U.S. Department of Labor Employee Benefits Security Administration
Washington, D.C. 20210

Fact Sheet

U.S. Department of Labor
Employee Benefits Security Administration
November 22, 2022

Final Rule on Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights

Today, the U.S. Department of Labor released a final rule under the Employee Retirement Income Security Act (ERISA) to empower plan fiduciaries to safeguard the savings of America's workers by clarifying that fiduciaries may consider climate change and other environmental, social, and governance (ESG) factors when they make investment decisions and when they exercise shareholder rights, including voting on shareholder resolutions and board nominations.

Background

Over the last approximately 40 years, the Department has periodically considered how ERISA's fiduciary duties of prudence and loyalty apply to plan investments that promote environmental, social, or governance goals.

In its interpretive guidance during this period, the Department has consistently recognized that ERISA does not prohibit fiduciaries from making investment decisions that reflect ESG considerations, depending on the circumstances. The interpretive guidance has also recognized that the exercise of voting rights and other shareholder rights connected to shares of stock are fiduciary acts subject to ERISA's prudence and loyalty requirements.

However, differences in the tone and tenor of guidance across Administrations during these approximately 40 years have contributed to confusion among stakeholders about these investment issues.

The 2020 Rules

On November 13, 2020, the Department published a final rule, "Financial Factors in Selecting Plan Investments,"[1] which adopted amendments to ERISA's "Investment Duties"[2] regulation. The amendments generally required plan fiduciaries to select investments and investment courses of action based solely on consideration of "pecuniary factors," which are factors defined in the regulation.

On December 16, 2020, the Department published a related final rule, "Fiduciary Duties Regarding Proxy Voting and Shareholder Rights,"[3] which also adopted amendments to the "Investment Duties" regulation. These amendments addressed plan fiduciaries' ERISA

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[1] 85 Fed. Reg. 72846.
[2] Originally published in 1979 and currently codified at 29 CFR 2550.404a-1.
[3] 85 Fed. Reg. 81658.

obligations when voting proxies and exercising other shareholder rights in connection with plan investments in shares of stock.

These two final rules (the 2020 rules)[4] sought to address uncertainty in these areas and respond to a perception that investment products could be marketed to ERISA fiduciaries based on goals and purported benefits that are unrelated to financial performance. The 2020 rules became effective in January 2021.

Following publication of the 2020 rules, the Department heard from a variety of stakeholders, including asset managers, labor organizations, corporate America, consumer groups, service providers, workers, and investment advisers. These stakeholders questioned whether the 2020 rules properly reflected the scope of fiduciaries' duties under ERISA to act prudently and solely in the interest of plan participants and beneficiaries. They also questioned whether the Department rushed the rulemakings and failed to adequately consider and address evidence submitted by public commenters on how ESG considerations can improve investment value and long-term investment returns for retirement investors.

The Department also heard from stakeholders that the 2020 rules and investor confusion about the rules were having a chilling effect on appropriate integration of ESG factors in investment decisions. Some stakeholders also expressed concern that under a special provision in the 2020 rules, funds would not be treated as qualified default investment alternatives (QDIAs) solely because they expressly considered climate change or other ESG factors, even if the funds were prudent based on consideration of their financial attributes alone.

President Biden's Executive Orders

Executive Order (E.O.) 13990, "Protecting Public Health and the Environment and Restoring Science to Tackle the Climate Crisis," which was signed on January 20, 2021, directed federal agencies to review regulations that:

(1) were promulgated, issued, or adopted between January 20, 2017, and January 20, 2021, and
(2) are or may be inconsistent with, or present obstacles to, the policies set forth in the order. Those policies included improving public health, protecting our environment, and bolstering resilience to the impacts of climate change.[5]

Section 2 of E.O. 13990 stated that for any such identified actions, the head of the relevant agency shall, as appropriate and consistent with applicable law, consider suspending, revising, or rescinding the agency action.

