcement policy announcement will be followed up by further review of the use of ESG factors in the financial evaluation of plan investments or the exercise of shareholder rights. As Principal Deputy Assistant Secretary for the Employee Benefits Security Administration Ali Khawar noted, "[w]e intend 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, while continuing to uphold fundamental fiduciary obligations." The DOL further noted that it intends to revisit the rules because it has heard from stakeholders that the rules and resulting investor confusion "have already had a chilling effect on appropriate integration of ESG factors in investment decisions, including in circumstances that the rules may in fact allow." Given the Biden administration's support of ESG investing and market interest in a different approach – 95% of the public comments the DOL received about the proposed Pecuniary Factors Rule were opposed to it – future rulemaking or guidance would not be surprising.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

Mark S. Bergman
+44-20-7367-1601
mbergman@paulweiss.com

Andrew L. Gaines
+1 212-373-3339
againes@paulweiss.com

Jean M. McLoughlin
+1 212-373-3135
jmcloughlin@paulweiss.com

Jake Glazeski
+1 212-373-3131
jglazeski@paulweiss.com

David Curran
Chief Sustainability/
ESG Officer
+1-212-373-2558
dcurran@paulweiss.com

ESG Associate Sofía D. Martos contributed to this Client Memorandum.