

## FIDUCIARY PERSPECTIVES

# ESG in retirement plans: Clarity but no certainty after DOL ruling

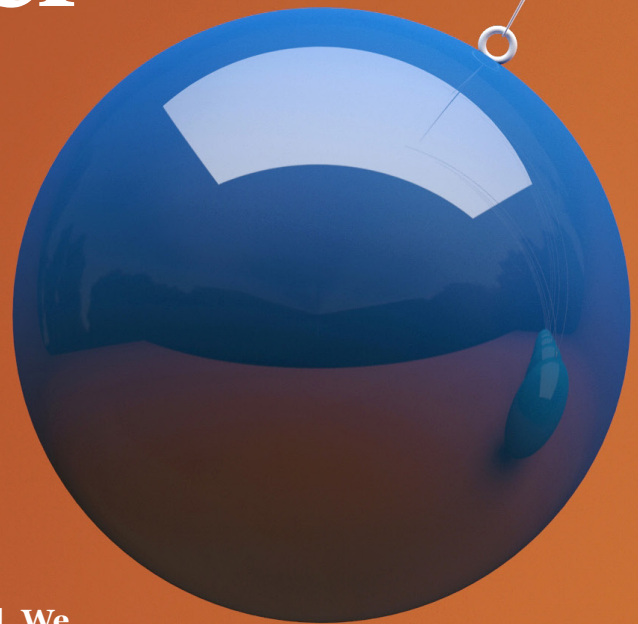
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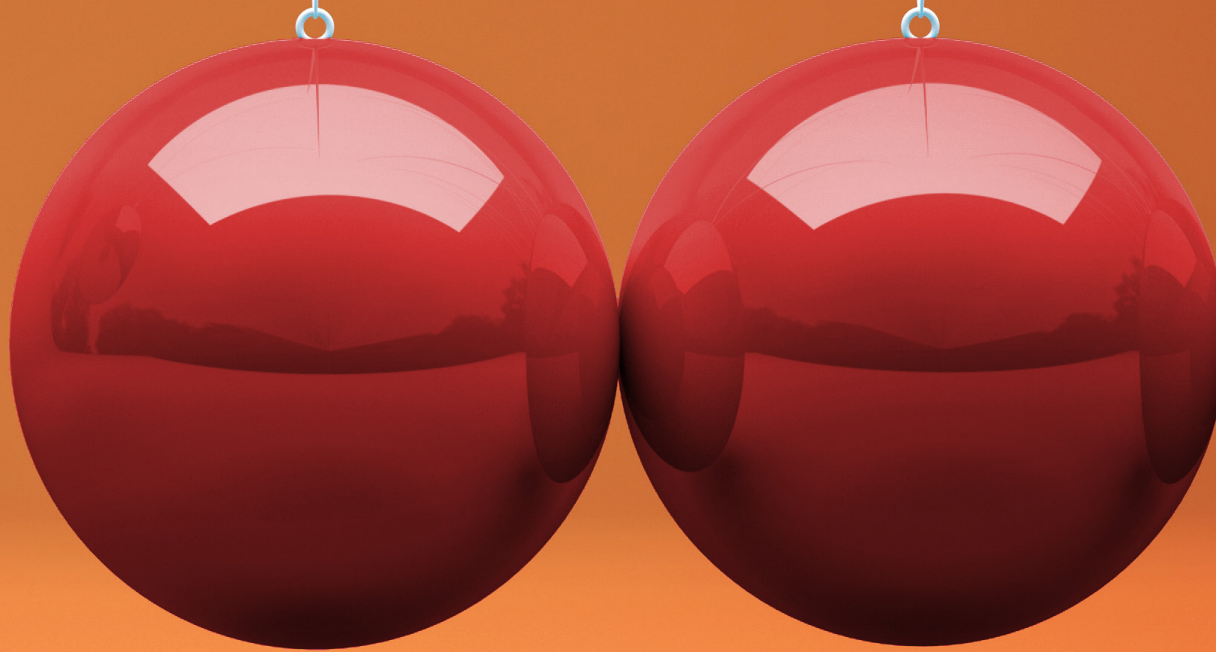
**As we discussed in an edition of *next* last year, there were a number of key themes that we were looking for in the DOL's final amendments to the so-called ESG Rule. Now we have the final text, and it is more neutral than the version the DOL originally proposed. We appreciate the DOL addressing the issue but there are remaining uncertainties around the regulation and impact on employers offering RI in their retirement plan menus.**

This more neutral approach is arguably a good thing. A more neutral ruling from the DOL hopefully reduces the likelihood that this particular rule becomes an endless ping pong ball of policy that bounces back and forth with every change of administration. With any luck, a more neutral ruling will give some regulatory certainty to this area and unlock the potential of ESG products to find their way into more investment menus.

