THE 30-YEAR HISTORY OF DILUTING ERISA'S FIDUCIARY DUTY*

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Under the Employee Retirement Income Security Act of 1974 (ERISA), fiduciaries have a strict duty of loyalty—to act "*solely* in the interest of participants and beneficiaries" and "for the *exclusive purpose*" of providing financial benefits to them.[1] Over the years, however, this exacting standard has been watered down by contra-textual interpretations published by the Department of Labor (DOL), which administers the fiduciary provisions of Title I of ERISA.[2] This article explains the history of the dilution of the ERISA duty of loyalty that has led to a status quo in which fiduciaries, in making investment decisions involving retirees' savings, may consider factors apart from ensuring and maximizing financial benefits to participants.

DOL's watered-down version of the ERISA duty of loyalty allows a fiduciary to consider interests other than providing pensioners a secure retirement income, so long as they do "*not subordinate*" the pensioners' financial interests to the other objectives. This administrative gloss on ERISA's sole interest and exclusive purpose standard has proved to be very malleable. The "not subordinate" language has been used to justify back-and-forth guidance issued by the DOL over the past thirty years. Interpretive Bulletins issued under the Clinton, Bush, and Obama Administrations oscillated between approving of

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* Note from the Editor: The Federalist Society takes no positions on particular legal and public policy matters. Any expressions of opinion are those of the author. To join the debate, please email us at info@fedsoc.org.

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[1] 29 U.S.C. § 1104(a)(1) (emphases added). *See* Fifth Third Bancorp v. Dudenhoeffer, 573 U.S. 409, 420-21 (2014) ("Read in the context of ERISA as a whole, the term 'benefits' . . . must be understood to refer to the sort of *financial* benefits (such as retirement income) that trustees who manage investments typically seek to secure for the trust's beneficiaries.").

[2] U.S. Department of Labor, *History of EBSA and ERISA*, https://www.dol.gov/agencies/ebsa/about-ebsa/about-us/history-of-ebsa-and-erisa.

and cautioning against fiduciaries' use of collateral considerations in making investment decisions and exercising shareholder rights on behalf of ERISA plans. Under the Trump and Biden Administrations, this has advanced into notice-and-comment rulemaking on applying environmental, social, and governance (ESG) factors to an ERISA fiduciary's obligations.

The fraught history of the "not-subordinate" interpretation suggests a return to the traditional, more objective "sole interest" standard would be better policy. Leaving any room for considerations other than the participants' financial interests in their retirement income opens fiduciaries up to a barrage of social and political concerns, whether personal or raised by others. Experience shows that mixed motives with investing leads to poor judgment and, as a result, financial loss. The best way to ensure that fiduciaries protect Americans' retirement income is to require them to focus entirely on that goal—as Congress did when it crafted the statutory language of ERISA.

I. ERISA'S DUTY OF LOYALTY & EARLY DOL INTERPRETATIONS

Under Title I of ERISA, "a fiduciary shall discharge his duties with respect to a plan *solely* in the interest of the participants and beneficiaries and . . . for the *exclusive purpose* of: (i) providing benefits to participants and their beneficiaries; and (ii) defraying reasonable expenses of administering the plan."[3] This fiduciary duty is derived from the law of trusts and codifies the common law sole interest standard as applied to retirement plans.[4] As the words "sole" and "exclusive" suggest, the statute requires undivided loyalty.[5] It means that "the trustee has a duty to the beneficiaries not to be influenced by the interest of any third person or by motives other than the accomplishment of the purposes of the trust."[6] "Acting with mixed motives triggers 'an irrebuttable presumption of wrongdoing,' full stop."[7] Courts have articulated this duty in the

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[3] 29 U.S.C. § 1104(a)(1) (emphases added).

[4] *See* Cent. States, Se. & Sw. Areas Pension Fund v. Cent. Transp., Inc., 472 U.S. 559, 570 (1985) (Section 1104(a)(1) imposes "strict standards of trustee conduct . . . derived from the common law of trusts."); Max M. Schanzenbach & Robert H. Sitkoff, *Reconciling Fiduciary Duty and Social Conscience: The Law and Economics of ESG Investing by a Trustee*, 72 STAN. L. REV. 381, 403 (2020).

[5] *See* RESTATEMENT (THIRD) OF TRUSTS § 78(1) cmt. a (2007) (explaining that the sole interest standard "states the trust law's fundamental principle of undivided loyalty").

[6] Schanzenbach & Sitkoff, *supra* note 4, at 403 (quoting RESTATEMENT (THIRD) OF TRUSTS § 78(1) cmt. f.).

[7] *Id.* at 401 (citations omitted).