E.O. 14030, "Climate-Related Financial Risk," which was signed on May 20, 2021, set forth policies to mitigate climate-related financial risk as well as actions to help safeguard the financial security of America's families, businesses and workers from climate-related financial risk that

[4] Codified at 29 CFR 2550.404a-1.
[5] Available at *www.whitehouse.gov/briefing-room/presidential-actions/2021/01/20/executive-order-protecting-public-health-and-environment-and-restoring-science-to-tackle-climate-crisis*.

may threaten the life savings and pensions of America's workers and families.[6] Section 4 of the order directed the Department to consider publishing for notice and comment a proposed rule to suspend, revise, or rescind the 2020 rules.

Department of Labor Review of 2020 Rules and Enforcement Policy

On March 10, 2021, the Department announced it was reviewing the 2020 rules and issued an enforcement policy statement under ERISA.[7] The statement announced that, until the publication of further guidance, the Department would not enforce the 2020 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 QDIA, an investment course of action, or an exercise of shareholder rights.

The 2021 Notice of Proposed Rulemaking

On October 14, 2021, the Department published a Notice of Proposed Rulemaking (NPRM) to amend the "Investment Duties" regulation. The intent of the NPRM was to address the Department's concern that the 2020 rules created uncertainty for ERISA fiduciaries around considering climate change and other ESG factors in investment decisions.

Such uncertainty resulted in the undesirable effect of discouraging ERISA fiduciaries from such considerations, even in cases where this consideration served the plan's financial interest. It also deterred fiduciaries from taking steps that other marketplace investors take in enhancing investment value and performance or improving investment portfolio resilience against the potential financial risks and impacts associated with climate change and other ESG factors.

The Department received approximately 900 written comments and over 20,000 petitions during the 60-day comment period.[8] These comments and petitions came from a variety of parties, including plan sponsors and other plan fiduciaries, individual plan participants and beneficiaries, financial services companies, academics, elected government officials, trade and industry associations, and others, both supporting and opposing the NPRM.

Overview of the Final Rule

The final rule clarifies how ERISA's fiduciary duties of prudence and loyalty apply to selecting investments and investment courses of action and exercising shareholder rights such as proxy voting.

The final rule retains the core principle that the duties of prudence and loyalty require ERISA plan fiduciaries to focus on relevant risk-return factors and not subordinate the interests of

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[6] Available at www.whitehouse.gov/briefing-room/presidential-actions/2021/05/20/executive-order-on-climate-related-financial-risk.
[7] *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 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.
[8] Comments to the NPRM are available at www.dol.gov/agencies/ebsa/laws-and-regulations/rules-and-regulations/public-comments/1210-AC03.

participants and beneficiaries (such as by sacrificing investment returns or taking on additional investment risk) to objectives unrelated to the provision of benefits under the plan.

The final rule also reiterates a second core principle, which is that when a plan's assets include shares of stock, the fiduciary duty to manage plan assets includes the management of shareholder rights related to those shares, such as the right to vote proxies.

I. Changes to Clarify Permissibility of Consideration of ESG Factors

An important change adopted in the final rule is the addition of regulatory text clarifying that a fiduciary's duty of prudence must be based on factors that the fiduciary reasonably determines are relevant to a risk and return analysis and that such factors may include the economic effects of climate change and other ESG considerations on the particular investment or investment course of action.[9]

II. Changes to Qualified Default Investment Alternative Provisions

The final rule removes the special rules for QDIAs that applied under the 2020 rules. Under the final rule, standards applied to QDIAs are no different from those applied to other investments. When selecting a QDIA, a plan fiduciary must, among other things, focus on relevant risk and return factors and not subordinate the interests of participants and beneficiaries (such as by sacrificing investment returns or taking on additional investment risk) to objectives unrelated to the provision of benefits under the plan.

The preamble to the final rule reaffirms that, in addition to the requirements under the "Investment Duties" regulation, other standards apply to QDIAs.[10]

III. Changes to Clarify the Application of the Duty of Loyalty

The Tiebreaker Test

Another important change to the 2020 rules is the final rule's formulation of the "tiebreaker" standard, which permits fiduciaries to consider collateral benefits as tiebreakers in some circumstances.

The 2020 rules required that competing investments be economically indistinguishable before fiduciaries could turn to collateral factors to break a tie. It also imposed a special documentation requirement on the use of collateral factors.

