DEPARTMENT OF LABOR

Employee Benefits Security Administration

29 CFR Part 2550

RIN 1210–AC03

Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights

AGENCY: Employee Benefits Security Administration, Department of Labor.

ACTION: Proposed rule.

SUMMARY: The Department of Labor (Department) in this document proposes amendments to the Investment Duties regulation under Title I of the Employee Retirement Income Security Act of 1974, as amended (ERISA), to clarify the application of ERISA's fiduciary duties of prudence and loyalty to selecting investments and investment courses of action, including selecting qualified default investment alternatives, exercising shareholder rights, such as proxy voting, and the use of written proxy voting policies and guidelines.

DATES: Comments on the proposal must be submitted on or before December 13, 2021.

ADDRESSES: You may submit written comments, identified by RIN 1210–AC03 to either of the following addresses:

- *Federal eRulemaking Portal: www.regulations.gov.* Follow the instructions for submitting comments.
- *Mail:* Office of Regulations and Interpretations, Employee Benefits Security Administration, Room N–5655, U.S. Department of Labor, 200 Constitution Avenue NW, Washington, DC 20210, Attention: Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights.

Instructions: All submissions received must include the agency name and Regulatory Identifier Number (RIN) for this rulemaking. Persons submitting comments electronically are encouraged not to submit paper copies. Comments will be available to the public, without charge, online at *www.regulations.gov* and *www.dol.gov/agencies/ebsa* and at the Public Disclosure Room, Employee Benefits Security Administration, Suite N–1513, 200 Constitution Avenue NW, Washington, DC 20210.

Warning: Do not include any personally identifiable or confidential business information that you do not want publicly disclosed. Comments are public records posted on the internet as received and can be retrieved by most internet search engines.

FOR FURTHER INFORMATION CONTACT: Fred Wong, Acting Chief of the Division of Regulations, Office of Regulations and Interpretations, Employee Benefits Security Administration, (202) 693–8500. This is not a toll-free number.

Customer Service Information: Individuals interested in obtaining information from the Department of Labor concerning ERISA and employee benefit plans may call the Employee Benefits Security Administration (EBSA) Toll-Free Hotline, at 1–866–444–EBSA (3272) or visit the Department of Labor's website (*www.dol.gov/ebsa*).

SUPPLEMENTARY INFORMATION:

A. Background and Purpose of Regulatory Action

1. General

Title I of the Employee Retirement Income Security Act of 1974 (ERISA) establishes minimum standards that govern the operation of private-sector employee benefit plans, including fiduciary responsibility rules. Section 404 of ERISA, in part, requires that plan fiduciaries act prudently and diversify plan investments so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so.[1] Sections 403(c) and 404(a) also require 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 and defraying reasonable expenses of administering the plan.[2]

For many years, the Department's non-regulatory guidance has recognized that, under the appropriate circumstances, ERISA fiduciaries can make investment decisions that reflect climate change and other environmental, social, or governance (''ESG'') considerations, including climate-related financial risk, and choose economically targeted investments (''ETIs'') selected, in part, for benefits apart from the investment return.[3] The Department's non-regulatory guidance has also recognized that the fiduciary act of managing employee benefit plan assets includes the management of voting rights as well as other shareholder rights connected to shares of stock, and that management of those rights, as well as shareholder engagement activities, is subject to ERISA's prudence and loyalty requirements.[4]

On June 30 and September 4, 2020, the Department published in the **Federal Register** proposed rules to remove prior non-regulatory guidance from the CFR and to amend the Department's Investment Duties regulation under Title I of ERISA at 29 CFR 2550.404a–1 (hereinafter ''current regulation'' or ''Investment Duties regulation,'' unless otherwise stated). The stated objective was to address perceived confusion about the implications of that non-regulatory guidance with respect to ESG considerations, ETIs, shareholder rights, and proxy voting. *See* 85 FR 39113 (June 30, 2020); 85 FR 55219 (Sept. 4, 2020). The preambles to the 2020 proposals expressed concern that some ERISA plan fiduciaries might be making improper investment decisions, and that plan shareholder rights were being exercised in a manner that subordinated the interests of plans and their participants and beneficiaries to unrelated objectives. *See* 85 FR 39116; 85 FR 55221.

On November 13, 2020, the Department published a final rule titled ''Financial Factors in Selecting Plan Investments,'' 85 FR 72846 (Nov. 13, 2020), which adopted amendments to the Investment Duties regulation that generally require plan fiduciaries to select investments and investment courses of action based solely on consideration of ''pecuniary factors.'' The current regulation also contains a prohibition against adding or retaining any investment fund, product, or model portfolio as a qualified default investment alternative (QDIA) as described in 29 CFR 2550.404c–5 if the fund, product, or model portfolio reflects non-pecuniary objectives in its investment objectives or principal investment strategies. On December 16, 2020, the Department published a final rule titled ''Fiduciary Duties Regarding Proxy Voting and Shareholder Rights,'' 85 FR 81658 (December 16, 2020), which also adopted amendments to the Investment Duties regulation to establish regulatory standards for the obligations of plan fiduciaries under ERISA when voting proxies and exercising other shareholder rights in connection with plan investments in shares of stock.

On January 20, 2021, the President signed Executive Order 13990 (E.O. 13990), titled ''Protecting Public Health and the Environment and Restoring Science to Tackle the Climate Crisis,''

[1] 29 U.S.C. 1104.

[2] 29 U.S.C. 1103(c) and 1104(a).

[3] See, *e.g.,* Interpretive Bulletin 2015–01, 80 FR 65135 (Oct. 26, 2015).

[4] See, *e.g.,* Interpretive Bulletin 2016–01, 81 FR 95879 (Dec. 29, 2016).

86 FR 7037 (Jan. 25, 2021). Section 1 of E.O. 13990 acknowledges the Nation's ''abiding commitment to empower our workers and communities; promote and protect our public health and the environment.'' Section 1 also sets forth the policy of the Administration to listen to the science; improve public health and protect our environment; bolster resilience to the impacts of climate change; and prioritize both environmental justice and the creation of the well-paying union jobs necessary to deliver on these goals. Section 2 directed agencies to review all existing regulations promulgated, issued, or adopted between January 20, 2017, and January 20, 2021, that are or may be inconsistent with, or present obstacles to, the policies set forth in section 1 of E.O. 13990. Section 2 further provided that for any such actions identified by the agencies, the heads of agencies shall, as appropriate and consistent with applicable law, consider suspending, revising, or rescinding the agency actions.[5]

On March 10, 2021, the Department announced that it had begun a reexamination of the current regulation, consistent with E.O. 13990 and the Administrative Procedure Act. The Department also announced that, pending its review of the current regulation, the Department will not enforce the current regulation or otherwise pursue enforcement actions against any plan fiduciary based on a failure to comply with the current regulation with respect to an investment, including a Qualified Default Investment Alternative, or investment course of action or with respect to an exercise of shareholder rights. In announcing the enforcement policy, the Department also stated its intention to conduct significantly more stakeholder outreach to determine how to craft rules that better recognize the role that ESG integration can play in the evaluation and management of plan investments, while continuing to uphold fundamental fiduciary obligations. See *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).[6]

On May 20, 2021, the President signed Executive Order 14030 (E.O. 14030), titled ''Executive Order on Climate-Related Financial Risk,'' 86 FR 27967 (May 25, 2021). The policies set forth in section 1 of E.O. 14030 include advancing acts to mitigate climate-related financial risk and actions to help safeguard the financial security of America's families, businesses, and workers from climate-related financial risk that may threaten the life savings and pensions of U.S. workers and families. Section 4 of E.O. 14030 directed the Department to consider publishing, by September 2021, for notice and comment a proposed rule to suspend, revise, or rescind ''Financial Factors in Selecting Plan Investments,'' 85 FR 72846 (Nov. 13, 2020), and ''Fiduciary Duties Regarding Proxy Voting and Shareholder Rights,'' 85 FR 81658 (Dec. 16, 2020).

2. The Department's Prior Non-Regulatory Guidance

The Department has a longstanding position that ERISA fiduciaries may not sacrifice investment returns or assume greater investment risks as a means of promoting collateral social policy goals. These proscriptions flow directly from ERISA's stringent standards of prudence and loyalty under section 404(a) of the statute.[7] The Department has a similarly longstanding position that the fiduciary act of managing plan assets that involve shares of corporate stock includes making decisions about voting proxies and exercising shareholder rights. Over the years the Department repeatedly has issued non-regulatory guidance to assist plan fiduciaries in understanding their obligations under ERISA in these areas.

Interpretive Bulletin 94–1 (IB 94–1), published in 1994, addressed economically targeted investments (ETIs) selected, in part, for collateral benefits apart from the investment return to the plan investor.[8] The Department's objective in issuing IB 94–1 was to state that ETIs[9] are not inherently incompatible with ERISA's fiduciary obligations. The preamble to IB 94–1 explained that the requirements of sections 403 and 404 of ERISA do not prevent plan fiduciaries from investing plan assets in ETIs if the investment has an expected rate of return at least commensurate to rates of return of available alternative investments, and if the ETI is otherwise an appropriate investment for the plan in terms of such factors as diversification and the investment policy of the plan. Some commentators have referred to this as the ''all things being equal'' test or the ''tie-breaker'' standard. The Department stated in the preamble to IB 94–1 that when competing investments serve the plan's economic interests equally well, plan fiduciaries can use such collateral considerations as the deciding factor for an investment decision.

In 2008, the Department replaced IB 94–1 with Interpretive Bulletin 2008–01 (IB 2008–01),[10] and then, in 2015, the Department replaced IB 2008–01 with Interpretive Bulletin 2015–01 (IB 2015–01).[11] Although the Interpretive Bulletins differed in tone and content to some extent, each endorsed the ''all things being equal'' test, while also stressing that the paramount focus of plan fiduciaries must be the plan's financial returns and providing promised benefits to participants and beneficiaries. Each Interpretive Bulletin also cautioned that fiduciaries violate

[5] A Fact Sheet issued simultaneously with E.O. 13990, specifically confirmed that the Department was directed to review the final rule on ''Financial Factors in Selecting Plan Investments'' (*https://www.whitehouse.gov/briefing-room/statements-releases/2021/01/20/fact-sheet-list-of-agency-actions-for-review/*).

[6] 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.*

[7] 29 U.S.C. 1104(a).

[8] 59 FR 32606 (June 23, 1994) (appeared in Code of Federal Regulations as 29 CFR 2509.94–1). Prior to issuing IB 94–1, the Department had issued a number of letters concerning a fiduciary's ability to consider the collateral effects of an investment and granted a variety of prohibited transaction exemptions to both individual plans and pooled investment vehicles involving investments that produce collateral benefits. See Advisory Opinions 80–33A, 85–36A and 88–16A; Information Letters to Mr. George Cox, dated Jan. 16, 1981; to Mr. Theodore Groom, dated Jan. 16, 1981; to The Trustees of the Twin City Carpenters and Joiners Pension Plan, dated May 19, 1981; to Mr. William Chadwick, dated July 21, 1982; to Mr. Daniel O'Sullivan, dated Aug. 2, 1982; to Mr. Ralph Katz, dated Mar. 15, 1982; to Mr. William Ecklund, dated Dec. 18, 1985, and Jan. 16, 1986; to Mr. Reed Larson, dated July 14, 1986; to Mr. James Ray, dated July 8, 1988; to the Honorable Jack Kemp, dated Nov. 23, 1990; and to Mr. Stuart Cohen, dated May 14, 1993. The Department also issued a number of prohibited transaction exemptions that touched on these issues. See PTE 76–1, part B, concerning construction loans by multiemployer plans; PTE 84–25, issued to the Pacific Coast Roofers Pension Plan; PTE 85–58, issued to the Northwestern Ohio Building Trades and Employer Construction Industry Investment Plan; PTE 87–20, issued to the Racine Construction Industry Pension Fund; PTE 87–70, issued to the Dayton Area Building and Construction Industry Investment Plan; PTE 88–96, issued to the Real Estate for American Labor A Balcor Group Trust; PTE 89–37, issued to the Union Bank; and PTE 93–16, issued to the Toledo Roofers Local No. 134 Pension Plan and Trust, et al. In addition, one of the first directors of the Department's benefits office authored an article on this topic in 1980. See Ian D. Lanoff, *The Social Investment of Private Pension Plan Assets: May It Be Done Lawfully Under ERISA?,* 31 Labor L.J. 387, 391–92 (1980) (stating that ''[t]he Labor Department has concluded that economic considerations are the only ones which can be taken into account in determining which investments are consistent with ERISA standards,'' and warning that fiduciaries who exclude investment options for non-economic reasons would be ''acting at their peril'').

[9] IB 94–1 used the terms ETI and economically targeted investments to broadly refer to any investment or investment course of action that is selected, in part, for its expected collateral benefits, apart from the investment return to the employee benefit plan investor.

[10] 73 FR 61734 (Oct. 17, 2008).

[11] 80 FR 65135 (Oct. 26, 2015).

ERISA if they accept reduced expected returns or greater risks to secure social, environmental, or other policy goals.

Additionally, the preamble to IB 2015–01 explained that if a fiduciary prudently determines that an investment is appropriate based solely on economic considerations, including those that may derive from ESG factors, the fiduciary may make the investment without regard to any collateral benefits the investment may also promote. In Field Assistance Bulletin 2018–01 (FAB 2018–01), the Department indicated that IB 2015–01 had recognized that there could be instances when ESG issues present material business risk or opportunities to companies that company officers and directors need to manage as part of the company's business plan, and that qualified investment professionals would treat the issues as material economic considerations under generally accepted investment theories. As appropriate economic considerations, such ESG issues should be considered by a prudent fiduciary along with other relevant economic factors to evaluate the risk and return profiles of alternative investments. In other words, in these instances, the factors are not ''tie-breakers,'' but ''risk-return'' factors affecting the economic merits of the investment.

FAB 2018–01 cautioned, however, that ''[t]o the extent ESG factors, in fact, involve business risks or opportunities that are properly treated as economic considerations themselves in evaluating alternative investments, the weight given to those factors should also be appropriate to the relative level of risk and return involved compared to other relevant economic factors.'' [12] The Department further emphasized in FAB 2018–01 that fiduciaries ''must not too readily treat ESG factors as economically relevant to the particular investment choices at issue when making a decision,'' as ''[i]t does not ineluctably follow from the fact that an investment promotes ESG factors, or that it arguably promotes positive general market trends or industry growth, that the investment is a prudent choice for retirement or other investors.'' Rather, ERISA fiduciaries must always put first the economic interests of the plan in providing retirement benefits and ''[a] fiduciary's evaluation of the economics of an investment should be focused on financial factors that have a material effect on the return and risk of an investment based on appropriate investment horizons consistent with the plan's articulated funding and investment objectives.'' [13]

FAB 2018–01 also explained that in the case of an investment platform that allows participants and beneficiaries an opportunity to choose from a broad range of investment alternatives, a prudently selected, well managed, and properly diversified ESG-themed investment alternative could be added to the available investment options on a 401(k) plan platform without requiring the plan to remove or forgo adding other non-ESG-themed investment options to the platform.[14] According to the FAB, however, the selection of an investment fund as a qualified default investment alternative (QDIA) [15] is not analogous to a fiduciary's decision to offer participants an additional investment alternative as part of a prudently constructed lineup of investment alternatives from which participants may choose. FAB 2018–01 expressed concern that the decision to favor the fiduciary's own policy preferences in selecting an ESG-themed investment option as a QDIA for a 401(k)-type plan without regard to possibly different or competing views of plan participants and beneficiaries would raise questions about the fiduciary's compliance with ERISA's duty of loyalty.[16] In addition the field assistance bulletin stated that, even if consideration of such factors could be shown to be appropriate in the selection of a QDIA for a particular plan population, the plan's fiduciaries would have to ensure compliance with the previous guidance in IB 2015–01. For example, the selection of an ESG-themed target date fund as a QDIA would not be prudent if the fund would provide a lower expected rate of return than available non-ESG alternative target date funds with commensurate degrees of risk, or if the fund would be riskier than non-ESG alternative available target date funds with commensurate rates of return.

The Department's past non-regulatory guidance has also consistently recognized that the fiduciary act of managing employee benefit plan assets includes the management of voting rights as well as other shareholder rights connected to shares of stock, and that management of those rights, as well as shareholder engagement activities, is subject to ERISA's prudence and loyalty requirements.