ERISA context as requiring a "single-minded devotion" or an "eye single to the interest of the participants and beneficiaries."[8]

A. Economically Targeted Investments

During the Clinton Administration, the DOL subtly redefined this standard. In a 1994 Interpretive Bulletin (IB 94-1), it interpreted "the requirements that a fiduciary act solely in the interest of, and for the exclusive purpose of providing benefits to, participants and beneficiaries as prohibiting a fiduciary from *subordinating the interests* of participants and beneficiaries in their retirement income to unrelated objectives."[9] This guidance marked a significant change from the traditional duty of loyalty codified in ERISA. Fiduciaries no longer were required to have an "eye single" to the financial interests of participants and beneficiaries in their retirement. Fiduciaries could now consider "unrelated objectives"—so long as they did *not subordinate* participants' financial interests in their retirement income to those other objectives. This became known as the "all things being equal" test.[10]

IB 94-1 dealt with "economically targeted investments" (ETIs), which were essentially a rebranding of the socially responsible investment (SRI) movement of the 1970s and '80s, also known as "social investing."[11] The DOL defined ETIs as investments selected "for the economic benefits they create in addition to" or "apart from" the investment return for the beneficiaries of the retirement plan.[12] While pure social investing openly subordinated financial returns to social objectives, ETIs were framed as not

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[8] Morris v. Winnebago Indus., 936 F. Supp. 1509, 1522 (N.D. Iowa 1996) (quoting Adams v. Avondale Indus., 905 F.2d 943, 946 (6th Cir. 1990)); State St. Bank & Trust Co. v. Salovaara, 326 F.3d 130, 136 (2d Cir. 2003) (citing Donovan v. Bierwirth, 680 F.2d 263, 271 (2d Cir. 1982)).

[9] Interpretive Bulletin Relating to the Fiduciary Standard Under ERISA in Considering Economically Targeted Investments, 59 Fed. Reg. 32,606, 32,607 (June 23, 1994) (emphasis added).

[10] Economically Targeted Investments (ETIs) and Investment Strategies that Consider Environmental, Social and Governance (ESG) Factors, Employee Benefits Security Administration (Oct. 22, 2015), https://www.dol.gov/sites/dolgov/files/ebsa/about-ebsa/our-activities/resource-center/fact-sheets/etis-and-investment-strategies-that-consider-esg-factors.pdf?source=post_page----------.

[11] *See* Alvin D. Lurie, *ETIs: A Scheme for the Rescue of City and Country with Pension Funds*, 5 CORNELL J.L. & PUB. POL'Y 315, 323 (1996) ("What is new . . . is the repudiation of the term 'social investing' in favor of the politically correct (if governmentese-laden) term 'economically targeted investing.'"); *see also* Schanzenbach & Sitkoff, *supra* note 4, at 392-93 (describing early social investment screens to avoid morally questionable investments in, for example, defense companies during the Vietnam War or firms doing business in apartheid South Africa).

[12] Interpretive Bulletin Relating to the Fiduciary Standard Under ERISA in Considering Economically Targeted Investments, 59 Fed. Reg. 32,606, 32,606-07 (June 23, 1994).

sacrificing financial returns for retirees but having additional "economic" benefits.[13] This paved the way for consideration of environmental and social benefits through ESG factors.[14]

B. Collateral Benefits for Union Members

In the years before it issued IB 94-1, the DOL had used this "not subordinate" language in less formal settings, including in several private opinions issued under various administrations. Many of these interpretations arose in the context of fiduciaries seeking advisory opinions from the DOL regarding whether it was permissible to invest plan assets for the purpose of providing collateral benefits specifically to union members. Although the DOL had informed trustees that "any arrangement whereby plan funds are used for any other purpose, such as reimbursement of expenses incurred by a union," could violate ERISA's sole interest and exclusive purpose requirements,[15] it approved of various less direct ways of promoting union interests with plan assets.

For example, the DOL allowed agreements between automobile manufacturers and the International Union, United Automobile, Aerospace and Agricultural Implement Workers of America (UAW) related to how retirement plan benefits should be invested. The DOL advised Chrysler's Pension Fund that its agreement with the UAW to receive recommendations about how trustees could invest a certain percent of plan assets to provide collateral benefits to union members' communities did not violate ERISA.[16] Similarly, the DOL approved of General Motors' agreement to receive UAW recommendations to invest a certain percent of pension plan assets in residential mortgages in communities with substantial numbers of UAW members, as well as in debt instruments of specific UAW-recommended non-profits.[17]

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[13] Edward A. Zelinsky, *ETI, Phone the Department of Labor: Economically Targeted Investments, IB 94-1 and the Reincarnation of Industrial Policy*, 16 BERKELEY J. EMP. & LAB. L. 333, 336 (1995).

[14] *See* Schanzenbach & Sitkoff, *supra* note 4, at 388 n.23 ("The Department of Labor, for example, has shifted from 'economically targeted investments' in earlier bulletins to 'ESG' in more recent bulletins.").

[15] Letter from Alan D. Lebowitz, Ass't Admin., Office of Fiduciary Standards, Pension and Welfare Benefits Admin., U.S. Dep't of Labor, to Mr. George M. Cox, Cox, Castle & Nicholson (July 16, 1979), 1979 WL 169909.

[16] *See* DOL Advisory Ops. 80-33A (June 3, 1980), 1980 WL 8934, and 88-16A (Dec. 19, 1988), 1988 WL 222716.