### What's in the rule?

As of January 30, 2023, the final rule that was released back in late November 2022 is now in effect. The rule, called "Prudence and loyalty in selecting plan investments and exercising shareholder rights" directs the federal government to identify and assess policies to protect savings and pensions from the threat of climate-related financial risks. One of the most important





factors to be reminded of is that the new DOL ruling still retains the core focus on the duties of prudence and loyalty. But it does give consideration into the growing movement in asset management, and society as a whole, that the economic effects of climate change are risk factors that are often worthy of consideration in the type of long-horizon investments such as those contained within retirement plans. The rule defines risk-return characteristics more broadly, and explicitly includes the consideration of ESG factors as potential elements for fiduciaries. Below we examine some key changes between the draft and final rules.

**There are five key elements to the DOL's final ruling:**

**1 The interpretation of the duty of prudence is largely unchanged, but generally more neutral than in the initial proposal.**

The final text removes the explicit endorsement of ESG as being material factors. The final rule therefore affirmed that a fiduciary's determination with respect to any particular investment must be based on a risk and return analysis, but such analysis may include the economic effects of climate change and other ESG factors if the plan fiduciary determines that they are relevant, or material.

**2 The duty of loyalty language in the final ruling is similar to the initial proposal.**

The DOL interpreted that in considering the duty of loyalty it would be contrary if the plan sponsor subordinated interests of participants to other objectives. There was also language to reiterate that plan sponsors should not sacrifice investment return or

take additional risk to invest in things that could harm retirement goals. However, from the proposal they took out specific examples of material ESG factors, as we suspected they might, to broaden the ruling.

**3 Tie-breaker tests include substantial changes from the previous version of the rule.**

Tie-breaker tests, as we wrote in our article last year, were one of the more contentious sections of the proposed rule. Under the 2020 version of the DOL rule there was a challenging concept that if a plan sponsor couldn't decide between two "economically indistinguishable" options, they could consider ESG. But this standard was almost an impossibility to reach and was unnecessarily restrictive.

However, the final rule says that a fiduciary is now permitted to consider "collateral benefits" to select between two alternatives for the plan that both "equally serve" the needs of participants. We view this new language as being fundamentally much more open as it shifts the emphasis away from hard economic standards. There are many ways that two investments could equally serve the participants, and the rule doesn't specifically call out factors such as return or risk, etc.

**4 With regard to proxy voting the ruling reiterates the fiduciary duty to vote proxies, unless there are undue burdens of voting.**

It also makes it clear that it does not impose a uniform methodology for determining participant preferences but leave this to the discretion of fiduciaries. We view this as being a more traditional, neutral approach.

**5 The final rule also clarifies that QDIAs are not treated differently, with the same overall level of tests being applied to default investments as to others on the menu.**

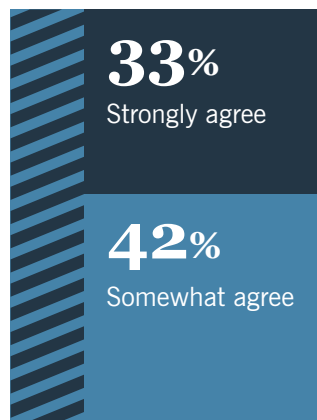
This is important as it potentially allows for sponsors to select ESG options for QDIAs as long as they can show that the selection is otherwise financially prudent.

**State vs. federal environment**

One large area that remains to be developed is the vastly mixed environment that exists regarding ESG on a state-by-state basis. Despite the DOL taking steps to clarify policy at a federal level, there exist a myriad efforts at the state level to penalize companies that are viewed as

**75%**  
of employees agree:

"Employers who have responsible investments on their retirement menu care about my retirement outcome."