The Department first issued non-regulatory guidance on proxy voting and the exercise of shareholder rights in the 1980s. For example, in 1988, the Department issued an opinion letter to Avon Products, Inc. (the Avon Letter), in which the Department took the position that the fiduciary act of managing plan assets that are shares of corporate stock includes the voting of proxies appurtenant to those shares, and that the named fiduciary of a plan has a duty to monitor decisions made and actions taken by investment managers with regard to proxy voting.[17] In 1994, the Department issued its first interpretive bulletin on proxy voting, Interpretive Bulletin 94–2 (IB 94–2).[18] IB 94–2 recognized that fiduciaries may engage in shareholder activities intended to monitor or influence corporate management if the responsible fiduciary concludes that, after taking into account the costs involved, there is a reasonable expectation that such shareholder activities (by the plan alone or together with other shareholders) will enhance the value of the plan's investment in the corporation. The Department also reiterated its view that ERISA does not permit fiduciaries, in voting proxies or exercising other shareholder rights, to subordinate the economic interests of participants and beneficiaries to unrelated objectives.

In October 2008, the Department replaced IB 94–2 with Interpretive Bulletin 2008–02 (IB 2008–02).[19] The Department's intent was to update the guidance in IB 94–2 and to reflect interpretive positions issued by the Department after 1994 on shareholder engagement and socially directed proxy voting initiatives. IB 2008–02 stated that fiduciaries' responsibility for managing proxies includes both deciding to vote and deciding not to vote.[20] IB 2008–02 further stated that the fiduciary duties described at ERISA sections 404(a)(1)(A) and (B) require that in voting proxies the responsible fiduciary shall consider only those factors that relate to the economic value of the plan's investment and shall not subordinate the interests of the participants and beneficiaries in their retirement income to unrelated objectives. In addition, IB 2008–02 stated that votes shall only be cast in accordance with a plan's economic interests. IB 2008–02 explained that if

[12] FAB 2018–01.

[13] *Id.*

[14] *Id.*

[15] 29 CFR 2550.404c–5.

[16] FAB 2018–01.

[17] Letter to Helmuth Fandl, Chairman of the Retirement Board, Avon Products, Inc. 1988 WL 897696 (Feb. 23, 1988). Only a few commenters on the proposal mentioned the Avon Letter, either supporting the views taken in the letter as being consistent with other professional codes of ethics or asserting that the proposed rule reversed the intent of the Avon Letter by establishing a presumption that voting proxies is a cost to be minimized and not an asset to be prudently managed.

[18] 59 FR 38860 (July 29, 1994).

[19] 73 FR 61731 (Oct. 17, 2008).

[20] 73 FR 61732.

the responsible fiduciary reasonably determines that the cost of voting (including the cost of research, if necessary, to determine how to vote) is likely to exceed the expected economic benefits of voting, the fiduciary has an obligation to refrain from voting.[21] The Department also reiterated in IB 2008–02 that any use of plan assets by a plan fiduciary to further political or social causes ''that have no connection to enhancing the economic value of the plan's investment'' through proxy voting or shareholder activism is a violation of ERISA's exclusive purpose and prudence requirements.[22]

In 2016, the Department issued Interpretive Bulletin 2016–01 (IB 2016–01), which reinstated the language of IB 94–2 with certain modifications.[23] IB 2016–01 reiterated and confirmed that ''in voting proxies, the responsible fiduciary [must] 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.'' [24] In its guidance, the Department has also stated that it rejects a construction of ERISA that would render the statute's tight limits on the use of plan assets illusory and that would permit plan fiduciaries to expend trust assets to promote myriad personal public policy preferences at the expense of participants' economic interests, including through shareholder engagement activities, voting proxies, or other investment policies.[25]

3. Review of Current Regulation—the 2020 Final Rules

As noted above, consistent with E.O. 13990 and E.O. 14030, the Department engaged in informal outreach to hear views from interested stakeholders on how to craft regulations that better recognize the important role that climate change and other ESG factors can play in the evaluation and management of plan investments, while continuing to uphold fundamental fiduciary obligations. The Department heard from a wide variety of stakeholders, including asset managers, labor organizations and other plan sponsors, consumer groups, service providers, and investment advisers. Many of the stakeholders expressed skepticism as to whether the current regulation properly reflects the scope of fiduciaries' duties under ERISA to act prudently and solely in the interest of plan participants and beneficiaries.

That outreach effort by the Department suggested that, rather than provide clarity, some aspects of the current regulation instead may have created further uncertainty surrounding whether a fiduciary under ERISA may consider ESG and other factors in making investment and proxy voting decisions that the fiduciary reasonably believes will benefit the plan and its participants and beneficiaries. Many stakeholders questioned whether the Department rushed the current regulation unnecessarily and failed to adequately consider and address substantial evidence submitted by public commenters suggesting that the use of climate change and other ESG factors can improve investment value and long-term investment returns for retirement investors. The Department has also heard from stakeholders that the current regulation, and investor confusion about it, including whether climate change and other ESG factors may be treated as ''pecuniary'' factors under the regulation, has already had a chilling effect on appropriate integration of climate change and other ESG factors in investment decisions, which has continued through the current non-enforcement period, including in circumstances that the current regulation may in fact allow.

After conducting a further review of the current regulation, the Department believes there is a reasonable basis for these concerns. A number of public comment letters criticized the 2020 proposed regulatory text for appearing to single out ESG investing for heightened scrutiny, which they asserted was inappropriate in light of research and investment practices suggesting that climate change and other ESG factors are material economic considerations.[26] In response, the Department did not include explicit references to ESG in the final regulation and furthermore acknowledged in the preamble discussion to the *Financial Factors in Selecting Plan Investments* final rulemaking that there are instances where one or more ESG factors may be properly taken into account by a fiduciary.[27] The preamble to the *Fiduciary Duties Regarding Proxy Voting and Shareholder Rights* final rulemaking also acknowledged academic studies and investment experience surrounding the materiality of ESG considerations in investment decision-making.[28] However, other statements in the preamble appeared to express skepticism about fiduciaries' reliance on ESG considerations. For instance, the preamble to the *Financial Factors in Selecting Plan Investments* final rulemaking asserted that ESG investing raises heightened concerns under ERISA, and cautioned fiduciaries against ''too hastily'' concluding that ESG-themed funds may be selected based on pecuniary factors.[29] Similarly, the preamble to the *Fiduciary Duties Regarding Proxy Voting and Shareholder Rights* final rulemaking expressed the view that it is likely that many environmental and social shareholder proposals have little bearing on share value or other relation to plan financial interests.[30] Many stakeholders have indicated that the rules have been interpreted as putting a thumb on the scale against the consideration of ESG factors, even when those factors are financially material.

The Department is concerned that, as stakeholders warned, uncertainty with respect to the current regulation may deter fiduciaries from taking steps that other marketplace investors would take in enhancing investment value and performance, or improving investment portfolio resilience against the potential financial risks and impacts often associated with climate change and other ESG factors. The Department is concerned that the current regulation has created a perception that fiduciaries are at risk if they include any ESG factors in the financial evaluation of

[21] *Id.*

[22] 73 FR 61734.

[23] 81 FR 95879 (Dec. 29, 2016). In addition, the Department issued a Field Assistance Bulletin to provide guidance on IB 2016–01 on April 23, 2018. *See* FAB 2018–01, at *www.dol.gov/sites/dolgov/files/ebsa/employers-and-advisers/guidance/field-assistance-bulletins/2018-01.pdf.*

[24] 81 FR 95882.

[25] *See* 81 FR 95881.

[26] *See, e.g.,* Comment #567 at *https://www.dol.gov/sites/dolgov/files/EBSA/laws-and-regulations/rules-and-regulations/public-comments/1210-AB95/00567.pdf* and Comment #709 at *https://www.dol.gov/sites/dolgov/files/EBSA/laws-and-regulations/rules-and-regulations/public-comments/1210-AB95/00709.pdf.*

[27] See 85 FR 72859 (Nov. 13, 2020) (''[T]he Department believes that it would be consistent with ERISA and the final rule for a fiduciary to treat a given factor or consideration as pecuniary if it presents economic risks or opportunities that qualified investment professionals would treat as material economic considerations under generally accepted investment theories'').

[28] 85 FR 81662 (Dec. 16, 2020) (''This [Fiduciary Duties Regarding Proxy Voting and Shareholder Rights] rulemaking project, similar to the recently published final rule on ERISA fiduciaries' consideration of financial factors in investment decisions, recognizes, rather than ignores, the economic literature and fiduciary investment experience that show a particular 'E,' 'S,' or 'G' consideration may present issues of material business risk or opportunities to a specific company that its officers and directors need to manage as part of the company's business plan and that qualified investment professionals would treat as economic considerations under generally accepted investment theories.'')

[29] 85 FR 72848, 72859 (Nov. 13, 2020).

[30] 85 FR 81681 (Dec. 16, 2020).

plan investments, and that they may need to have special justifications for even ordinary exercises of shareholder rights. The amendments proposed in this document are intended to address uncertainties regarding aspects of the current regulation and its preamble discussion relating to the consideration of ESG issues, including climate-related financial risk, by fiduciaries in making investment and proxy voting decisions, and to provide further clarity that will help safeguard the interests of participants and beneficiaries in the plan benefits. Accordingly, the proposal makes clear that climate change and other ESG factors are often material and that in many instances fiduciaries to should consider climate change and other ESG factors in the assessment of investment risks and returns. This is discussed further below in the Provisions of the Proposed Rule.

The Department believes that the changes proposed will improve the current regulation and further promote retirement income security and further retirement savings. Details on the estimated costs and benefits of this proposed rule can be found in the proposal's economic analysis.

B. Provisions of the Proposed Rule

The proposed rule would amend the ''Investment Duties'' regulation at 29 CFR 2550.404a–1. Although the changes to the regulation, as described below, are limited, the entire regulation is being republished in this proposal.

Paragraph (a) of the proposed rule includes a restatement of the statutory language of the exclusive purpose requirements of ERISA section 404(a)(1)(A), and the prudence duty of ERISA section 404(a)(1)(B).

1. Investment Prudence Duties

Paragraph (b) of the proposal addresses the duty of prudence under ERISA section 404(a)(1)(B). It provides a safe harbor for prudent investment and investment courses of action.[31] The Department proposes to change the title of the paragraph from ''Investment duties'' to ''Investment prudence duties'' to more precisely reflect the scope of the paragraph. Like the current regulation, paragraph (b)(1) of the proposed rule provides, as a safe harbor, that the requirements of section 404(a)(1)(B) of the Act set forth in paragraph (a) are satisfied with respect to a particular investment or investment course of action if the fiduciary (i) has given appropriate consideration to those facts and circumstances that, given the scope of such fiduciary's investment duties, the fiduciary knows or should know are relevant to the particular investment or investment course of action involved, including the role the investment or investment course of action plays in that portion of the plan's investment portfolio with respect to which the fiduciary has investment duties, and (ii) has acted accordingly.

Paragraph (b)(2) of the proposal provides that for purposes of paragraph (b)(1), ''appropriate consideration'' shall include, but is not necessarily limited to (i) a determination by the fiduciary that the particular investment or investment course of action is reasonably designed, as part of the portfolio (or, where applicable, that portion of the plan portfolio with respect to which the fiduciary has investment duties), 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 compared to the opportunity for gain (or other return) associated with reasonably available alternatives with similar risks, and (ii) consideration of the composition of the portfolio with regard to diversification, the liquidity and current return of the portfolio relative to the anticipated cash flow requirements of the plan, and the projected return of the portfolio relative to the funding objectives of the plan as those factors relate to such portion of the portfolio.

The Department proposes additional language in paragraph (b)(2)(ii)(C) specifying that consideration of the projected return of the portfolio relative to the funding objectives of the plan may often require an evaluation of the economic effects of climate change and other ESG factors on the particular investment or investment course of action. Similar to paragraph (b)(4) of the proposal, this provision is intended to counteract negative perception of the use of climate change and other ESG factors in investment decisions caused by the 2020 Rules, and to clarify that a fiduciary's duty of prudence may often require an evaluation of the effect of climate change and/or government policy changes to address climate change on investments' risks and returns.

While the additional text in paragraph (b)(2)(ii)(C) is new, its substance is not. The Department has long acknowledged the materiality of ESG, including climate-related financial risk, in fiduciaries' investment decision-making and portfolio construction. In Interpretive Bulletin 2015–01, the Department recognized there could be instances when ESG issues present material business risk or opportunities, stating that ''environmental, social, and governance issues may have a direct relationship to the economic value of the plan's investment. In these instances, such issues are not merely collateral considerations or tie-breakers, but rather are proper components of the fiduciary's primary analysis of the economic merits of competing investment choices.'' [32] In Field Assistance Bulletin 2018–01, the Department stated that IB 2015–01 recognized that ESG issues could present material business risk or opportunities to companies, and that a prudent fiduciary should consider such issues when evaluating the risk and return profiles of investment opportunities.[33] As additional evidence on the materiality of climate change in particular has emerged in the intervening years, the Department believes that consideration of the projected return of the portfolio relative to the funding objectives of the plan not only allows but in many instances may require an evaluation of the economic effects of climate change on the particular investment or investment course of action.

For example, climate change is already imposing significant economic consequences on a wide variety of businesses as more extreme weather damages physical assets, disrupts productivity and supply chains, and forces adjustments to operations. Climate change is particularly pertinent to the projected returns of pension plan portfolios that, because of the nature of their obligations to their participants and beneficiaries, typically have long-term investment horizons. The effects of climate change such as sea level rise, changing rainfall patterns, and more severe droughts, wildfires, and flooding are expected to continue to pose a threat

[31] 85 FR at 72853 (Nov. 13, 2020); *see also* 44 FR 37222 (June 26, 1979).

[32] 80 FR 65135 (Oct. 26, 2015).

[33] FAB 2018–01, acknowledging that the Department recognized that ''there could be instances when otherwise collateral ESG issues present material business risk or opportunities to companies that company officers and directors need to manage as part of the company's business plan and that qualified investment professionals would treat as economic considerations under generally accepted investment theories. In such situations, these ordinarily collateral issues are themselves appropriate economic considerations, and thus should be considered by a prudent fiduciary along with other relevant economic factors to evaluate the risk and return profiles of alternative investments. In other words, in these instances, the factors are more than mere tie-breakers. To the extent ESG factors, in fact, involve business risks or opportunities that are properly treated as economic considerations themselves in evaluating alternative investments, the weight given to those factors should also be appropriate to the relative level of risk and return involved compared to other relevant economic factors.''

to investments far into the future. Additionally, imminent or proposed regulations, for example, to reduce greenhouse gas emissions in the power sector, and other policies incentivizing a shift from carbon-intensive investments to low-carbon investments, could significantly lower the value of carbon-intensive investments while raising the value of other investments. This could create a potentially serious risk for plan participants and beneficiaries. Taking climate change into account, such as by assessing the financial risks of investments for which government climate policies will affect performance and account for the risk of companies that are unprepared for the transition, can have a beneficial effect on portfolios by reducing volatility and mitigating the longer-term economic risks to plans' assets. While it is not always the case, a growing body of evidence suggests a generally positive relationship between the financial performance of investments that address or account for climate change.[34]

Additional language in paragraph (b)(2)(i) requires consideration of how an investment or investment course of action compares to reasonably available alternative investments or investment courses of action. This additional language in paragraph (b)(2)(i) of the proposal, which is being carried forward from the current regulation, reflects the Department's view, articulated in Interpretive Bulletin 94–1 (as well as subsequent Interpretive Bulletins) as well as earlier interpretive letters, that facts and circumstances relevant to an investment or investment course of action would include consideration of the expected return on alternative investments with similar risks available to the plan.[35] This provision is a statement of general applicability and is not unique to the use of ESG factors in selecting investments. As such, the Department expects that the provision should be commonly understood by plan fiduciaries and uncontroversial in nature. Comments are solicited on whether it is necessary to restate this principle of general applicability as part of this prudence safe harbor.

Paragraph (b)(3) of the proposal carries forward, without change, regulatory language dating back to the 1979 Investment Duties regulation, and states that an investment manager appointed pursuant to the provisions of section 402(c)(3) of the Act to manage all or part of the assets of a plan may, for purposes of compliance with the provisions of paragraphs (b)(1) and (2) of the proposal, rely on, and act upon the basis of, information pertaining to the plan provided by or at the direction of the appointing fiduciary, if such information is provided for the stated purpose of assisting the manager in the performance of the manager's investment duties, and the manager does not know and has no reason to know that the information is incorrect.

