

A SUMMARY: DOL Final Rule on Financial Factors in Selecting Plan Investments



ERISA¹ requires fiduciaries to act solely in the interest of the plan's participants and beneficiaries, and for the exclusive purpose of providing benefits to participants and beneficiaries. This prohibits a fiduciary from subordinating the interests of participants and beneficiaries in their retirement income to unrelated objectives. The paramount focus of plan fiduciaries must be the plan's financial returns and providing promised benefits to participants and beneficiaries.

Courts have interpreted the exclusive purpose rule of to require fiduciaries to act with "complete and undivided loyalty to the beneficiaries,"² observing that their decisions must "be made with an eye single to the interests of the participants and beneficiaries."³ The Supreme Court unanimously held in the context of ERISA retirement plans that such interests must be understood to refer to "financial" rather than "nonpecuniary" benefits.⁴

The investment duties under the ERISA Prudent Man Standard of Care, prescribes that a fiduciary shall discharge his duties with respect to a plan 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 of a like character and with like aims.

This means that the fiduciary has given appropriate consideration⁵ to those facts and circumstances that the fiduciary knows or should know are relevant to the particular investment or investment course of action involved. When making decisions on investments and investment courses of action, plan fiduciaries must be focused solely on the plan's financial returns, and the interests of plan participants and beneficiaries in their benefits must be paramount.

¹ ERISA section 404(a)(1)(A)

² 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)).

³ Donovan v. Bierwirth, 680 F.2d 263, 271 (2d Cir. 1982).

⁴ Fifth Third Bancorp v. Dudenhoeffer, 573 U.S. 409, 421 (2014) (the "benefits" to be pursued by ERISA fiduciaries as their "exclusive purpose" does not include "nonpecuniary benefits") (emphasis in original).

⁵ § 2550.404a-1 Investment duties. Appropriate consideration means

(i) A determination by the fiduciary that the particular investment or investment course of action is reasonably designed, as part of the portfolio, to further the purposes of the plan, taking into consideration the risk of loss and the opportunity for gain (or other return) associated with the investment or investment course of action, and
(ii) Consideration of the following factors as they relate to such portion of the portfolio:

(A) The composition of the portfolio with regard to diversification;
(B) The liquidity and current return of the portfolio relative to the anticipated cash flow requirements of the plan; and
(C) The projected return of the portfolio relative to the funding objectives of the plan.

Pension plans are bound by ERISA statute to a narrow objective: prudent management with an “eye single” to maximizing the funds available to pay benefits under the plan. Providing a secure retirement for American workers is the paramount, and eminently worthy, “social” goal of ERISA plans; plan assets may never be enlisted in pursuit of other social or environmental objectives at the expense of ERISA’s fundamental purpose of providing secure and valuable retirement benefits.

The DOL is concerned with

- (1) the growing emphasis on environmental, social, and corporate governance (ESG) investing may prompt ERISA plan fiduciaries to make investment decisions for purposes distinct from providing benefit to participants and beneficiaries and defraying reasonable expenses of administering the plan; and
- (2) some investment products may be marketed to ERISA fiduciaries on the basis of purported benefits and goals unrelated to financial performance

On November 13, 2020, the DOL issued final regulation to promulgate principles of fiduciary standards for selecting and monitoring investments, and set forth the scope of fiduciary duties surrounding nonpecuniary issues. Under the final rule, plan fiduciaries, when making decisions on investments and investment courses of action, must focus solely on the plan’s financial risks and returns and keep the interests of plan participants and beneficiaries in their plan benefits paramount.

The fundamental principle is that

- (1) an ERISA fiduciary’s evaluation of plan investments must be focused solely on economic considerations that have a material effect on the risk and return of an investment based on appropriate investment horizons, consistent with the plan’s funding policy and investment policy objectives; and
- (2) ERISA fiduciaries must never sacrifice investment returns, take on additional investment risk, or pay higher fees to promote non-pecuniary benefits or goals.

The purpose of the final rule is to

- (1) set forth a regulatory structure to assist ERISA fiduciaries in navigating these ESG investment trends and
- (2) separate the legitimate use of risk-return factors from inappropriate investments that sacrifice investment return, increase costs, or assume additional investment risk to promote non-pecuniary benefits or objectives.

The final rule makes five major amendments to the investment duties regulation under Title I of ERISA 404a-1 by:

- (1) adding provisions to confirm that ERISA fiduciaries must evaluate investments and “investment courses of action”⁶ based solely on pecuniary factors—financial considerations that have a material effect on the risk and/or return of an investment based on appropriate investment horizons consistent with the plan’s investment objectives and funding policy.

⁶ The term “investment course of action” means “any series or program of investments or actions related to a fiduciary’s performance of the fiduciary’s investment duties, and includes the selection of an investment fund as a plan investment, or in the case of an individual account plan, a designated investment alternative under the plan.”

- (2) including an express regulatory provision stating that compliance with the exclusive purpose (loyalty) duty in ERISA section 404(a)(1)(A) prohibits fiduciaries from subordinating the interests of participants to unrelated objectives, and bars them from sacrificing investment return or taking on additional investment risk to promote nonpecuniary goals;
- (3) including a provision that requires fiduciaries to consider reasonably available alternatives to meet their prudence and loyalty duties under ERISA;
- (4) setting forth required investment analysis and documentation requirements⁷ for those circumstances in which plan fiduciaries use non-pecuniary factors when choosing between or among investments that the fiduciary is unable to distinguish on the basis of pecuniary factors alone; and
- (5) stating that the prudence and loyalty standards set forth in ERISA apply to a fiduciary's selection of designated investment alternatives to be offered to plan participants and beneficiaries in a participant-directed individual account plan.

In the case of selecting investment alternatives for an individual account plan that allows plan participants and beneficiaries to choose from a broad range of investment alternatives⁸, a fiduciary is not prohibited from considering or including an investment fund, product, or model portfolio merely because the fund, product, or model portfolio promotes, seeks, or supports one or more non-pecuniary goals, provided that the fiduciary satisfies the prudence and loyalty provisions in ERISA and the final rule, including the requirement to evaluate solely on pecuniary factors, in selecting any such investment fund, product, or model portfolio. However, the provision prohibits plans from adding any investment fund, product, or model portfolio as a qualified default investment alternative⁹, or as a component of such an investment alternative, if the fund, product, or model portfolio's investment objectives or goals or its principal investment strategies include, consider, or indicate the use of one or more non-pecuniary factors.

The final rule shall be effective on January 12, 2021, and shall apply in its entirety to all investments made and investment courses of action taken after January 12, 2021. Plans shall have until April 30, 2022 to make any changes to qualified default investment alternatives, where necessary to comply with the requirements

This summary, prepared by Philip Chao, is for general informational purpose only and should not be deemed as delivering any legal or regulatory guidance or advice regarding the subject matter. Please refer to the final rule in its entirety for a more complete understanding and application. Please consult with legal and regulatory counsel before taking any action. <https://www.federalregister.gov/documents/2020/11/13/2020-24515/financial-factors-in-selecting-plan-investments>

⁷ The final rule includes a related documentation requirement for such decisions intended to prevent fiduciaries from improperly finding economic equivalence or making investment decisions based on nonpecuniary benefits without appropriately careful analysis and evaluation.

⁸ 29 CFR 2550.404c-1(b)(3)

⁹ 29 CFR 2550.404c-5