The final rule replaces those provisions with a standard that instead requires the fiduciary to prudently conclude that competing investments or investment courses of action equally serve the financial interests of the plan over the appropriate time horizon. In such cases, the fiduciary is not prohibited from selecting the investment or investment course of action based on collateral benefits, meaning benefits other than investment returns.

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[9] See 29 CFR 2550.404a-1(b)(4).
[10] See 29 CFR 2550.404a-5.

The final rule also removes the special documentation requirement that commenters noted created unnecessary burdens to apply the tiebreaker provision and erroneously suggested to some fiduciaries that they should be wary of considering ESG factors, even when those factors are financially relevant to the investment decision. However, the final rule maintains the longstanding principle that the fiduciary may not accept reduced returns or greater risks to secure collateral benefits.[11]

Investment Alternatives in Participant-Directed Individual Account Plans

The final rule adds a new provision clarifying that fiduciaries do not violate their duty of loyalty solely because they take participants' non-financial preferences into account when constructing a menu of prudent investment options for participant-directed individual account plans.

This addition responds to commenters' suggestions that if accommodating participants' preferences will lead to greater participation and higher deferral rates, it could lead to greater retirement security. Thus, considering whether an investment option aligns with participants' preferences can be relevant to furthering the purposes of the plan.[12]

IV. Provisions on Shareholder Rights including Proxy Voting

Like the 2020 rules, the final rule adopts a principles-based approach to governing the exercise of shareholder rights. The final rule retains the core principle that when a plan's assets include shares of stock, the fiduciary duty to manage plan assets includes the management of shareholder rights related to those shares, such as the right to vote proxies. Like the NPRM, the final rule makes three noteworthy changes to the 2020 rules' provision on exercises of shareholder rights, including proxy voting.

First, the final rule eliminates the statement in paragraph (e)(2)(ii) of the 2020 rules that "the fiduciary duty to manage shareholder rights appurtenant to shares of stock does not require the voting of every proxy or the exercise of every shareholder right." The final rule eliminates this provision because it may be misread as suggesting that plan fiduciaries should be indifferent to the exercise of their rights as shareholders, even if the cost is minimal.

Second, the final rule removes the two "safe harbor" examples for proxy voting policies permissible under paragraphs (e)(3)(i)(A) and (B) of the 2020 rules. One of these safe harbors permitted a policy to limit voting resources to types of proposals that the fiduciary has prudently determined are substantially related to the issuer's business activities or are expected to have a material effect on the value of the investment. The other safe harbor permitted a policy of refraining from voting on proposals or types of proposals if the plan's holding in a single issuer relative to the plan's total investment assets was below a quantitative threshold.

Taken together, the Department believes the safe harbors encouraged abstention as the normal course. The Department does not believe the regulation should encourage abstention as the normal course because of the importance of prudent management of shareholder rights in enhancing the value of plan assets or protecting plan assets from risk. For this reason, the

[11] See 29 CFR 2550.404a-1(c)(2).
[12] See 29 CFR 2550.404a-1(c)(3).

Department is of the view that these safe harbors did not adequately protect the interests of plans and their participants and beneficiaries.

Third, the final rule eliminates specific requirements in the 2020 rules on maintaining records on proxy voting activities (paragraph (e)(2)(ii)(E) of the 2020 proxy voting rule) and monitoring obligations when using investment managers or proxy voting firms (paragraph (e)(2)(iii) of the 2020 proxy voting rule). The maintenance of records provision was widely perceived as treating proxy voting and other exercises of shareholder rights differently from other fiduciary activities. In that respect, it risked creating a misperception that proxy voting and other exercises of shareholder rights are disfavored or carry greater fiduciary obligations than other fiduciary activities.

Effective and Applicability Dates

The final rule will be effective 60 days after publication in the Federal Register. The rule will also be applicable on that date except for a delayed applicability until one year after publication for certain proxy voting provisions to allow fiduciaries and investment managers additional time to review any proxy voting policies and guidelines and make any necessary changes.

Contact Information

For questions about the final rule, contact EBSA's Office of Regulations and Interpretations at 202-693-8500.