[17] *See* Letter from Mark A. Greenstein, Acting Chief, Div. of Fiduciary Interp., Office of Reg. and Interp., U.S. Dep't of Labor, to Mr. Stuart Cohen, Legal Staff, General Motors Corp. (May 14, 1993), 1993 WL 1370527.

The DOL had also approved of trustees investing plan assets to support union labor projects. In a 1982 advisory opinion, the DOL explained with regard to investing in a "Union Construction Fund" that "a decision to make an investment may not be influenced . . . by a desire to stimulate the construction industry and generate employment"; that is, "unless the investment, when judged solely on the basis of its economic value to the plan, would be equal or superior to alternative investments available to the fund."[18] Then, in a 1988 letter, the DOL approved of fiduciaries investing in an account "designed . . . incidentally to help support the unionized sector of the building and construction industry."[19] It opined that the use of a "union labor condition" did not violate ERISA so long as the loans were made at prevailing market terms.[20]

These rulings approved of ERISA fiduciaries pursuing collateral benefits for union members using the assets of retirement plans. Through them, the DOL endorsed the idea underlying ETIs: that investments may be both in the financial interests of plan participants and provide an additional benefit. Employee retirement plan fiduciaries could look beyond merely achieving the best investment return for participants and beneficiaries to also promote union labor projects or community interests, provided they did not increase risk or sacrifice financial returns expected from the relevant asset class.

C. Political Criticism

When the DOL issued its guidance on ETIs, Republicans criticized it as the Clinton Administration's attempt to circumvent the democratic process to fund social programs using private pension funds.[21] Supporters of the DOL interpretation admitted that ETIs were "basically a scheme for using the funds of both public and private pensions to invest in . . . community projects."[22] Before and after he was elected president, Bill Clinton promoted ETIs and policies incentivizing pension funds to finance public works and environmental projects.[23] Likewise, "at least three of [his] Cabinet appointees

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[18] DOL Advisory Op. 82-52A (Sept. 28, 1992), 1982 WL 21235.

[19] Letter from Robert J. Doyle, Acting Dir. of Reg. and Interp., U.S. Dep't of Labor, to Mr. James S. Ray, Connerton, Ray & Simon (July 8, 1988), 1988 WL 897710.

[20] *Id.*

[21] *See, e.g.*, Joint Economic Committee Republicans, *Economically Targeted Investments (ETIs)* (June 7, 1995), *available at* https://www.jec.senate.gov/public/_cache/files/40c6425b-59ae-432c-ad1c-aa60606c0370/economically-targeted-investments-etis-june-7-1995.pdf.

[22] *See* Lurie, *supra* note 11, at 315.

[23] *Id.* at 319, 322.

into HUD, Labor, and Transportation in their confirmation hearings also endorsed tapping pension funds for 'the public interest.'"[24]

The Joint Economic Committee Republicans strongly opposed what they called "the Clinton Pension Grab."[25] Vice Chairman Jim Saxton worried that the "ultimate objective [was] to mandate social investing through compulsory ETI quotas, similar to lending quotas now imposed on financial institutions by the Clinton Administration."[26] Speaker Newt Gingrich saw this as a "classic example of pro-big government, of tax-and-spend liberals trying to achieve through the back door what they can't do through the front door."[27] Republicans proposed a law to undo IB 94-1, but it failed.[28]

Secretary of Labor Robert Reich defended the guidance and actively promoted ETIs. Under his leadership, the DOL spent over $1 million creating an ETI clearinghouse, which would "gather[] information about ETIs' investment performance and attributes and make it available to those in the pension community to aid investment decisions."[29] Some worried that this clearinghouse was a tool for government regulators to direct pension plans where to invest their beneficiaries' savings.[30] They were concerned that Secretary Reich was trying revive the doctrine of industrial policy, with the government playing a greater role in allocating capital and directing market forces.[31]

D. Expansion of the "Not Subordinate" Interpretation to Exercise of Shareholder Rights

In addition to the guidance on ETIs, the Clinton DOL issued guidance about the exercise of shareholder rights connected to ERISA plans.[32] The DOL had first stated in a 1988 opinion letter to Avon Products, Inc. (known

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[24] *Id.* at 319.

[25] Joint Economic Committee Republicans, *Stopping the Clinton Pension Grab* (June 7, 1995), *available at* https://www.jec.senate.gov/public/_cache/files/c1a0057a-8284-430f-a887-a6897f2026ec/stopping-the-clinton-pension-grab---june-7-1995.pdf.

[26] Letter from Jim Saxton (May 24, 1995), attached in H.R. Rep. No. 104-238, at 33.

[27] JEC Republicans, *Stopping the Clinton Pension Grab*, *supra* note 25, at 1.

[28] Pension Protection Act of 1995, H.R. 1594, 104th Cong.

[29] Letter from Barbara D. Bovbjerg, Assoc. Dir., Income Security Issues, U.S. General Accounting Office, to Jim Saxton, Chairman, Joint Economic Committee, at 1-2 (Feb. 27, 1998), *available at* https://www.gao.gov/assets/hehs-98-99r.pdf.