Paragraph (b)(4) is a new provision that addresses uncertainty under the current regulation as to whether a fiduciary may consider climate change and other ESG factors in making plan-related decisions under ERISA. This paragraph clarifies and confirms that a fiduciary may consider *any* factor material to the risk-return analysis, including climate change and other ESG factors. The intent of this new paragraph is to establish that material climate change and other ESG factors are no different than other ''traditional'' material risk-return factors, and to remove any prejudice to the contrary. Thus, under ERISA, if a fiduciary prudently concludes that a climate change or other ESG factor is material to an investment or investment course of action under consideration, the fiduciary can and should consider it and act accordingly, as would be the case with respect to any material risk-return factor. For the sake of clarity and to eliminate any doubt caused by the current regulation, paragraph (b)(4) of the proposal provides examples of factors, including climate change and other ESG factors, that a fiduciary may consider in the evaluation of an investment or investment course of action if material, including: (i) Climate change-related factors, such as a corporation's exposure to the real and potential economic effects of climate change, including its exposure to the physical and transitional risks of climate change and the positive or negative effect of Government regulations and policies to mitigate climate change; (ii) governance factors, such as those involving board composition, executive compensation, and transparency and accountability in corporate decision-making, as well as a corporation's avoidance of criminal liability and compliance with labor, employment, environmental, tax, and other applicable laws and regulations; and (iii) workforce practices, including the corporation's progress on workforce diversity, inclusion, and other drivers of employee hiring, promotion, and retention; its investment in training to develop its workforce's skill; equal employment opportunity; and labor relations. Paragraph (b)(4) of the proposal would not introduce any new conditions under the prudence safe harbor in paragraph (b); its sole purpose is to provide clarification through examples.

In the Department's view, and consistent with the comments of the concerned stakeholders mentioned above, the examples in paragraph (b)(4) of the proposal should eliminate unwarranted concerns about investing in climate change or ESG funds that are economically advantageous. If left unchanged, the rule could expose plans' investments and portfolios to avoidable climate-change-related risks which negatively impact performance, particularly over longer time horizons. The examples also reflect prior non-regulatory guidance on proxy voting, and include some examples which Interpretive Bulletin 2016–01 had previously indicated may be proper matters for fiduciary shareholder engagement activity.[36] To the extent such matters are appropriate for fiduciaries to consider when exercising shareholder rights with respect to existing plan investments, they would also be generally appropriate for fiduciaries to consider when making investments in the first place. The list of examples in paragraph (b)(4) of the proposal is not exclusive and the Department solicits comments on whether other or fewer examples would be helpful to avoid regulatory bias.

2. Investment Loyalty Duties

Paragraph (c) of the proposal and current regulation both address application of the duty of loyalty under ERISA. The proposal, however, differs in several respects from the current regulation. First, the standard applicable to a fiduciary's evaluation of an investment or investment course of

[34] Tensie Whelan, Ulrich Atz, Tracy Van Holt, and Casey Clark, ''ESG and Financial Performance: Uncovering the Relationship by Aggregating Evidence from 1,000 Plus Studies Published Between 2015–2020,'' NYU Stern Center for Sustainable Business and Rockefeller Asset Management (2021). Page 9 notes that, when assessing 59 climate change, or low carbon, studies related to financial performance, the majority found a positive result. *https://www.stern.nyu.edu/sites/default/files/assets/documents/NYU-RAM_ESG-Paper_2021%20Rev_0.pdf.*

[35] 59 FR at 32607 (''Other facts and circumstances relevant to an investment or investment course of action would, in the view of the Department, include consideration of the expected return on alternative investments with similar risks available to the plan''); *see, e.g.,* Information Letter to Mr. James Ray, dated July 8, 1988 (''It is the position of the Department that, to act prudently, a fiduciary must consider, among other factors, the availability, riskiness, and potential return of alternative investments.'').

[36] IB 2016–01, 81 FR 95879 (Dec. 29, 2016). *See also* IB 2015–01 (recognizing that ESG factors may be relevant economic factors considered, along with other relevant economic factors, in a prudent evaluation of alternative investments). The Department reaffirmed this view in FAB 2018–01.

action set forth in the proposal, by cross reference to paragraph (b)(4), includes clear text to indicate that ESG considerations, including climate-related financial risk, are, in appropriate cases, risk-return factors that fiduciaries should take into account when selecting and monitoring plan investments and investment courses of action.

Also, the proposal continues to include a ''tie-breaker'' standard, with the proposal more closely aligning with the Department's original non-regulatory guidance in this area, and eliminates the current regulation's specific documentation requirements, which singled out and created burdens specifically for investments providing collateral benefits, which many perceived as targeting ESG investing. The proposal makes it clear that the fiduciary is not prohibited from selecting the investment, or investment course of action, based on collateral benefits other than investment returns, so long as the requirements of the proposal are met. These include, in the case of such a collateral benefit for a designated investment alternative for an individual account plan, the prominent display of the collateral-benefit characteristic of the fund in disclosure materials. Further, the fiduciary cannot accept reduced returns or greater risks to secure the collateral-benefit.

Finally, the standards applicable to participant-directed individual account plans contained in paragraph (d) of the current regulation are merged into paragraph (c) of the proposal and revised to, among other things, eliminate the current regulation's special rule that prohibits certain investment alternatives from being used as a QDIA.

Paragraph (c)(1) of the proposal restates the Department's longstanding expression of a bedrock principle of ERISA's duty of loyalty in the context of investment decisions, as expressed in Interpretive Bulletins and associated preamble discussions. It provides 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 may not sacrifice investment return or take on additional investment risk to promote goals unrelated to the plan and its participants and beneficiaries. Paragraph (c)(2) of the current regulation contains similar language. The proposal would move this language from paragraph (c)(2) of the current regulation to paragraph (c)(1) to emphasize this bedrock principle encompassed within ERISA's duty of loyalty.

Proposed paragraph (c)(2) makes two modifications to the requirement contained in paragraph (c)(1) of the current regulation that a fiduciary's evaluation of an investment or investment course of action must be based on pecuniary factors, which is defined at paragraph (f)(3) of the current regulation as a factor that a fiduciary prudently determines is expected to 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 the funding policy established pursuant to section 402(b)(1) of ERISA. The first modification is a cross-reference to paragraph (b)(4) of the proposal to confirm that consideration of an economically material ESG factor, including climate-related financial risk, is consistent with ERISA's duty of loyalty. The second modification integrates the concept of ''risk/return'' factors directly into paragraph (c)(2) rather than as part of a separate definition of ''pecuniary'' factors. This approach addresses stakeholder concerns about ambiguity in the meaning and application of the ''pecuniary'' factors terminology of the current regulation and makes paragraph (c)(2) more readable. The separate definition of ''pecuniary factor'' in the current regulation, therefore, is unnecessary and is not included in the proposal.

Paragraph (c)(2) of the proposal thus provides that a fiduciary's evaluation of an investment or investment course of action must be based on risk and return factors that the fiduciary prudently determines are material to investment value. The proposal also expressly states that the weight given to any factor by a fiduciary should appropriately reflect a prudent assessment of its impact on risk-return. Whether any particular consideration is such a factor depends on the particular facts and circumstances. Depending on the investment or investment course of action under consideration, relevant factors may include such factors as the examples noted in paragraph (b)(4) of the proposal. As noted above, those examples include: (i) Climate change-related factors, such as a corporation's exposure to the real and potential economic effects of climate change, including exposure to the physical and transitional risks of climate change and the positive or negative effect of Government regulations and policies to mitigate climate change; (ii) governance factors, such as those involving board composition, executive compensation, transparency and accountability in corporate decision-making, as well as a corporation's avoidance of criminal liability and compliance with labor, employment, environmental, tax, and other applicable laws and regulations; (iii) workforce practices, including the corporation's progress on workforce diversity, inclusion, and other drivers of employee hiring, promotion, and retention; its investment in training to develop its workforce's skill; equal employment opportunity; and labor relations.

Paragraph (c)(3) of the proposal directly rescinds the ''tie-breaker'' standard in paragraph (c)(2) of the current regulation and replaces it with a standard that aligns more closely with the Department's original non-regulatory guidance, Interpretive Bulletin 94–1, which first advanced the ''tie-breaker'' concept. Specifically, paragraph (c)(3) of the proposal states that if, after the analysis described in paragraph (c)(2) of the proposal, a fiduciary prudently concludes that competing investment choices, or investment courses of action, equally serve the financial interests of the plan, a fiduciary can select the investment, or investment course of action, based on collateral benefits other than investment returns.

The tie-breaker provision in paragraph (c)(2) of the current regulation focuses on whether the competing investments are indistinguishable based on consideration of risk and return.[37] The Department has concerns, however, that this formulation could be interpreted too narrowly. For example, two investments may differ on a wide range of attributes, yet when considered in their totality, can serve the financial interests of the plan equally well. These investments are not indistinguishable, but they are equally appropriate additions to the plan's portfolio. Similarly, a fiduciary may prudently choose an investment as a hedge against a specific risk to the portfolio, even though the investment, when considered in isolation from the portfolio as a whole, is riskier or less likely to generate a significant positive return than other investments that do not serve the same hedging function.

Paragraph (c)(3) of the proposal, therefore, adopts a formulation of the tie-breaker standard that is intended to be broader and applies when choosing between competing choices or investment courses of action that a fiduciary prudently concludes ''equally serve the financial interests of the plan.''

[37] But it uses a different term, ''pecuniary factor,'' to do so.

The Department solicits comments on this approach, including whether it is sufficiently clear and appropriate in light of investment practices and strategies used by plan fiduciaries. The Department is also interested in other approaches that commenters believe may better reflect plan practices.

The proposal does not place parameters on the collateral benefits that may be considered by a fiduciary to break the tie. The Department believes this is consistent with prior non-regulatory guidance, but solicits comments on whether more specificity should be provided in the provision.[38] For instance, should the rule require that any collateral benefit relied upon as a tie-breaker be based upon an assessment of the shared interests or views of the participants, above and beyond their financial interests as plan participants, such as the investment's likely impact on participants' jobs or plan contribution rates?

Paragraph (c)(3) of the proposal also directly rescinds the current regulation's requirement for a fiduciary to specially document its analysis in those cases where the fiduciary has concluded that pecuniary factors alone were insufficient to be the deciding factor. As explained in the preamble to the current regulation, these provisions were included in paragraph (c)(2) of the current regulation ''to provide a safeguard against the risk that plan fiduciaries will improperly find economic equivalence and make decisions based on non-pecuniary factors without a proper analysis and evaluation.'' [39]

The Department, however, is concerned that singling out this one category of investment actions for a special documentation requirement may, in practice, chill investments based on climate change or other ESG factors, even when those factors are directly relevant to the financial merits of the investment decision or they are legitimately applied as a tie-breaker. For example, stakeholders assert that the entirety of the rulemaking process surrounding the current regulation, including negative preamble statements regarding the economic legitimacy of ESG investing, created a blanket perception that fiduciaries are uniquely at risk if they include climate change or other ESG factors in their financial evaluation of plan investments (even when they are expected to have a material effect on risk/return).[40] Therefore, many stakeholders misperceive that the consideration of climate change or other ESG factors may occur, if at all, only in the tie-breaker context and therefore only upon satisfaction of the documentation provisions. Consequently, even though the current regulation does not actually use the term ''ESG,'' many plans, plan fiduciaries, plan sponsors, and plan service providers believe the regulation (including the tie-breaker's documentation provisions) effectively singles out ESG investments for special scrutiny, even when these factors are directly relevant to the risk/return merits.

Similarly, all ESG is not equal, and when it is not material to the risk/return analysis, ESG still may be a legitimate collateral benefit for consideration under a tie-breaker analysis. In these circumstances, however, the documentation provisions in paragraph (c)(2) of the current regulation may have a chilling effect on their use. Likewise, the Department is concerned that the documentation provisions could have a chilling effect on the use of the tie-breaker provision more generally, including when ESG is not under consideration. For example, this might occur in instances when investments are selected on the basis of other factors that would benefit the plan and its participants, such as investment selection taking into account participant interest in investment options in order to increase retirement plan savings.[41] Contrary to the perception created during the promulgation of the current regulation, the Department does not view collateral benefits as being presumptively illegal, provided that the investment at issue is otherwise selected in accordance with ERISA's duties of prudence and loyalty.

In addition, the Department believes that a special documentation requirement is unnecessary given that fiduciaries are subject to a general prudence obligation and commonly document and maintain records about their investment selections pursuant to that obligation. Indeed, the Department is concerned that the documentation provisions in paragraph (c)(2) of the current regulation are too formulaic and rigid to consistently square with ERISA's prudence requirement. While the extent of documentation required to satisfy ERISA's general prudence obligations would depend on the individual facts and circumstances, the current regulation's tie-breaker provision sets out a one-size-fits-all documentation requirement. In practice, however, prudence may require something more, less, or different than is required under paragraph (c)(2) of the current regulation. The current documentation provisions, thus, could lead fiduciaries to over-documentation or under-documentation of their investment decisions. Importantly, the shortcoming of the documentation provisions in paragraph (c)(2) of the current regulation could become even more significant with the proposed broadening of the tie-breaker standard's formulation to choices or investment courses of action that a fiduciary prudently concludes ''equally serve the financial interests of the plan,'' as discussed above.

The Department's reconsidered view is that ERISA general prudence obligation is sufficiently protective in this context and, unlike the heightened documentation requirements in the current regulation, does not tip the scale against the particular investment that offers collateral benefits. In addition, as discussed later, as an added measure of transparency and protection, the proposal requires in the case of a designated investment alternative for an individual account plan, including a QDIA, that the plan fiduciary must ensure that the collateral-benefit characteristic of the fund, product, or model portfolio is prominently displayed in disclosure materials provided to participants and beneficiaries.

Finally, the Department notes that the current regulation's special rule that prohibits certain investment alternatives from being used as a QDIA is not carried forward in the proposal. Many stakeholders expressed concern that funds could be excluded from treatment as QDIAs solely because they expressly considered climate change or other ESG factors, even though the funds were prudent based on a consideration of their financial attributes alone. Often, QDIAs are the predominant investment for plan participants. If a fund expressly considers climate change or other ESG factors, is financially prudent, and meets the protective standards set out in the Department's QDIA regulation, 29 CFR 2550.404c–5 (Fiduciary Relief for Investments in Qualified Default

[38] *See, e.g.,* 80 FR 65135, 65137 (Oct. 26. 2015) (''The following Interpretive Bulletin [2015–01] deals solely with the applicability of the prudence and exclusive purpose requirements of ERISA as applied to fiduciary decisions to invest plan assets in ETIs, and in particular the collateral benefits they may provide apart from a plan's performance and the interests of participants and beneficiaries in their retirement income.'').

[39] 85 FR 72846, 72861.

[40] Some point to the skepticism of ESG considerations expressed in the preambles to the current regulation, such as a statement cautioning fiduciaries against ''too hastily'' concluding that ESG-themed funds may be selected based on pecuniary factors, as discussed above. *See, e.g.,* 85 FR 72859.

[41] 85 FR 72860.

Investment Alternatives), there appears to be no reason to foreclose plan fiduciaries from considering the fund as a QDIA.

However, with respect to the selection of designated investment alternatives under paragraph (c)(3) of the proposal, including QDIAs, for the collateral benefits they create in addition to investment return to the plan, paragraph (c)(3) adds a new requirement that the collateral-benefit characteristic of the fund, product, or model portfolio must be prominently displayed in disclosure materials provided to participants and beneficiaries. For example, if the tie-breaking characteristic of a particular designated investment alternative were that it better aligns with the corporate ethos of the plan sponsor or that it improves the esprit de corps of the workforce, for instance, then such feature or features prompting the selection of the investment must be prominently disclosed by the plan fiduciary under paragraph (c)(3) of the proposal. The essential purpose of this proposed disclosure requirement is to ensure that plan participants are given sufficient information to be aware of the collateral factor or factors that tipped the scale in favor of adding the investment option to the plan menu, as opposed to its economically equivalent peers that were not. It is possible, for instance, that a particular plan participant or a population of plan participants does not share the same preference for a given collateral purpose as the plan fiduciary that selected the designated investment alternative for placement on the menu among the plan's other options. The proposal intentionally provides flexibility in how plan fiduciaries may fulfill this requirement given the unknown spectrum of collateral benefits that might influence a plan fiduciary's selection. One likely way, however, is that the plan fiduciary could simply use the required disclosure under 29 CFR 2550.404a–5.[42] That regulation, adopted in 2012, already entitles participants in participant-directed individual account plans to receive sufficient information regarding designated investment alternatives to make informed decisions with regard to the management of their individual accounts. The information required by the 2012 rule includes information regarding the alternative's objectives or goals and the alternative's principal strategies (including a general description of the types of assets held by the investment) and principal risks. This proposal, therefore, assumes these existing disclosures are, or perhaps with minor modifications or clarifications could be, sufficient to satisfy the disclosure element of the tie-breaker provision in paragraph (c)(3) of the proposal. Accordingly, the Department believes such disclosures are already commonplace for many regulated investment products and, in any event, that this new disclosure will be useful to participants and beneficiaries in deciding how to invest their plan accounts. As with the tie-breaking provision in general, comments are solicited on the overall utility of this disclosure provision, including ideas on how best to operationalize the provision taking into account its intended purpose balanced against costs of implementation and compliance.