Source: Nuveen Seventh annual responsible investing survey<sup>1</sup>

too ESG-friendly (or vice versa in "blue states"). Despite some political certainty being granted at the national level by the DOL, state-based developments are keeping the topic of a fiduciary's responsibilities in the context of ESG investments in flux as party control has the potential to oscillate regularly.

It must also be said that while the DOL clearly tried to present a more neutral final rule so as to head off potential political back-and-forth, that plan was always going to be an uphill battle. In the middle of December, a number of House Republicans introduced a joint resolution to nullify the final ruling. While the resolution has little chance of passing while Democrats control the Senate and White House, the intent to keep the rule in the political realm remains clear.

## Participant preferences

The final rule from the DOL also permits fiduciaries to consider participant preferences in their investment selections, with a statement saying that such considerations are not in breach of the duty of loyalty. This, as we demonstrate below, could have useful repercussions for taking into account clear employee preferences for ESG options in retirement plans.

In Nuveen's seventh annual responsible investing survey, we interviewed over a thousand investors for their views on responsible investing.<sup>2</sup> Our survey continued to find strong support among employees for companies that offer RI options on their retirement menus. Seventy-six percent agree that employers who have RI on their retirement menu care about their personal retirement outcomes, with 95% of millennial and Gen Z employees agreeing with that statement.

We also found that most investors agree that having RI options on their retirement plan garners greater loyalty to their companies. Sixty-nine percent say that having RI options makes them feel good about working for their employer and 60% say it would make them

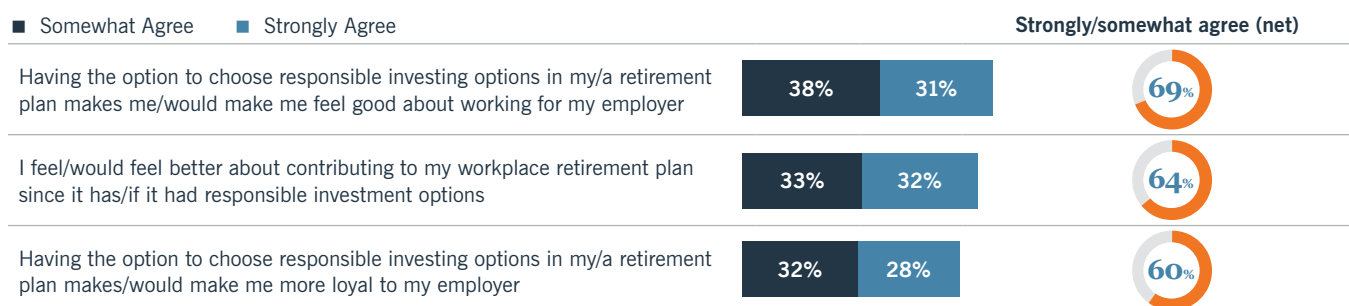


more loyal to their employer. Our survey also found that 91% of millennial and Gen Z investors agree that having RI options on their retirement menus would make them more loyal to their company, highlighting just how important this area of retirement planning and investing can be to younger employees. These numbers broadly speak to a significant number of employees who want their retirement plans to better reflect their personal values. These results also suggest that including RI options on retirement menus can be a way to encourage employee retention and increase overall employee satisfaction.

Even with the extensive survey response indicating that employees feel greater loyalty to their companies when they offer responsible investing retirement options, our survey found that one in four employees do not have any responsible investing options on their retirement plan today.



## Impact of employers offering RI on their retirement menu



Source: Nuveen Seventh annual responsible investing survey<sup>1</sup>

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**To learn more, visit us at [Nuveen.com/retirement](https://www.nuveen.com/retirement).**

**Endnotes**

- 1 Nuveen commissioned The Harris Poll to conduct an investor survey to further enhance the company's leadership position among investors, the media, customers, prospects, and the broader investment community. The investor survey was conducted online within the U.S. by The Harris Poll on behalf of Nuveen between 18 July 2022 and 1 August 2022 among 1,003 investors who met the following criteria: U.S. resident, age 21+, \$100,000 in investable assets (excluding 401(k) or 403(b) accounts or real estate), primary or joint decision-maker for household financial decisions, and currently working with a financial advisor.
- 2 Responsible investing incorporates Environmental Social Governance (ESG) factors that may affect exposure to issuers, sectors, industries, limiting the type and number of investment opportunities available, which could result in excluding investments that perform well.

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