[30] *See, e.g.*, Zelinsky, *supra* note 13, at 334-36; H.R. Rep. No. 104-238, at 5.

[31] Zelinsky, *supra* note 13, at 353-54.

[32] Interpretive Bulletin Relating to Written Statements of Investment Policy, Including Proxy Voting Policy or Guidelines, 59 Fed. Reg. 38,863 (July 29, 1994).

as the "Avon Letter") that a fiduciary's duty to manage plan assets that are shares of corporate stock includes the responsibility to vote the proxies appurtenant to those shares of stock.[33] Interpretive Bulletin 94-2 (IB 94-2) further explained that voting proxies appurtenant to plan assets fell under ERISA's fiduciary duty standards and required that, "in voting proxies, the responsible fiduciary consider those factors that may affect the value of the plan's investment and *not subordinate* the interests of the participants and beneficiaries in their retirement income to unrelated objectives."[34] The guidance also approved of ERISA fiduciaries engaging in "activities intended to monitor or influence the management of corporations in which the plan owns stock" when there was a "reasonable expectation" it was "likely to enhance the value of the plan's investment in the corporation."[35] IB 94-2 went a step further in naming examples of permissible topics for shareholder activism, including corporate governance, workplace practices, and "financial and non-financial measures of corporate performance."[36]

II. OSCILLATING SUB-REGULATORY GUIDANCE

With these actions, the Clinton Administration initiated more than twenty-five years of pendulum-swinging sub-regulatory guidance on whether and how to assess ETIs and, relatedly, the appropriate level of attention for fiduciaries to give proxy voting. During the Bush Administration, the DOL revisited the Clinton-era guidance on ETIs and the exercise of shareholder rights. It issued Interpretive Bulletins 2008-1 (IB 08-1) and 2008-2 (IB 08-2) to replace IB 94-1 and IB 94-2. While restating in slightly different wording the "not subordinate" formulation of ERISA's duty of loyalty from the previous guidance, the new bulletins reversed course on the permissibility of considering collateral interests.

First, in IB 08-1, the DOL interpreted the sole interest and exclusive purpose language in ERISA to mean that "fiduciaries may *never subordinate* the economic interests of the plan to unrelated objectives, and may not select investments on the basis of any factor outside the economic interest of the

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[33] Letter from Alan D. Lebowitz, Deputy Ass't Sec'y, Pension and Welfare Benefits Admin., U.S. Dep't of Labor, to Helmuth Fandl, Chairman of Ret. Bd., Avon Products, Inc. (Feb. 23, 1988), 1988 WL 897696.

[34] Interpretive Bulletin Relating to Written Statements of Investment Policy, Including Proxy Voting Policy or Guidelines, 59 Fed. Reg. at 38,863 (emphasis added).

[35] *Id.* at 38,864.

[36] *Id.*

plan except in very limited circumstances."[37] Under this stricter guidance, a fiduciary could not choose an ETI unless he "concluded that the alternative options are truly equal, taking into account a quantitative and qualitative analysis of the economic impact on the plan."[38] Previously, the DOL had approved of various scenarios of fiduciaries investing plan assets to support union members and their communities. Here, the DOL gave examples that showed how a fiduciary's consideration of collateral benefits, such as creating local jobs, financing affordable housing, promoting environmental goals, and using union labor, "should be rare" and should be carefully documented.[39]

IB 08-1's tone indicated skepticism that ERISA fiduciaries could consider these goals without violating the duty of loyalty. As explained by its examples, a plan that prefers to invest in local construction projects could incur extra risk due to its lack of diversification.[40] Financing a local affordable housing project may mean reduced liquidity compared to other bonds.[41] A fund that invests based on environmental or union labor criteria must consider alternative investments.[42] If relying on non-economic criteria for a decision, fiduciaries should "justify their investment choice by recording their analysis in writing" showing that their choice is economically "equal or superior" to the alternatives, "provid[ing] equal or better returns at the same or lower risks" while "play[ing] the same role in the plan's portfolio."[43]

Likewise, in IB 08-2, the DOL reiterated the "not subordinate" language while walking back IB 94-2's guidance.[44] The new guidance emphasized that in deciding whether or how to vote a proxy, fiduciaries could only consider factors related to the economic value of the plan's investment. They could not consider "objectives, considerations, and economic effects unrelated to the plan's economic interests."[45] IB 08-2 also added explicit warnings related to "socially-directed" exercises of shareholder rights. It stated that fiduciaries "shall not use an investment policy to promote myriad public policy

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[37] Interpretive Bulletin Relating to Investing in Economically Targeted Investments, 73 Fed. Reg. 61,734, 61,735 (Oct. 17, 2008) (emphasis added).

[38] *Id.*

[39] *Id.* at 61,734, 61,736.

[40] *Id.* at 61,736.

[41] *Id.*

[42] *Id.*

[43] *Id.*

[44] Interpretive Bulletin Relating to the Exercise of Shareholder Rights and Written Statements of Investment Policy, Including Proxy Voting Policies or Guidelines, 73 Fed. Reg. 61,732 (Oct. 17, 2008).