As indicated above, under the proposal, the standards applicable to selection of designated investment alternatives in participant-directed individual account plans contained in paragraphs (d)(1) and (d)(2)(i) of the current regulation are being incorporated into paragraph (c) of the proposal. Selection of an investment fund as a designated investment alternative under a plan is considered an ''investment course of action'' under the proposal, and therefore is covered under paragraph (c)(2) of the proposal. Additionally, as described above, paragraph (c)(3) of the proposal covers selection of designated investment alternatives for economic benefits they create in addition to investment return to the plan.

The current regulation's special provisions on QDIAs, at paragraph (d)(2)(ii) of the current regulation, are not being carried forward in this proposal. The Department's justification for these provisions was based on a perceived need for heightened protection for QDIAs given the important role they play in facilitating retirement savings under ERISA. The Department generally is of the view that QDIAs warrant special treatment because plan participants have not affirmatively directed the investment of their assets into the QDIA, but are nevertheless dependent on the investments for long-run financial security. Although the Department continues to believe as a general matter that special protections may be needed in some contexts for plans containing these investments, the Department no longer supports the particular restrictions in paragraph (d)(2)(ii) of the current regulation. As structured, paragraph (d)(2)(ii) of the current regulation disallows a fund to serve as a QDIA if it, or any of its component funds in a fund-of-fund structure, has investment objectives, goals, or principal investment strategies that include, consider, or indicate the use of non-pecuniary factors in its investment objectives, even if the fund is objectively economically prudent from a risk/return perspective or even best in class. Rather than protecting the interests of plan participants, stakeholders therefore allege that paragraph (d)(2)(ii) of the current regulation will only serve to harm participants by depriving them of otherwise financially prudent options as QDIAs. The Department agrees and, consequently, proposes to directly rescind paragraph (d)(2)(ii) of the current regulation. The rescission of this provision, however, does not leave participants and beneficiaries in plans with QDIAs without protections. QDIAs would continue to be subject to the same rules under the proposal as all other investments, including the prohibition against subordinating the interests of the participants and beneficiaries in their retirement income to other objectives. QDIAs also would continue to be subject to the separate protections of the QDIA regulation.[43] And, finally, participants in these plans would get the collateral benefit disclosure under the tie-breaker test in paragraph (c)(3) of the proposal, if applicable.

3. Proxy Voting and Exercise of Shareholder Rights

Paragraph (d) of the proposal contains provisions that address the application of the duties of prudence and loyalty under ERISA to the exercise of shareholder rights, including proxy voting. These provisions correspond to provisions contained in paragraph (e) of the current regulation. The proposed rule would move these provisions on the exercise of shareholder rights from paragraph (e) of the current regulation to paragraph (d) of the proposal for organizational purposes.

[42] 29 CFR 2550.404a–5 *Fiduciary Requirements for Disclosure in Participant-directed Individual Account Plans* (When the documents and instruments governing an individual account plan provide for the allocation of investment responsibilities to participants or beneficiaries, the plan administrator, as defined in section 3(16) of ERISA, must take steps to ensure, consistent with section 404(a)(1)(A) and (B) of ERISA, that such participants and beneficiaries, on a regular and periodic basis, are made aware of their rights and responsibilities with respect to the investment of assets held in, or contributed to, their accounts and are provided sufficient information regarding the plan, including fees and expenses, and regarding designated investment alternatives, including fees and expenses attendant thereto, to make informed decisions with regard to the management of their individual accounts.).

[43] 29 CFR 2550.404c–5.

(a) Major Changes to the Current Regulation

Paragraph (d) of the proposal includes four noteworthy changes from paragraph (e) of the current regulation. They are highlighted below followed by a technical overview of paragraph (d) of the proposal in its entirety.

First, the proposal would eliminate the statement in paragraph (e)(2)(ii) of the current regulation 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 exercise of shareholder rights is important to ensuring management accountability to the shareholders that own the company.[44] Accordingly, the Department is concerned that the statement could be misread as suggesting that plan fiduciaries should be indifferent to the exercise of their rights as shareholders, particularly in circumstances where the cost is minimal as is typical of voting proxies. In general, fiduciaries should take their rights as shareholders seriously, and conscientiously exercise those rights to protect the interests of plan participants. Paragraph (d) of the proposal sets forth standards for compliance with ERISA's duties when making decisions on the exercise of shareholder rights and proxy voting.

The proposed removal of the statement, however, does not mean that fiduciaries must always vote proxies or engage in shareholder activism. The Department's longstanding view of ERISA is that proxies should be voted as part of the process of managing the plan's investment in company stock unless a responsible plan fiduciary determines voting proxies may not be in the plan's best interest (*e.g.,* if there are significant costs or efforts associated with voting).[45] Voting proxies are a crucial lever in ensuring that shareholders' interests, as the company's owners, are protected.[46] Moreover, abstaining from a vote is not a neutral act, which has no bearing on the outcome of the matter put to the shareholders for vote, but rather, depending on the relevant voting standard under state law and the company's governing documents, could determine whether a particular matter or proposal is approved.[47] Prudent fiduciaries should take steps to ensure that the cost and effort associated with voting a proxy is commensurate with the significance of an issue to the plan's financial interests. The solution to proxy-voting costs is not total abstention, but is, instead, for the fiduciary to be prudent in incurring expenses to make proxy decisions and, wherever possible, to rely on efficient structures (*e.g.,* proxy voting guidelines, proxy advisers/managers that act on behalf of large aggregates of investors, etc.).

Second, the proposal streamlines the regulation by eliminating a provision in the current regulation (paragraph (e)(2)(iii)) that sets out specific monitoring obligations where the authority to vote proxies or exercise shareholder rights has been delegated to an investment manager or where a proxy voting firm performs advisory services as to voting proxies. Instead, the regulation addresses such monitoring obligations in another provision that more generally covers selection and monitoring obligations (paragraph (d)(2)(ii)(E) of the proposal). The revised text does not represent a change in the Department's view or requirements under the current regulation. Rather, the Department believes that, as previously expressed in Interpretive Bulletin 2016–01,[48] the general prudence and loyalty duties under ERISA section 404(a)(1) already impose a monitoring requirement. Accordingly, the Department is concerned that the specific provision in the current regulation may be read as requiring some special obligations above and beyond the statutory obligations of prudence and loyalty that generally apply to monitoring the work of service providers.

Third, the proposal revises the provision of the current regulation that addresses proxy voting policies, paragraph (e)(3)(i) of the current regulation, by removing the two ''safe harbor'' examples for proxy voting policies that would be permissible under the provisions of the current regulation. The Department continues to believe, as it stated in Interpretive Bulletin 2016–1, that the maintenance by an employee benefit plan of a statement of investment policy designed to further the purposes of the plan and its funding policy is consistent with the fiduciary obligations set forth in section 404(a)(1)(A) and (B) of ERISA, and that since the act of managing plan assets that are shares of corporate stock includes the voting of proxies appurtenant to those shares, a statement of proxy voting policy is an important part of any comprehensive statement of investment policy.[49] The Department also continues to believe that proxy voting policies can help fiduciaries reduce costs and compliance burden. However, the Department recognizes that, because the examples in the current regulation are characterized as safe harbors, they may become widely adopted by plan fiduciaries. It therefore is crucial for the Department to have confidence that the safe harbors adequately safeguard the interests of plans and their participants and beneficiaries. Based on its outreach to interested stakeholders, the Department is not confident that the safe harbors are necessary or helpful for that purpose, and, accordingly, does not believe it is appropriate to include them in the proposal. Rather, the Department specifically solicits comments on those safe harbor provisions to assist the Department in its review of the proposed regulation.

Fourth, the proposal would eliminate the requirement in paragraph (e)(2)(ii)(E) of the current regulation that, when deciding whether to exercise shareholder rights and when exercising shareholder rights, plan fiduciaries must maintain records on proxy voting activities and other exercises of shareholder rights. The proposal would remove this provision from the current regulation because, in context, it appears to treat proxy voting and other exercises of shareholder rights differently from other fiduciary activities and may create a misperception that proxy voting and other exercises of shareholder rights are disfavored or carry greater fiduciary obligations, and therefore greater potential liability, than other fiduciary activities. Such a misperception may potentially chill plan fiduciaries from exercising their rights, or result in excessive expenditures as fiduciaries

[44] See, *e.g.,* Comment #262 at *https://www.dol.gov/sites/dolgov/files/EBSA/laws-and-regulations/rules-and-regulations/public-comments/1210-AB91/00262.pdf;* Comment #209 at *https://www.dol.gov/sites/dolgov/files/EBSA/laws-and-regulations/rules-and-regulations/public-comments/1210-AB91/00209.pdf.*

[45] 81 FR 95881.

[46] See, *e.g.,* Comment #290 at *https://www.dol.gov/sites/dolgov/files/EBSA/laws-and-regulations/rules-and-regulations/public-comments/1210-AB91/00290.pdf;* Comment #288 at *https://www.dol.gov/sites/dolgov/files/EBSA/laws-and-regulations/rules-and-regulations/public-comments/1210-AB91/00288.pdf;* Comment #142 at *https://www.dol.gov/sites/dolgov/files/EBSA/laws-and-regulations/rules-and-regulations/public-comments/1210-AB91/00142.pdf.*

[47] For example, an abstention would generally have the legal effect of an ''against'' vote if the voting standard for a proposal is the affirmative vote of the majority of the shares present and entitled to vote or the majority of the outstanding shares. Similarly, the failure of a shareholder who holds its shares in ''street name'' to provide voting instructions to its broker-dealer would generally have the legal effect of an ''against'' vote for a matter where the voting standard is the majority of the outstanding shares.

[48] 81 FR 95882–3.

[49] 81 FR 95883.

over-document their efforts. Removal of the requirement is intended to address this concern.

The first and third of these proposed changes (to paragraphs (e)(2)(ii) and (e)(3)(i)(A) and (B), respectively) would be direct rescissions of provisions in the current regulation. The intent of these to-be-rescinded provisions was to offer plan fiduciaries two examples of policies they might adopt to efficiently discharge their responsibilities under section 404 of ERISA with respect to voting proxies.[50] The Department continues to be supportive of the concept of policies that promote the efficient discharge of proxy voting responsibilities. In light of stakeholder feedback, however, the Department is concerned that these provisions will not achieve this objective. To the contrary, the Department believes that the ''no vote'' statement in paragraph (e)(2)(ii) of the current regulation and the two safe harbors in paragraph (e)(3)(i) of the current regulation, in combination, may be construed as little more than regulatory permission for plans to broadly abstain from proxy voting without properly considering their interests as shareholders and without legal repercussions. Moreover, the Department is concerned about the application of the safe harbors individually. In particular, the Department is concerned that fiduciaries may take too much comfort in the safe harbor in paragraph (e)(3)(i)(A) of the current regulation. This safe harbor vaguely overlaps with the general standard that precedes it and, to that extent, provides illusory safe harbor protection to plan fiduciaries. In addition, the safe harbor in paragraph (e)(3)(i)(B) of the current regulation appears to be subject to practical drawbacks that substantially erode its actual utility. In particular, stakeholders assert that the multiple investment managers of sub-portfolios of certain ERISA look-through investment vehicles lack the information necessary to calculate the requisite threshold across the sub-portfolios, at the plan level. Even if these managers are able to ascertain a particular plan's proportional interest in the sub-portfolios, the managers do not know the plan's total investment assets, according to the stakeholders. For these reasons, the Department is proposing to rescind these particular provisions.

(b) Technical Overview of Paragraph (d) of the Proposal

Paragraph (d)(1) of the proposal, like paragraph (e)(1) of the current regulation and prior Interpretive Bulletins, provides that the fiduciary duty to manage plan assets that are shares of stock includes the management of shareholder rights appurtenant to those shares, such as the right to vote proxies.

Paragraph (d)(2)(i) of the proposal provides that when deciding whether to exercise shareholder rights and when exercising such rights, including the voting of proxies, fiduciaries must carry out their duties prudently and solely in the interests of the participants and beneficiaries and for the exclusive purpose of providing benefits to participants and beneficiaries and defraying the reasonable expenses of administering the plan.

Paragraph (d)(2)(ii) of the proposal sets forth specific standards for fiduciaries to meet when deciding whether to exercise shareholder rights and when exercising shareholder rights. In particular, a fiduciary must act solely in accordance with the economic interest of the plan and its participants and beneficiaries (paragraph (d)(2)(ii)(A)) and consider any costs involved (paragraph (d)(2)(ii)(B)). Additionally, the proposal expressly provides that a fiduciary must not subordinate the interests of the participants and beneficiaries in their retirement income or financial benefits under the plan to benefits or goals unrelated to those financial interests of the plan's participants and beneficiaries (paragraph (d)(2)(ii)(C)). Furthermore, a fiduciary must evaluate material facts that form the basis for any particular proxy vote or other exercise of shareholder rights (paragraph (d)(2)(ii)(D)). Paragraph (d)(2)(ii)(E) of the proposal additionally requires that a fiduciary must exercise prudence and diligence in the selection and monitoring of persons, if any, chosen to exercise shareholder rights or otherwise to advise on or assist with exercises of shareholder rights, such as providing research and analysis, recommendations regarding proxy votes, administrative services with voting proxies, and recordkeeping and reporting services. This provision (paragraph (d)(2)(ii)(E)) is broader than the current regulation and covers obligations related to monitoring service providers such as investment managers and proxy advisory firms that are addressed in paragraph (e)(2)(iii) of the current regulation. These provisions (paragraphs (d)(2)(ii)(A) through (E)) are intended to confirm and restate what the prudence and loyalty obligations of ERISA section 404(a)(1)(A) and (B) would require in these areas. The Department specifically invites comments on whether these provisions are necessary and whether they may be read as creating special duties and requirements beyond what ERISA section 404(a)(1)(B) would demand. We note that, as discussed above, paragraph (d)(2)(ii) does not carry forward the current regulation's specific requirement (paragraph (e)(2)(ii)(E)) for maintenance of records on proxy voting activities and other exercise of shareholder rights.

Paragraph (d)(2)(iii) of the proposal states that a fiduciary may not adopt a practice of following the recommendations of a proxy advisory firm or other service provider without a determination that such firm or service provider's proxy voting guidelines are consistent with the fiduciary's obligations described in provisions of the regulation. This provision of the current regulation was intended to address specific concerns involving fiduciaries' use of proxy advisory firms and similar service providers, including use of automatic voting mechanisms relying on proxy advisory firms.[51] The Department invites comments on whether this provision is necessary given the more general requirement in paragraph (d)(2)(ii)(E) of the proposal that fiduciaries must exercise prudence and diligence in the selection and monitoring of persons, if any, selected to exercise shareholder rights or otherwise advise on or assist with exercises of shareholder rights.

Paragraph (d)(3)(i) of the proposal provides that in deciding whether to vote a proxy pursuant to paragraphs (d)(2)(i) and (ii) of the proposal, fiduciaries may adopt proxy voting policies providing that the authority to vote a proxy shall be exercised pursuant to specific parameters prudently designed to serve the plan's interest in providing benefits to participants and their beneficiaries and defraying reasonable expenses of administering the plan. As discussed above, this provision is not carrying forward the two ''safe harbor'' proxy voting policies contained in the current regulation. The Department is concerned that the policies described in the current regulation may effectively encourage adoption of proxy voting policies that may be biased against the exercise of a plan's voting rights.

Paragraph (d)(3)(ii) of the proposal requires plan fiduciaries to periodically review proxy voting policies adopted pursuant to the regulation. Paragraph (d)(3)(iii) further provides that no proxy voting policies adopted pursuant to paragraph (d)(3)(i) of the proposal shall

[50] 85 FR 81672.

[51] *See* 85 FR 81668 (Dec. 16, 2020).

preclude submitting a proxy vote when the fiduciary prudently determines that the matter being voted upon is expected to have a material effect on the value of the investment or the investment performance of the plan's portfolio (or investment performance of assets under management in the case of an investment manager) after taking into account the costs involved, or refraining from voting when the fiduciary prudently determines that the matter being voted upon is not expected to have such a material effect after taking into account the costs involved. This provision in the proposal recognizes that, depending on the circumstances, a fiduciary may conclude that the best interests of the plan and its participant and beneficiaries would not be served by following the plan's proxy voting policies in a particular case. In such cases, paragraph (d)(3)(iii) of the proposal ensures that a fiduciary will have the needed flexibility to deviate from those policies and take a different approach.

