EMPLOYEE BENEFITS AND EXECUTIVE COMPENSATION

DEPARTMENT OF LABOR ANNOUNCES NON-ENFORCEMENT POLICY FOR INVESTMENT AND PROXY VOTING REGULATIONS ADDRESSING ESG INVESTMENTS BY BENEFIT PLANS

On March 10, 2021, the Department of Labor ("DOL") announced a temporary non-enforcement policy for the "investment duties" and "proxy voting" rules finalized on November 13, 2020 and December 16, 2020, respectively, by the Trump Administration.[1]

Concededly, the regulations as finalized were in line with long-standing precedent in requiring that all investment and voting activities be in keeping with a benefit plan's economic best interest, and removed much of the content in the proposed regulations that expressly disfavored consideration of "environmental, social and governance" ("ESG") factors. The final regulations also reduced the procedural burdens that the proposed versions of the regulations would have imposed on use of ESG factors. Nonetheless, the regulations were widely understood as opposed to consideration of ESG factors when making investment and voting decisions. The new administration does not share that hostility toward ESG activity, and the Trump administration's anti-ESG stance and the regulations themselves had garnered widespread and vocal opposition from the financial industry. In light of concerns that legitimate investment activities and offerings had been and would continue to be disrupted by the regulations, the DOL announced the non-enforcement policy to allow it time to reconsider and redesign the regulations.

Statistics have long indicated that most benefit plans have not engaged in active ESG investing or voting, other than when considering economic risk and return factors that also happen to involve ESG concerns (e.g., weighing the economic risks of investing in the fossil fuel industry in light of increasing consumer demand for green energy). Some participant-directed plans also offered an ESG-oriented fund that was considered to be of appropriate cost and quality as an available option on the plan's investment platform. Both of these categories of ESG activity were conceded to be permissible under the new regulations, although use of ESG-themed funds would have required abiding by specified safeguards, and such funds would have been barred from serving as qualified default investment alternatives. Accordingly, most plans probably did not experience a major operational impact from the new regulations. However, plans should bear the following in mind when deciding how to react to the new regulations and the DOL's non-enforcement policy:

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[1] The rules are described at more length in our newsletters originally published November 2, 2020 and December 15, 2020.

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- The DOL's non-enforcement policy is not binding on plaintiffs or courts, and does not prevent the DOL itself from taking action if it believes plan fiduciaries have acted imprudently. Accordingly, plan fiduciaries should continue to make decisions that are in line with prudent investment practices and the economic best interests of the plan.
- Plans considering overtly relying on ESG factors without independent economic justification for doing so should consult counsel regarding their obligations and any procedural safeguards or documentation they may need or want.
- With respect to proxy voting:
  - The DOL's proxy voting regulations emphasized that voting should not occur if the cost of voting was not justified by the likely benefit to the plan. While the final regulations had removed specific cost-benefit analysis requirements initially included in the proposed regulations, and the DOL's non-enforcement policy further reduces concern that a decision to vote will need to be affirmatively justified in every case, prudent consideration of the costs of investment-related activities (including voting) relative to anticipated benefits remains appropriate. That said, it seems likely that voting costs will be minimal for many plans. Most plans either rely on the research and voting practices established by their professional managers across their books of business, or pass through voting rights to participants who can exercise them as they see fit.
  - The DOL's proxy voting regulations also emphasized that plan fiduciaries need to be sure that managers' proxy voting policies comply with ERISA and that voting decisions are made appropriately. In that respect, the new regulations were consistent with pre-regulatory guidance and ERISA's general principles. Accordingly, prudent (and cost-effective) engagement with voting practices and policies remains appropriate. Plan fiduciaries should take the opportunity to reengage with existing managers' policies to confirm they are aligned with ERISA principles, and request that managers provide appropriate documentation that they have been voting in line with their guidelines. If a plan does find itself in a position where voting is likely to have material implications for the value of its investments, more in-depth review of voting practices may be necessary.

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