[45] *Id.*

preferences" and cautioned that they "risk violating the exclusive purpose rule when they exercise their fiduciary authority in an attempt to further legislative, regulatory or public policy issues through the proxy process."[46] The DOL opined that spending plan assets on proxy votes not sufficiently tied to the economic value of its investment would run afoul of ERISA's fiduciary duty.[47]

Seven years later, under the Obama Administration, the DOL again changed its guidance, issuing Interpretive Bulletin 2015-1 (IB 15-1) to replace IB 08-1.[48] This guidance reiterated the language from IB 94-1: "The Department has construed the requirements that a fiduciary act solely in the interest of, and for the exclusive purpose of providing benefits to, participants and beneficiaries as prohibiting a fiduciary from *subordinating the interests* of participants and beneficiaries in their retirement income to unrelated objectives."[49] The guidance went on to say that "fiduciary standards applicable to ETIs are no different than the standards applicable to plan investments generally."[50] Read in light of the background section, which expressed concerns that IB 08-1 had "unduly discouraged fiduciaries from considering ETIs and ESG factors,"[51] this marked another flip in policy.

The Obama-era DOL also withdrew the prior guidance on proxy voting and shareholder rights. It issued Interpretive Bulletin 16-1 to correct the effect IB 08-2 had of discouraging shareholder engagement, especially on ESG issues.[52] The new guidance expressly condoned the incorporation of ESG considerations into investment policies and voting guidelines. It gave examples of appropriate shareholder issues on which plan fiduciaries should engage, such as board composition, business plans on climate change, and workforce diversity.[53]

Then in 2018, during the Trump Administration, the DOL issued a Field Assistance Bulletin marking yet another switch in rhetoric about considering collateral benefits. The bulletin warned ERISA fiduciaries against "too readily

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[46] *Id.* at 61,734.

[47] *Id.*

[48] Interpretive Bulletin Relating to the Fiduciary Standard Under ERISA in Considering Economically Targeted Investments, 80 Fed. Reg. 65,135 (Oct. 26, 2015).

[49] *Id.* at 65,137 (emphasis added).

[50] *Id.*

[51] *Id.* at 65,136.

[52] Interpretive Bulletin Relating to the Exercise of Shareholder Rights and Written Statements of Investment Policy, Including Proxy Voting Policies or Guidelines, 81 Fed. Reg. 95,879, 95,880 (Dec. 29, 2016).

[53] *Id.* at 95,884.

treat[ing] ESG factors as economically relevant."[54] It focused on fiduciaries' duty to "always put first the economic interests of the plan in providing retirement benefits" and evaluate investments based on "financial factors."[55] With respect to exercising shareholder rights, it stated that "routine or substantial expenditure of plan assets to actively engage with management on environmental or social factors" should be backed up by a documented cost-benefit analysis.[56]

III. ESG RULEMAKING

In 2020, after more than two decades of sub-regulatory about-faces, the DOL under the Trump Administration conducted regulatory notice-and-comment rulemakings to address ESG practices in connection with ERISA plans. The Trump DOL promulgated two final rules on the topic, each modifying a portion of the investment duties regulation at 29 C.F.R. § 2550.404a-1. The first rule, "Financial Factors in Selecting Plan Investments," addressed fiduciaries' general obligations in considering investments or investment courses of action for employee benefit plans. The second, "Fiduciary Duties Regarding Proxy Voting and Shareholder Rights," addressed fiduciaries' obligations with respect to proxy voting. Both retained some form of the "not subordinate" phrase in interpreting the fiduciary duty of loyalty. DOL further found that strict regulations are necessary to protect participants from "shortcomings in the rigor of the prudence and loyalty analysis by some participating in the ESG investment marketplace."[57]

The Financial Factors rule required fiduciaries to evaluate investments "based only on pecuniary factors," which the rule stated should be weighed according to their "impact on risk-return."[58] The regulatory text of the proposed rule published on June 30, 2020, specified that ESG considerations were pecuniary factors if they present material economic risks or opportunities, and it described how such factors should be assessed and evaluated in

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[54] Department of Labor, Field Assistance Bulletin 2018-01 (Apr. 23, 2018), https://www.dol.gov/agencies/ebsa/employers-and-advisers/guidance/field-assistance-bulletins/2018-01.

[55] *Id.*

[56] *Id.*

[57] Financial Factors in Selecting Plan Investments, 85 Fed. Reg. 72,846, 72,847, 72,850 (Nov. 13, 2020); Fiduciary Duties Regarding Proxy Voting and Shareholder Rights, 85 Fed. Reg. 81,658, 81678 (Dec. 16, 2020).