Paragraphs (d)(4)(i) and (ii) of the proposal, like paragraphs (e)(4)(i) and (ii) of the current regulation, reflect longstanding positions expressed in the Department's prior Interpretive Bulletins. Paragraph (d)(4)(i)(A) of the proposal states that the responsibility for exercising shareholder rights lies exclusively with the plan trustee except to the extent that either the trustee is subject to the directions of a named fiduciary pursuant to ERISA section 403(a)(1); or the power to manage, acquire, or dispose of the relevant assets has been delegated by a named fiduciary to one or more investment managers pursuant to ERISA section 403(a)(2). Paragraph (d)(4)(ii)(B) of the proposal states that where the authority to manage plan assets has been delegated to an investment manager pursuant to ERISA section 403(a)(2), the investment manager has exclusive authority to vote proxies or exercise other shareholder rights appurtenant to such plan assets in accordance with this section, except to the extent the plan, trust document, or investment management agreement expressly provides that the responsible named fiduciary has reserved to itself (or to another named fiduciary so authorized by the plan document) the right to direct a plan trustee regarding the exercise or management of some or all of such shareholder rights.

Paragraph (d)(4)(ii) of the proposal describes obligations of an investment manager of a pooled investment vehicle that holds assets of more than one employee benefit plan. The provision provides that an investment manager of such a pooled investment vehicle may be subject to an investment policy statement that conflicts with the policy of another plan. Furthermore, it provides that compliance with ERISA section 404(a)(1)(D) requires the investment manager to reconcile, insofar as possible, the conflicting policies (assuming compliance with each policy would be consistent with ERISA section 404(a)(1)(D)).[52] The provision further states that, in the case of proxy voting, to the extent permitted by applicable law, the investment manager must vote (or abstain from voting) the relevant proxies to reflect such policies in proportion to each plan's economic interest in the pooled investment vehicle. Such an investment manager may, however, develop an investment policy statement consistent with Title I of ERISA and the regulation, and require participating plans to accept the investment manager's investment policy statement, including any proxy voting policy, before they are allowed to invest. In such cases, a fiduciary must assess whether the investment manager's investment policy statement and proxy voting policy are consistent with Title I of ERISA and the regulation before deciding to retain the investment manager.

Paragraph (d)(4)(ii) of the proposal is identical to paragraph (e)(4)(ii) of the current regulation. Although the provision in the current regulation, and thus the proposal uses different language than prior Interpretive Bulletins in describing the obligations of investment managers to pooled investment funds, as explained in the preamble to the *Fiduciary Duties Regarding Proxy Voting and Shareholder Rights* final rule, the objective was to clarify the requirement and not fundamentally alter that guidance.[53] The Department solicits comments on whether this provision would be clearer if revised to conform more closely to the prior Interpretive Bulletins.

Finally, paragraph (d)(5) of the proposal provides that the regulation does not apply to voting, tender, and similar rights with respect to shares of stock that, pursuant to the terms of an individual account plan, are passed through to participants and beneficiaries with accounts holding such shares.

[52] Section 404(a)(1)(D) of ERISA provides that a fiduciary must discharge its duties with respect to the plan in accordance with the documents and instruments governing the plan insofar as such documents are consistent with the provisions of title I and title IV of ERISA. Under section 404(a)(1)(D), a fiduciary to whom an investment policy applies would be required to comply with such policy unless, for example, it would be imprudent to do so in a given instance.

[53] 85 FR 81675.

4. Miscellaneous

Paragraph (e) defines the terms used in the proposal. The terms and definitions do not include a definition of ''pecuniary factors'' because the proposal does not rely on that term.

Under paragraph (e)(1) of the proposal, ''investment duties'' means any duties imposed upon, or assumed or undertaken by, a person in connection with the investment of plan assets which make or will make such person a fiduciary of an employee benefit plan or which are performed by such person as a fiduciary of an employee benefit plan as defined in section 3(21)(A)(i) or (ii) of ERISA. Paragraph (e)(2) defines the term ''investment course of action'' as 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. Paragraph (e)(3) defines ''plan'' to mean an employee benefit plan to which Title I of ERISA applies. Finally, under paragraph (e)(4) of the proposal, the term ''designated investment alternative'' means any investment alternative designated by the plan into which participants and beneficiaries may direct the investment of assets held in, or contributed to, their individual accounts. The provision further provides that the term ''designated investment alternative'' shall not include ''brokerage windows,'' ''self-directed brokerage accounts,'' or similar plan arrangements that enable participants and beneficiaries to select investments beyond those designated by the plan.

Paragraph (f) of the proposal, like paragraph (h) of the current regulation, provides that if any provision of the regulation is held to be invalid or unenforceable by its terms, or as applied to any person or circumstance, or stayed pending further agency action, the provision shall be construed so as to continue to give the maximum effect to the provision permitted by law, unless such holding shall be one of invalidity or unenforceability, in which event the provision shall be severable from this section and shall not affect the remainder thereof.

Finally, this proposed regulation does not undermine serious reliance interests on the part of fiduciaries selecting investments and investment courses of action and exercising shareholder rights. Nor does it upend a longstanding view of the agency on the standards governing the selection of investments and investment courses of action or the exercise of shareholder rights, including the voting of proxies. It instead addresses new policies included in a recently promulgated regulation. Further, the Department stayed its enforcement of the regulation immediately after its effective date and before its full applicability. Consequently, the Department concludes serious reliance on the 2020 rule is unlikely, and certainly would not overwhelm the Department's good reasons for this change.

C. Request for Public Comments

The Department invites comments from interested persons on all facets of the proposed rule. Commenters are free to express their views not only on the specific provisions of the proposal as set forth in this document, but on any issues germane to the subject matter of the proposal. Comments should be submitted in accordance with the instructions at the beginning of this document.

D. Regulatory Impact Analysis

This section of the preamble analyzes the regulatory impact of proposed amendments to 29 CFR 2550.404a–1. As explained earlier in this preamble, the proposed amendments would clarify the legal standard imposed by sections 404(a)(1)(A) and 404(a)(1)(B) of ERISA with respect to the selection of a plan investment or, in the case of an ERISA section 404(c) plan or other individual account plan, a designated investment alternative under the plan, and with respect to the exercise of shareholder rights, including proxy voting.

The primary benefit of the proposal is clarification of legal standards and the prevention of confusion to plan fiduciaries that otherwise might persist as a result of certain provisions in the current regulation that are the subject of the proposed amendments. The Department has heard from stakeholders that the current regulation, and investor confusion about it, has already had a chilling effect on appropriate integration of climate change and other ESG factors in investment decisions, including in circumstances that the current regulation may in fact allow. Based on stakeholder feedback, the Department has concerns that aspects of the current regulation could deter plan fiduciaries from: (a) Taking into account climate change and other ESG factors when they are material to a risk-return analysis; (b) engaging in proxy voting and other exercises of shareholder rights when doing so is in the plan's best interest; and (c) choosing QDIAs that include climate change and other ESG factors in their investments. If these concerns with the current regulation are correct, and left unaddressed, the current regulation could continue to have (a) a negative impact on plans' financial performance as they avoid materially sound investments or integration of climate change and other ESG considerations that are often material in investment analysis, (b) a negative impact on plans' financial performance as they shy away from economically relevant considerations in voting and from exercising shareholder rights on material issues, and (c) broader negative economic/societal impacts (*e.g.,* negative impacts on climate change, on workers' productivity and engagement, and on corporate managers' accountability). The proposal's clarification of the relevant legal standards is intended to address these negative impacts.

Other benefits of the proposal consist of costs savings associated with revisions and improvements to the current regulation, for example, the elimination of the current regulation's special documentation provisions, elimination of its proxy voting safe harbors, clarification of its tie-breaker standard, and the clarification of its standards governing QDIAs. All benefits of the proposal are discussed below in Section 1.3. As discussed in Section 1.4 below, the proposal would also impose some modest additional costs. For example, some plans will incur costs to review the rule to ensure compliance. But, the costs of the proposal are expected to be relatively small, in part because the Department assumes most plan fiduciaries are complying with the pre-2020 interpretive bulletins (specifically Interpretive Bulletin 2016–1 and 2015–1), which the proposal tracks. Overall, the Department estimates that the proposal's benefits justify its costs.

The Department has examined the effects of this proposal as required by Executive Order 12866,[54] Executive Order 13563,[55] the Congressional Review Act,[56] the Paperwork Reduction Act of 1995,[57] the Regulatory Flexibility Act,[58] section 202 of the Unfunded Mandates Reform Act of 1995,[59] and Executive Order 13132.[60]

[54] Regulatory Planning and Review, 58 FR 51735 (Oct. 4, 1993).

[55] Improving Regulation and Regulatory Review, 76 FR 3821 (Jan. 21, 2011).

[56] 5 U.S.C. 804(2) (1996).

[57] 44 U.S.C. 3506(c)(2)(A) (1995).

[58] 5 U.S.C. 601 *et seq.* (1980).

[59] 2 U.S.C. 1501 *et seq.* (1995).

[60] Federalism, 64 FR 43255 (Aug. 10, 1999).

1. Executive Orders 12866 and 13563

Executive Orders 12866 and 13563 direct agencies to assess all costs and benefits of available regulatory alternatives and, if regulation is necessary, to select regulatory approaches that maximize net benefits (including potential economic, environmental, public health, and safety effects; distributive impacts; and equity). Executive Order 13563 emphasizes the importance of quantifying costs and benefits, reducing costs, harmonizing rules, and promoting flexibility.

Under Executive Order 12866, ''significant'' regulatory actions are subject to review by the Office of Management and Budget (OMB). Section 3(f) of the Executive order defines a ''significant regulatory action'' as an action that is likely to result in a rule (1) having an annual effect on the economy of $100 million or more, or adversely and materially affecting a sector of the economy, productivity, competition, jobs, the environment, public health or safety, or state, local, or tribal governments or communities (also referred to as ''economically significant''); (2) creating a serious inconsistency or otherwise interfering with an action taken or planned by another agency; (3) materially altering the budgetary impacts of entitlement grants, user fees, or loan programs or the rights and obligations of recipients thereof; or (4) raising novel legal or policy issues arising out of legal mandates, the President's priorities, or the principles set forth in the Executive order. The Department and OMB have determined that this proposed rule is significant within the meaning of section 3(f)(4) of Executive Order 12866, under which rules are significant if they ''[r]aise novel legal or policy issues arising out of legal mandates [or] the President's priorities.'' The Department and OMB also treat the regulation as economically significant within the meaning of section 3(f)(1) of that Executive order. Given the large scale of investments held by covered plans, approximately $12.2 trillion, we assume that changes in investment decisions and/or plan performance are likely to be economically significant under the Executive order.[61] Therefore, the Department provides an assessment of the potential costs, benefits, and

[61] EBSA projected ERISA covered pension, welfare, and total assets based on the 2018 Form 5500 filings with the U.S. Department of Labor (DOL), reported SIMPLE assets from the Investment Company Institute (ICI) Report: The U.S. Retirement Market, First Quarter 2021, and the Federal Reserve Board's Financial Accounts of the United States Z1 June 10, 2021.

transfers associated with the proposal below.

1.1. Introduction and Need for Regulation

In late 2020, the Department published two final rules dealing with the selection of plan investments and the exercise of shareholder rights, including proxy voting. The Department published those rules to provide clarity and certainty to plan fiduciaries regarding their legal duties under ERISA section 404 in connection with making plan investments and for exercising shareholder rights. The Department was also concerned that some investment products may be marketed to ERISA fiduciaries on the basis of purported benefits and goals unrelated to financial performance. Before issuing the rules, the Department had periodically considered and issued guidance pertaining to the application of ERISA's fiduciary rules to plan investment decisions that are based, in whole or part, on factors unrelated to financial performance. Confusion with respect to these factors persisted, perhaps due in part to varied statements the Department had made on the subject over the years in non-regulatory guidance. Accordingly, the 2020 rules were intended to interpret ERISA and provide clarity and certainty regarding the scope of fiduciary duties surrounding such issues.

Responses to the 2020 rules, however, suggest that the new rules may have inadvertently caused more confusion than clarity. Many interested stakeholders have told the Department that the terms and tone of the final rules and preambles have increased concerns and uncertainty about the extent to which plan fiduciaries may consider climate change and other ESG factors in their investment decisions, and that the final rules have chilling effects contrary to the interests of participants and beneficiaries. Consequently, on March 10, 2021, the Department announced that it would stay enforcement of the 2020 rules pending a complete review of the matter. Subsequently, on May 20, 2021, the President issued Executive Order 14030, entitled ''Executive Order on Climate-Related Financial Risk.'' Section 4 of the Executive order directs the Department to consider suspending, revising, or rescinding any rules from the prior administration that would have barred plan fiduciaries (and their investment-firm service providers) from considering climate change and other ESG factors in their investment decisions related to workers' pensions.[62] In light of the foregoing, the Department concluded that additional notice and comment rulemaking was necessary to safeguard the interests of participants and beneficiaries in their retirement and welfare plan benefits.

The baseline for purposes of the analysis in this section is a future in which the current regulation is implemented. However, immediately after its effective date in January but before its full applicability date, the Department stayed enforcement of the current regulation pursuant the March 10 non-enforcement policy.[63] The Department assumes that this stay, in conjunction with the President's Executive order in January, prevented plans from incurring sunk-costs. Comments are requested on the accuracy of this assumption. Specifically, how many plans, if any, had already incurred costs to comply with the current regulation between its January effective date and the March stay, and what was the magnitude of the costs incurred? Commenters are encouraged to be as specific as possible in responding to this solicitation and to support their comments with data when possible.

1.2. Affected Entities

The clarifications in the proposal would affect subsets of ERISA-covered plans and their participants and beneficiaries. The subset of plans affected by the proposed modifications of paragraphs (c) of § 2550.404a–1 include those plans whose fiduciaries consider or will begin considering climate change and other ESG factors when selecting investments and the participants in those plans. Another subset of affected plans include ERISA-covered plans (pension, health, and other welfare) that hold shares of corporate stock. This subset of plans would be affected by the proposed modifications to paragraph (d) (relating to proxy voting) of § 2550.404a–1. Some plans would be in both subsets, some in only one subset, and some in neither. There is substantial uncertainty on the number and size of the affected plans. Moreover, if the Department had not immediately stayed enforcement of the 2020 rules, the class of affected entities could have looked somewhat different.

a. Subset of Plans Affected by Proposed Modifications of Paragraph (c) of § 2550.404a–1

The best data on affected plans comes from surveys of ESG investing by plans. The plans affected by the proposed modifications of paragraph (c) of § 2550.404a–1 consist of those ERISA-covered plans whose fiduciaries consider or will begin considering climate change and other ESG factors when selecting investments and the participants in those plans. A challenge in relying on survey data, however, is that one cannot readily determine how much of the ESG investing is driven by material risk-return factors as opposed to non-risk-return or collateral factors.[64]

The Department estimates as a lower bound that approximately 11 percent of retirement plans, or 78,300 plans, would be affected by paragraph (c) of the proposal.

This estimate of the share of retirement plans already considering ESG factors is derived from combining estimates of 9 percent for participant-directed defined contribution plans and 19 percent for other plans, weighted to reflect the relative prevalence of these types of retirement plans. These estimates are drawn from survey findings and administrative data. According to the Plan Sponsor Council of America, about 3 percent of 401(k) and/or profit sharing plans offered at least one ESG-themed investment option in 2019.[65] Vanguard's 2018 administrative data suggest that approximately 9 percent of DC plans offered one or more ''socially responsible'' domestic equity fund options.[66] In a comment letter, Fidelity Investments reported that 14.5 percent of corporate DC plans with fewer than 50 participants offered an ESG option, and that the figure is higher for large

[62] *See* White House Fact Sheet titled *FACT SHEET: President Biden Directs Agencies to Analyze and Mitigate the Risk Climate Change Poses to Homeowners and Consumers, Businesses and Workers, and the Financial System and Federal Government Itself* (May 20, 2021) (stating, ''The Executive Order directs the Labor Secretary to consider suspending, revising, or rescinding any rules from the prior administration that would have barred investment firms from considering environmental, social and governance factors, including climate-related risks, in their investment decisions related to workers' pensions.'').