[58] Financial Factors in Selecting Plan Investments, 85 Fed. Reg. at 72,884.

considering ESG-oriented investment alternatives.[59] After DOL considered over 8,700 public comments, the final rule focused on a fiduciary's obligations overall in selecting investment alternatives, omitting specific reference to ESG factors in the regulatory text and instead reiterating that "[a] fiduciary may *not subordinate* the interests of the participants and beneficiaries in their retirement income or financial benefits under the plan to other objectives," and prohibiting "sacrific[ing] investment return or tak[ing] on additional investment risk to promote non-pecuniary benefits or goals."[60] The rule permitted adding investment alternatives that promoted non-pecuniary goals to a menu of individual account plan options, provided the investment alternative satisfied a due diligence review based on pecuniary factors, but it prohibited including an investment fund that considered or used non-pecuniary factors in a qualified default investment alternative (QDIA). The rule included the Clinton-era "all things being equal" provision in permitting consideration of non-pecuniary factors as tiebreakers, but only when choosing among indistinguishable investment alternatives (which presumably would rarely occur). And if used as a tiebreaker, analysis of the investment had to be documented. This safeguard was "intended to prevent fiduciaries from improperly finding economic equivalence."[61]

The Proxy Voting rule established parameters around when a fiduciary should or should not engage in proxy voting, and it imposed oversight obligations on fiduciaries who engage proxy advisors.[62] In the preamble to the proposed rule, DOL leadership noted changes in the investment landscape that had occurred since the DOL released the Avon Letter, and it commented particularly on the rise of proxy advisory firms (namely, ISS Analytics and Glass Lewis) that fiduciaries often retain to advise on the increasingly complex issues that may be considered in assessing a company's governance practices. The DOL aimed to clarify a fiduciary's obligation in voting proxies in light of those changes and recent SEC guidance. It sought to allay a perception that ERISA fiduciaries must vote every proxy and to provide efficient parameters for fiduciaries to use to determine the proper shareholder activities in which to engage, restricting them from focusing on non-pecuniary initiatives. This rule, like Financial Factors rule, used the "not subordinate" phrase, articulating with respect to proxy voting that fiduciaries must not "promote

[59] *Id.* at 72,849.
[60] *Id.* at 72,884 (emphasis added).
[61] *Id.* at 72,849.
[62] Fiduciary Duties Regarding Proxy Voting and Shareholder Rights, 85 Fed. Reg. at 81,658.

non-pecuniary benefits or goals unrelated to th[e] financial interests of the plan's participants and beneficiaries."[63] Notably, the DOL specifically stated in response to commenters that it did not mean for the rule to condone activities "with the goal of advancing non-pecuniary goals unrelated to the financial interests of the plan's participants and beneficiaries."[64]

Shortly after the final rules were promulgated, President Biden took office, and the DOL announced that it would not enforce the Trump-era rules.[65] The DOL acknowledged that "[d]ifferences in the tone and tenor in different Administration's [sic] iterations of sub-regulatory guidance" had "created confusion about these investment issues."[66] It issued a Notice of Proposed Rulemaking in October 2021 to replace the 2020 Final Rules,[67] and it promulgated a new final rule at the end of 2022, which took effect on January 30, 2023.[68] The DOL stated that its changes were intended to address the "chilling effect" stakeholders had experienced in considering ESG factors in investment decisions and in exercising shareholder rights following the 2020 Final Rules.[69]

The current rule expresses the duty of loyalty as follows:

> A fiduciary may *not subordinate* the interests of the participants and beneficiaries in their retirement income or financial benefits under the plan to other objectives, and may *not sacrifice investment return or take on additional investment risk* to promote benefits or goals unrelated to interests of the participants and beneficiaries in their retirement income or financial benefits under the plan.[70]

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[63] *Id.* at 81,694.

[64] *Id.* at 81,667.

[65] U.S. Department of Labor Statement Regarding Enforcement of Its Final Rules on ESG Investments and Proxy Voting by Employee Benefit Plans (Mar. 10, 2021), *available at* https://www.dol.gov/sites/dolgov/files/ebsa/laws-and-regulations/laws/erisa/statement-on-enforcement-of-final-rules-on-esg-investments-and-proxy-voting.pdf.

[66] Notice of Proposed Rulemaking on Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights, Dep't of Labor (Oct. 13, 2021), https://www.dol.gov/sites/dolgov/files/EBSA/about-ebsa/our-activities/resource-center/fact-sheets/notice-of-proposed-rulemaking-on-prudence-and-loyalty-in-selecting-plan-investments-and-exercising-shareholder-rights.pdf.

[67] Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights, 86 Fed. Reg. 57,272 (proposed Oct. 14, 2021).

[68] 29 C.F.R. § 2550.404a-1 (2023).

[69] *See* Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights, 87 Fed. Reg. 73,826 (Dec. 1, 2022).

[70] 29 C.F.R. § 2550.404a-1(c)(1)(emphasis added).

This language removes references here and throughout to the "pecuniary" and "non-pecuniary" distinctions utilized in the Supreme Court's decision in *Fifth Third Bancorp v. Dudenhoeffer* and codified in the 2020 Final Rules.[71] This rule change thus removed a clear restatement of law, even though DOL had previously found that "shortcomings in the rigor of the prudence and loyalty analysis by some participating in the ESG investment marketplace" risked harm to participants.[72] In addition, the rule removes the requirement of specific documentation when considering investment alternatives based on collateral benefits as a tiebreaker. It also eliminates the "economically indistinguishable" requirement of the 2020 tiebreaker provision, replacing it with the more subjective and difficult to challenge threshold that allows a fiduciary to choose an investment based on collateral benefits if "competing investments . . . equally serve the financial interests of the plan over the appropriate time horizon."[73] The rule also removes the restriction against including ESG investments or other investments with non-pecuniary objectives in QDIAs.

Moreover, the DOL amended a fiduciary's prudence obligations to state that a fiduciary's analysis of an investment's relevant risk and return "may include the economic effects of climate change and other environmental, social, or governance factors."[74] The preamble to the rule explains this language through examples of factors potentially relevant to a fiduciary's risk-return analysis, including "exposure to the physical and transitional risks of climate change," board composition, and "the corporation's progress on workforce diversity, inclusion, and other drivers of employee hiring, promotion, and retention."[75]

In early 2023, Congress passed a joint resolution with bipartisan support nullifying the new DOL rule,[76] but President Biden vetoed the resolution,[77] and Congress failed to override the veto.[78] A coalition of 26 states, along with private plaintiffs, challenged the rule in federal court under the

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[71] *See* 573 U.S. at 420-21.

[72] 85 Fed. Reg. at 72,847, 72,850; 85 Fed. Reg. at 81,678.

[73] 29 C.F.R. § 2550.404a-1(c)(2).

[74] 29 C.F.R. § 2550.404a-1(b)(4).

[75] Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights, 87 Fed. Reg. 73,832.

[76] H.R.J. Res. 30, 118th Cong. (2023).

[77] Joseph R. Biden Jr., Message to the House of Representatives — President's Veto of H.J. Res 30 (Mar. 20, 2023), https://www.whitehouse.gov/briefing-room/presidential-actions/2023/03/20/message-to-the-house-of-representatives-presidents-veto-of-h-j-res-30/.

[78] *See* Actions Overview, H.J. Res. 30 — 118th Cong. (2023-2024), https://www.congress.gov/bill/118th-congress/house-joint-resolution/30/actions.

Administrative Procedure Act.[79] The district court upheld the rule "after affording DOL the deference it is presently due under *Chevron*."[80] The decision has been appealed to the Fifth Circuit.[81] The outcome of the litigation may depend on the Supreme Court's treatment of *Chevron* in *Relentless, Inc. v. Department of Commerce* and *Loper Bright Enterprises v. Raimondo*, which will be argued in January.

IV. THE "NOT SUBORDINATE" STANDARD IS BAD POLICY

The dilution of the sole interest standard to merely require that fiduciaries not subordinate pensioners' financial interests in their retirement income is bad policy, both within and outside of the ERISA context. When DOL released the proposed 2020 Financial Factors rule, then-Secretary of Labor Eugene Scalia pointed out that "[a] fiduciary's duty is to retirees alone, because under Erisa one 'social' goal trumps all others—retirement security for American workers."[82] Furthermore, as congressional Republicans argued back in the 1990s, "[o]nce an investment manager ceases to focus exclusively on maximizing the return for beneficiaries, it is very difficult to avoid social or even political considerations."[83] Any consideration of collateral benefits opens pension-fund fiduciaries up to pressures from public officials and private interest groups, and away from their primary duty of maximizing retirement income for participants and beneficiaries.

Permitting consideration of collateral benefits—from favoring UAW neighborhoods and union labor projects to allowing environmental activists to influence investment policy—removes the political insulation pension-fund fiduciaries need if they are to act in investors' best interest. Numerous historical examples show how the consideration of collateral benefits clouds fiduciaries' vision and impairs their judgment. State retirement funds lost tens of millions of dollars in the 1980s and '90s through the failures of ETIs that aimed to promote in-state jobs or companies.[84] Kansas lost at least $138 million on defaulted loans from in-state investments, Connecticut lost $25

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[79] *See* Utah v. Walsh, No. 23-016, 2023 WL 6205926 (N.D. Tex. Sept. 21, 2023).

[80] *Id.* at *5.

[81] Notice of Appeal, Utah v. Walsh, No. 23-016 (N.D. Tex. Oct. 26, 2023).

[82] Eugene Scalia, Opinion, *Retirees' Security Trumps Other Social Goals*, WALL ST. J. (June 23, 2020), https://www.wsj.com/articles/retirees-security-trumps-other-social-goals-11592953329.

[83] JEC Republicans, *ETIs*, *supra* note 21, at 3.