[63] 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.*

[64] *See* Max Schanzenbach & Robert Sitkoff, *Reconciling Fiduciary Duty and Social Conscience: The Law and Economics of ESG Investing by a Trustee,* 72 Stan. L. Rev. 381 (2020) (distinguishing between ''collateral benefits ESG'' investing—defined as ''ESG investing for moral or ethical reasons or to benefit a third party''—which is not permissible under ERISA, and ''risk-return ESG'' investing, which is).

[65] *63rd Annual Survey of Profit Sharing and 401(k) Plans,* Plan Sponsor Council of America (2020).

[66] *How America Saves 2019,* Vanguard (June 2019), *https://pressroom.vanguard.com/nonindexed/Research-How-America-Saves-2019-Report.pdf.*

plans with at least 1,000 participants. Considering these three sources together, the Department uses the median figure of 9 percent for its estimate of the share of participant-directed individual account plans that have at least one ESG-themed designated investment alternative. This represents 53,000 participant-directed individual account plans.[67] To estimate ESG investing by other types of retirement plans, the Department looked at surveys that included many defined benefit plans as well as some defined contribution plans. According to a 2018 survey by the NEPC, approximately 12 percent of private pension plans have adopted ESG investing.[68] Another survey, conducted by the Callan Institute in 2019, found that about 19 percent of private sector pension plans consider ESG factors in investment decisions.[69] Since the Callan Institute survey included a greater share of defined benefit plans, the Department draws upon its finding and assumes that 19 percent of defined benefit plans and nonparticipant-directed defined contribution plans use ESG investing, which represents 25,300 plans.[70] The total number of affected plans is approximately 78,300, which is 11 percent of all pension plans.[71]

An estimate of 11 percent is our best approximation of the share of plans that were using ESG factors under the prior non-regulatory guidance. The Department anticipates that all plans using ESG factors would be affected in some way by the proposal. The estimate is a lower bound because it is likely that more plans will start to consider ESG factors, including climate-related financial risk, as a result of the new rule, as is already evidenced by the growing consideration of climate-related financial risk and ESG factors by investors through entities such as the Task Force on Climate-Related Financial Disclosure.[72] Furthermore, ESG factors are becoming more mainstream for the investment community. Morningstar data shows that between 2015 and 2020, assets under management in sustainable funds increased by more than four times.[73] This growth may well carry over to ERISA plans and participants.

These statistics do not reflect, however, the proportion of plan assets actually invested in ESG options. One recent survey indicates that the average DC plan has less than 0.1 percent of its assets invested in ESG funds.[74]

b. Subset of Plans Affected by Proposed Modifications of Paragraph (e) of § 2550.404a–1

The proposal, at paragraph (d), would codify longstanding principles of prudence and loyalty applicable to the exercise of shareholder rights, including proxy voting, the use of written proxy voting policies and guidelines, and the selection and monitoring of proxy advisory firms. In particular, paragraph (d) of the proposal would adopt the Department's longstanding position, which was first issued in guidance in the 1980s, that the fiduciary act of managing plan assets includes the management of voting rights (as well as other shareholder rights) appurtenant to shares of stock. Paragraph (d) of the proposal also would eliminate the two safe harbors in paragraphs (e)(3)(i)(A) and (B) of § 2550.404a–1.

Under paragraph (d) of the proposal, when deciding whether to exercise shareholder rights and when exercising such rights, including the voting of proxies, fiduciaries must carry out their duties prudently and solely in the interests of the participants and beneficiaries and for the exclusive purpose of providing benefit to participants and beneficiaries and defraying the reasonable expenses of administering the plan. Nevertheless, because affected parties will or could be impacted by the proposal should it become a final rule (for example, at minimum they will have to review the proposed regulation for compliance), an assessment of affected parties follows, but the Department considers the number of affected parties to be an upper bound.

Paragraph (d) of the proposal would affect ERISA-covered pension, health, and other welfare plans that hold shares of corporate stock. It would affect plans with respect to stocks that they hold directly, as well as with respect to stocks they hold through ERISA-covered intermediaries, such as common trusts, master trusts, pooled separate accounts, and 103–12 investment entities. Paragraph (d) would not affect plans with respect to stock held through registered investment companies, because it would not apply to such funds' internal management of such underlying investments. Paragraph (d) of the proposal also would not apply to voting, tender, and similar rights with respect to securities that are passed through pursuant to the terms of an individual account plan to participants and beneficiaries with accounts holding such securities.

ERISA-covered plans annually report data on their asset holdings. However, only plans that file the Form 5500 schedule H report their stock holdings as a separate line item (see Table 1). Most of these plans filing schedule H have 100 or more participants (large plans).[75] Additionally, all plans with employer stock report their holdings on either schedule H or schedule I. However, schedule I lacks the specificity to determine if small plans hold employer stock or other employer securities. Approximately 27,000 defined contribution plans and 5,000 defined benefit plans, with approximately 84 million participants, file the schedule H and report holding common stocks or are an Employee Stock Ownership Plan (ESOP). Additionally, 573 health and other welfare plans file the schedule H and report holding common stocks either

[67] DOL calculations are based on statistics from *Private Pension Plan Bulletin: Abstract of 2018 Form 5500 Annual Reports,* Employee Benefits Security Administration (2020), Table A1, *https://www.dol.gov/sites/dolgov/files/EBSA/researchers/statistics/retirement-bulletins/private-pension-plan-bulletins-abstract-2018.pdf.* This estimate is calculated as 9% × 588,499 401(k) type plans = 52,965 rounded to 53,000.

[68] Brad Smith & Kelly Regan, *NEPC ESG Survey: A Profile of Corporate & Healthcare Plan Decisionmakers' Perspectives,* NEPC (Jul. 11, 2018), *https://cdn2.hubspot.net/hubfs/2529352/files/2018%2007%20NEPC%20ESG%20Survey%20Results%20.pdf?t=1532123276859.*

[69] *2019 ESG Survey,* Callan Institute (2019), *www.callan.com/wp-content/uploads/2019/09/2019-ESG-Survey.pdf.*

[70] DOL calculations are based on statistics from *Private Pension Plan Bulletin: Abstract of 2018 Form 5500 Annual Reports,* Employee Benefits Security Administration (2020), Table A1, *https://www.dol.gov/sites/dolgov/files/EBSA/researchers/statistics/retirement-bulletins/private-pension-plan-bulletins-abstract-2018.pdf.* This estimate is calculated as 19% × (721,876 pension plans − 588,499 401(k) type plans) = 25,342 rounded to 25,300.

[71] DOL calculations are based on statistics from *Private Pension Plan Bulletin: Abstract of 2018 Form 5500 Annual Reports,* Employee Benefits Security Administration (2020), Table A1, *https://www.dol.gov/sites/dolgov/files/EBSA/researchers/statistics/retirement-bulletins/private-pension-plan-bulletins-abstract-2018.pdf.* This estimate is calculated as 52,965 participant-directed individual account plans + 25,342 defined benefit and nonparticipant-directed defined contribution plans = 78,307 plans rounded to 78,300. 78,307 affected pension plans / 721,876 total pension plans = 10.8% rounded to 11%.

[72] See additional studies on the growing body of evidence for value creation from ESG investing here: CFA Institute, ''Climate Change Analysis in the Investment Process,'' (2020) *https://www.cfainstitute.org/en/research/industry-research/climate-change-analysis.* A growing number of investors are also participating in the Task Force on Climate-Related Financial Disclosure and the Taskforce on Nature-related Financial Disclosures.

[73] Morningstar, ''Sustainable Funds U.S. Landscape Report: More Funds, More Flows, and Impressive Returns in 2020,'' (February 10, 2021), *https://www.morningstar.com/lp/sustainable-funds-landscape-report.*

[74] *63rd Annual Survey of Profit Sharing and 401(k) Plans,* Plan Sponsor Council of America (2020).

[75] 431 plans with less than 100 participants filed the Form 5500 schedule H and reported holding common stock.

directly or indirectly. In total, pension plans and welfare plans filing schedule H hold approximately $1.7 trillion in common stock value. Common stocks constitute about 25 percent of total assets of those pension plans that are not ESOPs and hold common stock. Out of the 25,400 pension plans that hold common stock and are not ESOPs, about 20,000 plans hold common stock through an ERISA-covered intermediary and approximately 3,500 plans hold common stock directly. A smaller number of plans hold stock both directly and indirectly.[76] In total, information is available on approximately 32,000 pension plans, welfare plans, and ESOPs that hold either common stock or employer stock.

TABLE 1—NUMBER OF PENSION AND WELFARE PLANS REPORTING HOLDING COMMON STOCKS OR ESOP BY TYPE OF PLAN, 2018 [a]

Common stock (no employer securities)	Defined benefit	Defined contribution	Total pension plans	Welfare plans	Total all plans
Direct Holdings Only	1,272	2,286	3,558	569	4,127
Indirect Holdings Only	2,792	17,591	20,383	3	20,386
Both Direct and Indirect	941	586	1,527	1	1,528
Total	5,005	20,463	25,468	573	26,041
ESOP (No Common Stock)		5,809	5,809		5,809
Common Stock and ESOP		591	591		591
Total All Plans Holding Stocks	5,005	26,863	31,868	573	32,441

[a] DOL calculations from the 2018 Form 5500 Pension Research Files.

There are approximately 629,000 small pension plans that hold assets, and some may invest in stock.[77] Given that fewer than 1 percent of small plans file a Schedule H, there is minimal data available about small plans' stock holdings. While the majority of participants and assets are in large plans, most plans are small plans. The Department lacks sufficient data to estimate the number of small plans that hold stock, but it assumes that small plans are significantly less likely to hold stock than larger plans. Many small plans may hold stock only through mutual funds, and consequently would not be significantly affected by paragraph (d) of this proposal. The Department asks for comments on the impacts on small plans holding stock only through mutual funds. For purposes of illustrating the number of small plans that could be affected, the Department preliminarily assumes that five percent of small plans, or 31,470 small pension plans, hold stock. The Department requests comments on this assumption.

The combined effect of these assumptions is an estimate of 63,911 plans, large and small, that would be affected by the proposed amendments pertaining to proxy voting.

While paragraph (d) of this proposed rule would directly affect ERISA-covered plans that possess the relevant shareholder rights, the activities covered under paragraph (d) would be carried out by responsible fiduciaries on plans' behalf. Many plans hire asset managers to carry out fiduciary asset management functions, including proxy voting. In 2018, large ERISA plans reportedly used approximately 17,800 different service providers, some of whom provide services related to the exercise of plans' shareholder rights.[78] Such service providers include trustees, trust companies, banks, investment advisers, investment managers, and proxy advisory firms.[79] Asset managers hired as fiduciaries to carry out proxy voting functions would be subject to the proposal to the same extent as a plan trustee or named fiduciary. The proposal could indirectly affect proxy advisory firms to the extent that plan fiduciaries opt for customized recommendations about which particular proxy proposals to vote or how they should cast their vote. Plans' preferences for proxy advice services moreover could shift to prioritize services offering more rigorous and impartial recommendations. These effects may be more muted, however, if recent rule amendments by the Securities and Exchange Commission (SEC) enhance the transparency, accuracy, and completeness of the information provided to clients of proxy voting firms in connection with proxy voting decisions.[80]

1.3. Benefits

The proposed amendments would clarify the legal standard imposed by sections 404(a)(1)(A) and 404(a)(1)(B) of ERISA with respect to the selection of a plan investment or investment course of action, and to the exercise of shareholder rights, including proxy voting. As indicated above, a significant benefit of the proposal is that it clearly permits plan fiduciaries to consider climate change and other ESG factors that are often material, and to exercise shareholder rights that may enhance the value of plan investments. As discussed above, the Department is concerned that

[76] DOL estimates from the 2018 Form 5500 Pension Research Files.

[77] The Form 5500 does not require these plans to categorize the assets as common stock, so the Department does not know if they hold stock.

[78] One commenter pointed out that in a proprietary survey of the largest pension funds and defined contribution plans, approximately 92 percent of the respondents indicated that they have formally delegated proxy voting responsibilities to another named fiduciary (*e.g.,* an Investment Manager), and approximately 42 percent of respondents engage a proxy advisory firm (directly or indirectly) to help with voting some or all proxies.

[79] DOL estimates are derived from the 2018 Form 5500 Schedule C.

[80] In September 2019, the SEC issued an interpretation and guidance addressing the application of the proxy rules to proxy voting advice businesses. *Commission Interpretation and Guidance Regarding the Applicability of the Proxy Rules to Proxy Voting Advice,* 84 FR 47416 (Sept. 10, 2019) (''2019 Interpretation and Guidance''). In July of 2020, The SEC adopted amendments to 17 CFR 240.14a–1(l), 240.14a–2(b), and 240. 14a–9 (Rules 14a–1(l), 14a–2(b), and 14a–9) concerning proxy voting advice. *See Exemptions from the Proxy Rules for Proxy Voting Advice,* 85 FR 55082 (Sept. 3, 2020) (''2020 Rule Amendments''). On June 1, 2021, SEC Chair Gary Gensler directed SEC staff to consider whether to recommend further regulatory action regarding proxy voting advice. In particular, SEC staff are to consider whether to recommend that the SEC revisit its 2020 codification of the definition of solicitation as encompassing proxy voting advice, the 2019 Interpretation and Guidance regarding that definition, and the conditions on exemptions from the information and filing requirements in the 2020 Rule Amendments, among other matters.

the current rule discouraged plan fiduciaries from such considerations and activities, even when financially material to the plan. Stakeholders told the Department that the current regulation has already had a chilling effect on appropriate integration of material climate change and other ESG factors in investment decisions. Acting on material climate change and other ESG factors in these contexts, and in a manner consistent with the proposal, will redound, in the first instance, to employee benefit plans covered by ERISA and their participants and beneficiaries, and secondarily, to society more broadly but without any detriment to the participants and beneficiaries in ERISA plans. The Department anticipates that the resulting benefits will be appreciable.

Paragraph (b) of the proposal addresses ERISA section 404(a)(1)(B)'s duty of prudence and clarifies how that duty applies to a fiduciary's consideration of an investment or investment course of action. Paragraphs (b)(1)–(3) of the proposal carry forward much of the same regulatory language that has been in place since 1979. The preservation of settled law should avoid the imposition of new costs. Paragraph (b)(2)(ii)(C) adds that a prudent fiduciary's consideration of the projected return of a portfolio relative to the funding objectives of a plan may often require an evaluation of the economic effects of climate change on the particular investment or investment course of action. Similar to paragraph (b)(4) of the proposal, this new provision is intended to counteract the negative perception regarding the use of climate change and other ESG factors, including climate-related financial risk, in investment decisions caused by the 2020 Rules, and to clarify that a fiduciary's duty of prudence may require an evaluation of the effect of climate change and/or government policy changes to address climate change on investments' risks and returns.

Paragraph (b)(4), which complements paragraph (b)(2)(ii)(C), is a new provision that addresses uncertainty under the current regulation as to whether a fiduciary may consider climate change and other ESG factors in making plan-related decisions under ERISA. This paragraph clarifies and confirms that a fiduciary may consider *any* factor that is material to the risk-return analysis, including climate change and other ESG factors. The intent of this new paragraph is to establish through examples that material climate change and other ESG factors are no different than other ''traditional'' material risk-return factors and to remove prejudice to the contrary. Thus, under ERISA, if a fiduciary prudently concludes climate change and other ESG factors are material to an investment or investment course of action under consideration, the fiduciary can and should consider them and act accordingly, as would be the case with respect to any material risk-return factor. For the sake of clarity and to eliminate any doubt caused by the current regulation, paragraph (b)(4) of the proposal provides examples of factors, including climate change and other ESG factors, that a fiduciary may consider in the evaluation of an investment or investment course of action if material, including: (i) Climate change-related factors, such as a corporation's exposure to the real and potential economic effects of climate change, including exposure to the physical and transitional risks of climate change and the positive or negative effect of Government regulations and policies to mitigate climate change; (ii) governance factors, such as those involving board composition, executive compensation, transparency and accountability in corporate decision-making, as well as a corporation's avoidance of criminal liability and compliance with labor, employment, environmental, tax, and other applicable laws and regulations; and (iii) workforce practices, including the corporation's progress on workforce diversity, inclusion, and other drivers of employee hiring, promotion, and retention; its investment in training to develop its workforce's skill; equal employment opportunity; and labor relations.

Much of the anticipated economic benefits under this proposal derive from the examples in paragraph (b)(4) and the clarity they provide to plan fiduciaries. In the Department's view, and consistent with the comments of the concerned stakeholders mentioned above, the examples in paragraph (b)(4) of the proposal should go a long way to overcoming unwarranted concerns about investing in climate-change-focused or ESG-sensitive funds that are economically advantageous to plans.