[84] M. Wayne Marr, John R. Nofsinger, & John L. Trimble, *Economically Targeted and Social Investments: Investment Management and Pension Fund Performance*, RSCH. FOUND. INST. CHARTERED FIN. ANALYSTS, at 5-6 (1995).

million by investing in a local manufacturing company, and Pennsylvania lost $40 million by financing an in-state auto plant.[85] Alaska lost millions of dollars through its $250 million investment in unguaranteed home mortgages, many of which were in-state, when over a third of the loans became delinquent.[86] More recently, the California Public Employees' Retirement System lost over $3.5 billion by divesting from tobacco.[87] Numerous other plans that have divested from fossil fuel holdings to pursue environmentally friendly investment alternatives have presumably lost significant sums in recent years due to reduced diversification and losing out on recent gains from historic fuel price increases.[88]

Even if collateral benefits are only used as a tiebreaker between equal investment opportunities, fiduciaries considering them are forced to weigh the value of social goals to third parties in addition to the financial returns they must secure for retirees. Any consideration of "other benefits" complicates what should be a straightforward duty of assessing objective and quantifiable risk and return. With the permissibility of tiebreaking, "groups expecting to benefit from ETIs have strong incentives to compel . . . trustees to declare ties."[89]

Moreover, social investing, even when rebranded as ETIs or ESG, is based on flawed economic assumptions. Mixed motives in investment decision making negatively impact financial returns. Choosing investments based on nonfinancial goals means accepting greater risk, lower returns, or both. The idea of tiebreaking between financially equal but socially unequal investments is not a solution either. "[I]f two investments in fact have identical risk and return attributes, textbook financial economics teaches that, liquidity constraints and transaction costs to the side, the investor should invest in both on diversification grounds."[90] And if an investment has competitive rates of

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[85] *Id.*

[86] U.S. Gen. Accounting Office, GAO/PEMD-95-13, *Public Pension Plans: Evaluation of Economically Targeted Investment Programs*, at 23 (1995).

[87] Randy Diamond, *CalPERS Decision to Divest from Tobacco Is Costly*, CHIEF INV. OFFICER (Dec. 12, 2018), https://www.ai-cio.com/news/calpers-decision-divest-tobacco-costly/.

[88] *See* Patrick Temple-West & Kristen Talman, *ESG Shares Underperform Oil and Gas in 2021*, FIN. TIMES (Dec. 30, 2021), https://www.ft.com/content/70984a9e-ab65-4905-a2fa-83202e3db68b; Alicia McElhaney, *Investors Dropped Oil Due to Underperformance and ESG Concerns. Now They're Reconsidering.*, INSTITUTIONAL INV. (Apr. 5, 2022), https://www.institutionalinvestor.com/article/2bstolqfnrubgolhso54w/portfolio/investors-dropped-oil-due-to-underperformance-and-esg-concerns-now-theyre-reconsidering.

[89] Zelinsky, *supra* note 13, at 348.

[90] Schanzenbach & Sitkoff, *supra* note 4, at 409.

return, it will attract capital by normal market forces without needing to rely on its collateral benefits.[91]

Finally, some worry that *permitting* the consideration of ESG goals in investing pension funds may pave the way for government *mandates* to do so.[92] The vast amount of wealth held by pension funds remains a tempting source of funding for politicians and others seeking to advance their idea of the common good from a position of control rather than through republican governance or free market mechanisms. The thrust of the modern ESG movement, like its predecessors, threatens to divert more private capital to the government to decide how best to allocate it. A sole interest fiduciary standard, without the malleable "not subordinate" gloss, provides protection against that possibility and permits capital to flow to investments that produce the best economic returns.

Other Views:

- Max M. Schanzenbach & Robert H. Sitkoff, *ESG Investing After the DOL Rule on "Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights,"* HARV. L. SCH. FORUM ON CORP. GOV. (Feb. 2, 2023), https://corpgov.law.harvard.edu/2023/02/02/esg-investing-after-the-dol-rule-on-prudence-and-loyalty-in-selecting-plan-investments-and-exercising-shareholder-rights/.
- David H. Webber, *New Department of Labor Investment Rules Could Be Big Win for Everyone but Labor*, CLS BLUE SKY BLOG (Mar. 28, 2022), https://clsbluesky.law.columbia.edu/2022/03/28/new-department-of-labor-investment-rules-could-be-big-win-for-everyone-but-labor/.
- Martin Lipton, *ESG, Stakeholder Governance, and the Duty of the Corporation*, HARV. L. SCH. FORUM ON CORP. GOV. (Sept. 18, 2022), https://corpgov.law.harvard.edu/2022/09/18/esg-stakeholder-governance-and-the-duty-of-the-corporation/.

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[91] Zelinsky, *supra* note 13, at 336.

[92] Comments on the DOL's 2021 Proposed Rule express such fears. *See, e.g.*, National Center for Public Policy Research, Comment Letter on Proposed Rule Regarding Prudence and Loyalty (Dec. 10, 2021), at 2, https://www.regulations.gov/comment/EBSA-2021-0013-0323 (arguing that the proposed rule would "effectively coerce pension managers into investing in and voting for overtly political [ESG] shareholder resolutions"); U.S. Senate Ranking Members, Comment Letter on Proposed Rule Regarding Prudence and Loyalty (Dec. 10, 2021), at 1, https://www.regulations.gov/comment/EBSA-2021-0013-0318 ("[T]he proposal effectively mandates consideration of climate change and ESG factors in all investment and proxy voting decisions.").