Paragraph (c)(1) of the proposal addresses the application of the duty of loyalty under ERISA as applied to a fiduciary's consideration of an investment or investment course of action. The primary benefit of this provision to plan participants and beneficiaries is that it clarifies in no uncertain terms that a plan fiduciary may not subordinate the interests of 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 the interests of participants and beneficiaries in their retirement income or financial benefits under the plan. By ensuring that plan fiduciaries may not sacrifice investment returns or take on additional investment risk to promote unrelated goals, this provision (paragraph (c)(1)) is expected to lead to increased investment returns over the long run, which would accrue to participants and sponsors of ERISA-covered plans. Over the years, the Department has stated this bedrock principle of loyalty many times in non-regulatory guidance and this proposal, like the current regulation, would incorporate the principle directly into title 29 of the Code of Federal Regulations. This incorporation would result in a higher degree of permanency and certainty for plan fiduciaries, relative to periodic restatements in non-regulatory guidance, and as such is considered a benefit.

Paragraph (c)(2) of the proposal directly supports paragraph (c)(1) of the proposal by giving fiduciaries concrete direction by restating the longstanding principle that a fiduciary's evaluation of an investment or investment course of action must be based on risk and return factors that the fiduciary prudently determines are material to investment value, based on an appropriate investment horizon consistent with the plan's investment objectives and taking into account the funding policy of the plan. When plan fiduciaries follow this directive, they can be certain that they have not subordinated the interests of participants and beneficiaries of the plan to goals unrelated to the provision of retirement income or financial benefits under the plan. Plan fiduciaries and plan participants will benefit from this simple and clear directive.

Paragraph (c)(2), importantly, cross references paragraph (b)(4) of the proposal to clarify that a fiduciary is not disloyal under ERISA if, after a prudent analytical process, the fiduciary determines climate change or other ESG factors are relevant to the risk-return analysis of a particular investment or investment course of action. Paragraphs (c)(2) and (b)(4) of the proposal, combined, thus would lay to rest any remaining ambiguity or uncertainty, resulting from the Department's prior guidance or the current regulation, regarding whether these factors are impermissible tools for a plan fiduciary to use when selecting an investment or investment course of action. Removing this uncertainty is considered a primary benefit of this proposal, as is the requirement that the plan fiduciary only use these tools when prudently determining they are relevant to the risk-return analysis, or as tie-breakers when competing investment alternatives would equally serve the plans' interests. The Department has recognized that fiduciaries can appropriately consider material ESG factors multiple times over the years in various preambles and non-regulatory guidance documents.[81] Despite that repeated recognition, many stakeholders continue to have confusion or doubt on the matter. Paragraph (c)(2) of the proposal would clearly redress any lingering uncertainty by explicitly acknowledging that a fiduciary may consider any factors in the evaluation of an investment or investment course of action that are material to the risk-return analysis, including climate change and other ESG factors.

As described above, paragraph (c)(3) of the proposal would replace the tie-breaker provision in the current regulation with a formulation that is intended to be broader. In relevant part paragraph (c)(3) provides that, if, after the analysis in paragraph (c)(2) of the proposal, a fiduciary prudently concludes that competing investments or investment courses of action equally serve the financial interests of the plan over the appropriate time horizon, the fiduciary is not prohibited from selecting the investment, or investment course of action, based on collateral benefits other than investment returns. Paragraph (c)(3) also would not carry forward the documentation requirements contained in paragraphs (c)(2)(i) through (iii) of the current regulation, which stakeholders identified as potentially burdensome and effectively singles out climate change and other ESG investments for special scrutiny. Regardless of the frequency of ties, stakeholders point to these particularized documentation provisions as casting an unnecessarily negative shadow on investments or investment courses of action that are otherwise prudent. Paragraph (c)(3) of the proposal thus permits fiduciaries to take into account an investment's potential collateral effects, including potential increases in plan contributions, to break a tie. This, too, is considered a benefit of the proposal.

The clarifications provided by paragraphs (b) and (c) of this proposal relate to the appropriate use of climate change and other ESG factors by plan fiduciaries in selecting investments or investment courses of action. Reflective of the significant economic impacts of climate change to date across various sectors of the economy, the Department believes it is often appropriate to treat climate change as a material risk-return factor in the assessment of investments. As noted in a U.S. Commodity Futures Trading Commission (CFTC) report in 2020: ''Climate change is already impacting or is anticipated to impact nearly every facet of the economy, including infrastructure, agriculture, residential and commercial property, as well as human health and labor productivity . . . Risks include disorderly price adjustments in various asset classes, with possible spillovers into different parts of the financial system, as well as potential disruption of the proper functioning of financial markets.'' [82] The CFTC report states: ''[c]limate change could pose systemic risks to the U.S. financial system . . . [and that] the United States and financial regulators should . . . confirm the appropriateness of making investment decisions using climate-related factors in retirement and pension plans covered by [ERISA] as well as non-ERISA managed situations where there is fiduciary duty.'' [83] A Government Accountability Office Report to Congress in 2021 noted the exposure risk of retirement investment plans specifically to climate change,[84] and it is estimated that there is approximately $970 billion in value at risk due to climate change for the world's 500 largest companies.[85] According to a Federal Reserve Board report in 2020, ''[c]limate change, which increases the likelihood of dislocations and disruptions in the economy, is likely to increase financial shocks and financial system vulnerabilities that could further amplify these shocks.'' [86] The report further states: ''Opacity of exposures and heterogeneous beliefs of market participants about exposures to climate risks can lead to mispricing of assets and the risk of downward price shocks.'' [87] BlackRock describes the repercussions of these broad market events on investors, stating: ''[i]nvestors are increasingly . . . recognizing that climate risk is investment risk . . . [and that] these questions are driving a profound reassessment of risk and asset values.'' [88] It further states: ''And because capital markets pull future risk forward, we will see changes in capital allocation more quickly than we see changes to the climate itself. In the near future—and sooner than most anticipate—there will be a significant reallocation of capital.'' [89] Several pension funds have already divested from certain investments in part in response to climate-related risk. Both the New York City Employees' Retirement System and the New York City Teachers' Retirement System, for example, have committed to divesting away from fossil fuel-related investments.[90]

There is a breadth of literature that provides evidence for the materiality of climate change as a driver of risk-adjusted returns. These risks are often referred to in two broad categories: physical risk and transition risk. Physical risk captures the financial impacts associated with a rise in extreme weather events and a changing climate—both chronic and acute. The literature maintains that these risks can be especially material for long duration assets and grow in severity the more that climate mitigation and adaptation are neglected.[91] We are already seeing significant economic costs as a result of warming, and a certain amount of additional warming is guaranteed based on the greenhouse gas pollution already in the atmosphere.[92] This implies that

[81] *See, e.g.,* 85 FR 72857, 80 FR 65136.

[82] Climate-Related Market Risk Subcommittee, ''Managing Climate Risk in the U.S. Financial System'' Washington, DC: U.S. Commodity Futures Trading Commission, Market Risk Advisory Committee (2020) *https://www.cftc.gov/sites/default/files/2020-09/9-9-20%20Report%20of%20the%20Subcommittee%20on%20Climate-Related%20Market%20Risk%20-%20Managing%20Climate%20Risk%20in%20the%20U.S.%20Financial%20System%20for%20posting.pdf.*

[83] *Id.*

[84] U.S. Government Accountability Office, ''Retirement Savings: Federal Workers' Portfolios Should Be Evaluated For Possible Financial Risks Related to Climate Change'' (2021) *https://www.gao.gov/assets/gao-21-327.pdf.*

[85] ''Global Climate Change Analysis 2018,'' CDP (June 2019).

[86] Board of Governors of the Federal Reserve System, ''Financial Stability Report,'' (November 2020) *https://www.federalreserve.gov/publications/files/financial-stability-report-20201109.pdf.*

[87] *Id.*

[88] BlackRock, ''A Fundamental Reshaping of Finance,'' Larry Fink's 2020 Letter to CEOs. *https://www.blackrock.com/us/individual/larry-fink-ceo-letter.*

[89] *Id.*

[90] Ross Kerber and Kanishka Singh, ''NYC pension funds vote to divest $4 billion from fossil fuels,'' (January 25, 2021) *https://www.reuters.com/article/us-usa-new-york-fossil-fuels-pensions/nyc-pension-funds-vote-to-divest-4-billion-from-fossil-fuels-idUSKBN29U23Q.*

[91] Climate-Related Market Risk Subcommittee, ''Managing Climate Risk in the U.S. Financial System,'' U.S. Commodity Futures Trading Commission, Market Risk Advisory Committee (2020).

[92] Renee Cho, ''How Climate Change Impacts the Economy,'' (June 20, 2019) *https://news.climate.columbia.edu/2019/06/20/climate-change-economy-impacts/* Celso Brunetti, Benjamin Dennis, Dylan Gates, Diana Hancock, David Ignell, Elizabeth K. Kiser, Gurubala Kotta, Anna Kovner, Richard J. Rosen, and Nicholas K. Tabor, ''Climate Change and Financial Stability,'' FEDS Notes. Washington: Board of Governors of the Federal

Continued

the physical risks of climate change to our economy and to investments will persist. A 2019 report from BlackRock notes that the physical risk of extreme weather poses growing risks that are underpriced in certain sectors and asset classes.[93] Additionally, S&P Trucost found that almost 60 percent of the companies in the S&P500 index hold assets that were at high risk to the physical effects of climate change.[94]

Additionally, existing government policies and increasingly ambitious national and international greenhouse reduction goals will continue to create significant transition risk for investments. Transition risk reflects the risks that carbon-dependent businesses lose profitability and market share as government policies and new technology drive the transition to a carbon-neutral economy. Studies assess the value of global financial assets at risk from climate change to be in the range of $2.5 trillion to $4.2 trillion, including transition risks and other impacts from climate change.[95] A 2016 report found that the total value of assets in an average U.S. public pension portfolio could be 6 percent lower by 2050 than under a business-as-usual scenario due largely to transition risks associated with climate change.[96]

It is worth noting that climate change also represents a substantial investment opportunity, with research suggesting that investment in climate change mitigation will produce increasingly attractive yields.[97] Addressing transition risks can present opportunities to identify companies and investments that are strategically positioning themselves to succeed in the transition. Gradual, yet meaningful, shifts in investor preferences toward sustainability and the growing recognition that climate risk is investment risk may lead to a long-term reallocation of capital that will have a self-fulfilling impact on risk and return.

Given this substantial body of evidence, the Department welcomes comments on whether fiduciaries should consider climate change as presumptively material in their assessment of investment risks and returns, if adopted. If yes, comments also are welcome on the proper evidentiary bases to rebut such a presumption. The Department also welcomes comments on the extent to which climate-related financial risk is not already incorporated into market pricing.

Other ESG issues can often be material in the assessment of investment risks and returns. This is not to say that ESG factors are material in every instance, or that funds that use ESG screens can be expected to outperform other funds on a systematic basis. While there is a growing body of literature on a wide range of ESG investing generally outside of ERISA, its findings vary. Outside the ERISA context, investors may choose to invest in funds that promote collateral objectives, and even choose to sacrifice return or increase risk to achieve those objectives. Such conduct, however, would be impermissible for ERISA plan fiduciaries, who cannot sacrifice return or increase risk for the purpose of promoting collateral goals unrelated to the economic interests of plan participants in their benefits. The Department requests comments specifically addressing any evidence on the financial materiality of ESG factors in various investment contexts.

The body of research evaluating ESG investing as a whole shows ESG investing has financial benefits, although the literature overall has varied findings. In a large meta-study of peer-reviewed articles published between 2015 and 2020, Whelan et al. (2021) find that most studies show that ESG investing has positive effects on financial performance.[98] Some specific studies have shown that ESG investing outperforms conventional investing. Verheyden, Eccles, and Feiner's research analyzes stock portfolios that used negative screening[99] to exclude operating companies with poor ESG records from the portfolios.[100] The study finds that negative screening tends to increase a stock portfolio's annual performance by 0.16 percent. Similarly, Kempf and Osthoff's research, which examines stocks in the S&P 500 and the Domini 400 Social Index (renamed as the MSCI KLD 400 Social Index in 2010), finds that it is financially beneficial for investors to positively screen their portfolios.[101] Additionally, Ito, Managi, and Matsuda's research finds that socially responsible funds outperformed conventional funds in the European Union and United States.[102] Additional studies found a positive relationship between ESG investing and firms' market valuation.[103]

In contrast, however, other studies have found that ESG investing has resulted in lower returns than conventional investing. For example, Winegarden shows that over ten years, a portfolio of ESG funds has a return that is 43.9 percent lower than if it had

Reserve System, March 19, 2021, *https://doi.org/10.17016/2380-7172.2893.*

[93] BlackRock Investment Institute, ''Getting Physical: Assessing Climate Risks,'' (2019) *https://www.blackrock.com/us/individual/insights/blackrock-investment-institute/physical-climate-risks.*

[94] S&P Trucost Limited, Understanding Climate Risk at the Asset Level: The Interplay of Transition and Physical Risks (2019) *https://www.spglobal.com/_division_assets/images/special-editorial/understanding-climate-risk-at-the-asset-level/sp-trucost-interplay-of-transition-and-physical-risk-report-05a.pdf.*

[95] EY, ''Climate Change: The Investment Perspective,'' (2016) *https://assets.ey.com/content/dam/ey-sites/ey-com/en_gl/topics/banking-and-capital-markets/ey-climate-change-and-investment.pdf.*

[96] Mercer and Center for International Environmental Law, ''Trillion-Dollar Transformation: A Guide to Climate Change Investment Risk Management for US Public Defined Benefit Trustees'' (October 2016).

[97] Channell, Curmi, Nguyen, Prior, Syme, Jansen, Rahbari, Morse, Kleinman, Kruger, ''Energy Darwinism II'', Citi, August 2015, © 2015. Citigroup5''World Energy Investment Outlook'', International Energy Agency, June 2014, © 2014 OECD/IEA.

[98] Tensie Whelan, Ulrich Atz, Tracy Van Holt, and Casey Clark, ''ESG and Financial Performance: Uncovering the Relationship by Aggregating Evidence from 1,000 Plus Studies Published Between 2015–2020,'' NYU Stern Center for Sustainable Business and Rockefeller Asset Management (2021). *https://www.stern.nyu.edu/sites/default/files/assets/documents/NYU-RAM_ESG-Paper_2021%20Rev_0.pdf.*

[99] Negative screening refers to the exclusion of certain sectors, companies, or practices from a fund or portfolio based on ESG criteria.

[100] Tim Verheyden, Robert G. Eccles, and Andreas Feiner, *ESG for all? The Impact of ESG Screening on Return, Risk, and Diversification.* 28 *Journal of Applied Corporate Finance* 2 (2016).

[101] Alexander Kempf and Peer Osthoff, *The Effect of Socially Responsible Investing on Portfolio Performance,* 13 *European Financial Management* 5 (2007).

[102] Yutaka Ito, Shunsuke Managi, and Akimi Matsuda, *Performances of Socially Responsible Investment and Environmentally Friendly Funds,* 64 *Journal of the Operational Research Society* 11 (2013).

[103] De Villiers and Ana Marques, *Corporate Social Responsibility, Country-Level Predispositions, and the Consequences of Choosing a Level of Disclosure, Accounting and Business Research, Taylor & Francis Journals,* Vol. 46(2) (2016). Dhaliwal, Dan, Suresh Radhakrishnan, Albert Tsang, and Yong George Yang, *Nonfinancial Disclosure and Analyst Forecast Accuracy: International Evidence on Corporate Social Responsibility Disclosure, The Accounting Review* Vol. 87(3) (2012). Godfrey, Paul C., Craig B. Merrill, and Jared M. Hansen, *The Relationship between Corporate Social Responsibility and Shareholder Value: An Empirical Test of the Risk Management Hypothesis, Strategic Management Journal,* Vol. 30(4) (2009). Guidry, Ronald. and Patten, Dennis, *Market Reactions to the First-Time Issuance of Corporate Sustainability Reports: Evidence that Quality Matters, Sustainability Accounting, Management and Policy Journal,* Vol. 1(1) (2010). Marsat,Sylvain and Benjamin Williams, *CSR and Market Valuation: International Evidence, Bankers Markets & Investors: an Academic & Professional Review,* Groupe Banque, Vol. 123 (2013). Marvelskemper, Laura and Daniel Streit, *Enhancing Market Valuation of ESG Performance: Is Integrated Reporting Keeping its Promise? Business Strategy and the Environment,* Wiley Blackwell, Vol. 26(4) (2017). Sharfman, Mark and Chitru Fernando, *Environmental Risk Management and the Cost of Capital. Strategic Management Journal,* Vol. 29(6) (2008).

been invested in an S&P 500 index fund.[104] Trinks and Scholten's research, which examines socially responsible investment funds, finds that a screened market portfolio significantly underperforms an unscreened market portfolio.[105] Ferruz, Muñoz, and Vicente's research, which examines U.S. mutual funds, finds that a portfolio of mutual funds that implements negative screening underperforms a portfolio of conventionally matched pairs.[106] Likewise, Ciciretti, Dalò, and Dam's research, which analyzes a global sample of operating companies, finds that companies that score poorly in terms of ESG indicators have higher expected returns.[107] Marsat and Williams' research has very similar findings.[108] Operating companies with better ESG scores according to MSCI had lower market valuation. The reviewed studies in this paragraph may not be completely representative of ERISA investment outcomes. The studies generally do not limit their focus to investments by ERISA plan fiduciaries. ERISA fiduciaries must focus on financial materiality with undivided loyalty. Thus, to the extent a study analyzes investments that fail to meet these fiduciary standards, it will likely observe investment outcomes that have a weaker performance.

Furthermore, there are many studies with mixed or inconclusive results. Goldreyer and Diltz's research, which examines 49 socially responsible mutual funds, finds that employing positive social screens does not affect the investment performance of mutual funds.[109] Similarly, Renneboog, Ter Horst, and Zhang's research, which analyzes global socially responsible mutual funds, finds that the risk-adjusted returns of socially responsible mutual funds are not statistically different from conventional funds.[110] Bello's research, which examines 126 mutual funds, finds that the long-run investment performance is not statistically different between conventional and socially responsible funds.[111] Likewise, Ferruz, Muñoz, and Vicente's research finds that a portfolio of mutual funds that implement positive screening[112] performs equally well as a portfolio of conventionally matched pairs.[113] Finally, Humphrey and Tan's research, which examines socially responsible investment funds, finds no evidence of negative screening affecting the risks or returns of portfolios.[114]

Many compelling studies show the material financial benefits of diverse and inclusive workplaces. There are three main vectors across which a company's diversity and inclusion practices can have a financially material impact on their business: Employee recruitment and retention, performance and productivity, and litigation. Examples of this material impact are outlined below:

Employee Recruitment and Retention

- In a survey of 2,745 respondents, the job site Glassdoor found that 76% of employees and job seekers overall look at workforce diversity when evaluating an offer.[115]
- It costs firms an estimated $64 billion per year from losing and replacing over 2 million American professionals and managers who leave their jobs each year due to unfairness and discrimination.[116]
- To replace a departing employee costs somewhere between $5,000 and $10,000 for an hourly worker, and between $75,000 and $211,000 for an executive making $100,000 per year.[117]

Performance and Productivity

- Empirical evidence finds that an increase of 10 percentage points in the representation of female directors on a company board is associated with 6% more patents and 7% more citations for a given amount of R&D spending.[118]
- A study of 171 German, Swiss, and Austrian companies shows a clear relationship between the diversity of companies' management teams and the revenues they get from innovative products and services.[119]
- Research finds that socially different group members do more than simply introduce new viewpoints or approaches. In the study, diverse groups outperformed more homogeneous groups not because of an influx of new ideas, but because diversity triggered more careful information processing that is absent in homogeneous groups.[120]
- When employees think their organization is committed to, and supportive of diversity and they feel included, employees report better business performance in terms of ability to innovate, (83% uplift) responsiveness to changing customer needs (31% uplift) and team collaboration (42% uplift).[121]
- Publicly traded companies with 2D diversity (exhibiting both inherent and acquired diversity) were 70% more likely to capture a new market, 75% more likely to see ideas actually become productized, and 158% more likely to understand their target end-users and innovate effectively if one or more members on the team represent the user's demographic.[122]
- Companies in the top-quartile for gender diversity on executive teams were 21% more likely to outperform on profitability. Companies in the top-quartile for ethnic/cultural diversity on executive teams were 33% more likely to have industry-leading profitability.[123]
- A study on 366 public companies found that those in the top quartile for ethnic and racial diversity in

[104] Wayne Winegarden, Environmental, Social, and Governance (ESG) Investing: An Evaluation of the Evidence. Pacific Research Institute (2019).

[105] Pieter Jan Trinks and Bert Scholtens, The Opportunity Cost of Negative Screening in Socially Responsible Investing, 140 Journal of Business Ethics 2 (2017).

[106] Luis Ferruz, Fernando Muñoz, and Ruth Vicente, Effect of Positive Screens on Financial Performance: Evidence from Ethical Mutual Fund Industry (2012).

[107] Rocco Ciciretti, Ambrogio Dalò, and Lammertjan Dam, The Contributions of Betas versus Characteristics to the ESG Premium (2019).

[108] Sylvain Marsat and Benjamin Williams, CSR and Market Valuation: International Evidence. Bankers, Markets & Investors: An Academic & Professional Review, Groupe Banque (2013).

[109] Elizabeth Goldreyer and David Diltz, The Performance of Socially Responsible Mutual Funds: Incorporating Sociopolitical Information in Portfolio Selection, 25 Managerial Finance 1 (1999).

[110] Luc Renneboog, Jenke Ter Horst, and Chendi Zhang, The Price of Ethics and Stakeholder Governance: The Performance of Socially Responsible Mutual Funds, 14 Journal of Corporate Finance 3 (2008).

[111] Zakri Bello, Socially responsible investing and portfolio diversification, 28 Journal of Financial Research 1 (2005).

[112] Positive screening refers to including certain sectors and companies that meets the criteria of non-financial objectives.

[113] Ferruz, Muñoz, and Vicente, Effect of Positive Screens on Financial Performance (2012).

[114] Jacquelyn Humphrey and David Tan, Does It Really Hurt to be Responsible?, 122 Journal of Business Ethics 3 (2014).

[115] ''What Job Seekers Really Think About Your Diversity and Inclusion Stats,'' *Glassdoor* (July 12, 2021) *https://www.glassdoor.com/employers/blog/diversity/*. ''Glassdoor's Diversity and Inclusion Workplace Survey,'' (updated September 30, 2020), *https://www.glassdoor.com/blog/glassdoors-diversity-and-inclusion-workplace-survey/*.

[116] Level Playing Field Institute, ''The Cost of Employee Turnover Due Solely to Unfairness in the Workplace'' (2007).

[117] Gail Robinson and Kathleen Dechant, ''Building a business case for diversity,'' Academy of Management Executive 11 (3) (1997): 21–31.

[118] ''Female board representation, corporate innovation and firm performance.'' Jie Chen, Woon Sau Leung and Kevin P. Evans (2018).

[119] Rocio Lorenzo, Nicole Voigt, Karin Schetelig, Annika Zawadzki, Isabelle Welpe, and Prisca Brosi, ''The Mix that Matters: Innovation through Diversity,'' BCG (2017).

[120] ''Better Decisions through Diversity,'' *Kellogg School of Management* (2010).

[121] ''Waiter, is that inclusion in my soup? A new recipe to improve business performance,'' *Deloitte* (2013).

[122] Sylvia Ann Hewlett, Melinda Marshall, Laura Sherbin, and Tara Gonsalves, ''Innovation, Diversity, and Market Growth,'' *Center for Talent Innovation* (2013).

[123] Vivian Hunt, Sara Prince, Sundiatu Dixon-Fyle, Lareina Ye, ''Delivering through Diversity,'' McKinsey & Company (January 2018).

management were 35% more likely to have financial returns above the median for their industry in their country, and those in the top quartile for gender diversity were 15% more likely to have returns above the median for their industry in their country.[124]

Litigation

- The U.S. Equal Employment Opportunity Commission (EEOC) received 67,448 charges of workplace discrimination in Fiscal Year (FY) 2020. The agency secured $439.2 million for victims of discrimination in the private sector and state and local government workplaces through voluntary resolutions and litigation.[125]

Other Cross-Cutting Studies

- A meta-analysis on 7,939 business units in 36 companies further confirms that higher employee satisfaction levels are associated with higher profitability, higher customer satisfaction, and lower employee turnover.[126]
- One study found that companies reporting high levels of racial diversity brought in nearly 15 times more sales revenue on average than those with low levels of racial diversity. Companies with high rates reported an average of 35,000 customers compared to 22,700 average customers among those companies with low rates of racial diversity.[127]
- Diversity management is strongly linked to both work group performance and job satisfaction, and people of color see benefits from diversity management above and beyond those experienced by white employees.[128]
- In a 6-month research study, found evidence that a growing number of companies known for their hard-nosed approach to business—such as Gap Inc., PayPal, and Cigna—have found new sources of growth and profit by driving equitable outcomes for employees, customers, and communities of color.[129]

Paragraph (d) of the proposal contains the provisions addressing the application of the prudence and exclusive benefit purpose duties to the exercise of shareholder rights, including proxy voting, the use of written proxy voting guidelines, and the selection and monitoring of proxy advisory firms. Proposed paragraph (d) would benefit plans by providing improved guidance regarding these activities. As discussed above, non-regulatory guidance that the Department has previously issued over the years may have led to a misunderstanding among some that fiduciaries are required to vote on all proxies presented to them or, conversely, that they may not vote proxies unless they first perform a cost-benefit analysis and quantify net benefits. Although the current regulation sought to address the first misunderstanding (*i.e.,* that fiduciaries are required to vote on all proxies) with express language, the Department is concerned that the language used may effectively reinstate the second misunderstanding by suggesting that fiduciaries need special justification to vote proxies at all.

We believe that the principles-based approach retained in paragraph (d) of the proposal would address these misunderstandings and clarify that neither extreme is always required. Instead, plan fiduciaries, after an evaluation of material facts that form the basis for any particular proxy vote or other exercise of shareholder rights, must make a reasoned judgment both in deciding whether to exercise shareholder rights and when actually exercising such rights. In making this judgment, plan fiduciaries must act solely in accordance with the economic interest of the plan, must consider any costs involved, and must never subordinate the interests of participants in their retirement benefits to unrelated goals. This proposal's clarifications may lead to more proxy voting in comparison to the current regulation, which is beneficial because it ensures that shareholders' interests as the company's owners are protected and, by extension, that the interests of participants and beneficiaries in plans that are shareholders are also protected. While the Department is confident that the proposal would promote, rather than deter, responsible proxy voting, particularly as compared to the current regulation, it is less certain that it will result in any increase in proxy voting as compared to the pre-regulatory guidance, which took a similar approach. The Department invites comments on the question.

Preserving flexibility, paragraph (d) of the proposal carries forward core elements of the provision from the current regulation that allows a plan to have written proxy voting policies that govern decisions on when to vote or not vote categories or types of proposals, subject to the aforementioned principles. With the ability for plans to adopt policies to govern the decision whether to vote on a matter or class of matters, plan fiduciaries will be better positioned to conserve plan assets by establishing specific parameters designed to serve the plan's interests.

Cost Savings Relative to the Current Regulation

Paragraph (d) of the proposal would eliminate the recordkeeping requirement in paragraph (e)(2)(ii)(E) of the current regulation which provides that, when deciding whether to exercise shareholder rights and when exercising shareholder rights, plan fiduciaries must maintain records on proxy voting activities and other exercises of shareholder rights. The change is expected to produce a cost savings of $6.05 million per year relative to the current regulation. The proposal also would revise the provision of the current regulation that addresses proxy voting policies, paragraph (e)(3)(i) of the current regulation, by removing the two ''safe harbor'' examples for proxy voting policies that would be permissible under the provisions of the current regulation. This revision reduces the burden related to proxy voting policies and procedures and voting by $13.3 million in the first year relative to the current regulation.[130] The proposal also would eliminate the current regulation's requirement for a fiduciary to specially document consideration of benefits in addition to investment return under the tie-breaker rule. This proposed elimination would save an estimated $122,000 annually.[131] Finally, the

[124] Vivian Hunt, Dennis Layton, and Sara Prince, ''Why diversity matters,'' McKinsey & Company (2015).

[125] ''EEOC Releases Fiscal Year 2020 Enforcement and Litigation Data,'' (2021).

[126] James K. Harter, Frank L. Schmidt, and Theodore L. Hayes, ''Business-Unit-Level Relationship Between Employee Satisfaction, Employee Engagement, and Business Outcomes: A Meta-Analysis.'' *Journal of Applied Psychology* 87(2) (2002) 268–279.

[127] Cedric Herring, ''Does Diversity Pay? Race, Gender, and the Business Case for Diversity,'' *American Sociological Review* (2009).

[128] David Pitts, ''Diversity Management, Job Satisfaction, and Performance: Evidence from U.S. Federal Agencies,'' *Public Administration Review* (2009).

[129] Angela Glover Blackwell, Mark Kramer, Lalitha Vaidyanathan, Lakshmi Iyer, and Josh Kirschenbaum, ''The Competitive Advantage of Racial Equity,'' FSG and PolicyLink, (2018).

[130] In the 2020 final rule published on December 16, it was estimated that a legal professional would expend, on average, two hours to update policies and procedures for each of the estimated 63,911 plans affected by the rule, resulting in an annual burden estimate of 127,822 hours in the first year, with an equivalent cost of $17,691,809. In the proposal, the Department estimates that it will take a legal professional just thirty minutes to update policies and procedures for each of the estimated 63,911 plans affected by the rule, resulting in a cost of $4,422,961. This results in a cost savings of $13,268,857. 85 FR 81658.

[131] In the 2020 final rule published on November 13, it was estimated that that plan fiduciaries and clerical staff would each expend, on average, two hours of labor to maintain the needed documentation, resulting in an annual burden estimate of 1,290 hours annually, with an equivalent cost of $122,115 for DB plans and DC plans with ESG investments. This requirement has been eliminated in the proposal. 85 FR 72846.

proposal also would eliminate the requirement and the related disruption caused by the requirement that under no circumstances may any investment fund, product, or model portfolio be added as, or as a component of, a QDIA if its investment objectives or goals or its principal investment strategies include, consider, or indicate the use of one or more non-pecuniary factors.

1.4. Costs

By reversing aspects of the current regulation, this proposal would facilitate certain changes by plan fiduciaries in their investment behavior, including changes in asset management strategies such as proxy voting, that these plan fiduciaries otherwise likely would not take under the current regulation. The precise impact of this proposal on such behavior is uncertain. Therefore, a precise quantification of all costs similarly is not possible. Despite this, some impact is predictable and these costs are quantified below. Regardless of these limitations, to the extent that the proposal changes behavior, its benefits are expected to outweigh the costs. Overall, the costs of the proposal are expected to be relatively small, in part because the Department assumes most plan fiduciaries are complying with the pre-2020 interpretive bulletins (specifically Interpretive Bulletin 2016–1 and 2015–1), which the proposal tracks to a very large extent. Known incremental costs of the proposal would be minimal on a per-plan basis.

(a) Cost of Reviewing NPRM and Reviewing Plan Practices

Plans, plan fiduciaries, and their service providers would incur costs to read the proposal and evaluate how it would impact current documents and practices. With respect to the investment duties of a plan fiduciary when selecting an investment or investment course of action, as set forth in paragraphs (a)–(c) of the proposal, the Department estimates that 78,307 plans have exposure to investments selected using ESG factors, consisting of 25,342 defined benefit pension plans and 52,965 participant-directed individual account plans.[132] Fiduciaries of each of these types of plans will need to spend time reviewing the proposal, evaluating how it might affect their investment practices, and what would be needed to implement any necessary changes. The Department estimates that this review process will require a lawyer to spend approximately four hours to complete, resulting in a cost burden of approximately $43.4 million.[133] The Department believes that these processes will likely be performed by a service provider for most plans that likely oversee multiple plans. Therefore, the Department's estimate likely is an upper bound, because it is based on the number of affected plans, without regard to the likely shared expense incurred by service providers that service multiple plans. The Department does not have data that would allow it to estimate the number of service providers acting in such a capacity for these plans.

Similarly, plans will need to spend time reviewing paragraph (d) of the proposal, evaluating how it affects their proxy voting practices, and implementing any necessary changes. The Department estimates that this review process will require a lawyer on average to spend approximately four hours to complete, resulting in a cost burden of approximately $35.4 million.[134] The Department believes that these processes will likely be performed for most plans by a service provider that likely oversees multiple plans. Therefore, the Department's estimate likely represents an upper bound, because it is based on the number of affected plans. The Department does not have sufficient data that would allow it to estimate the number of service providers acting in such a capacity for these plans.

(b) Possible Changeover Costs

If existing plan investments are replaced due to the proposal, the replacement may involve some short-term costs. Some plans may change investments or investment courses of action to begin acquiring or to acquire more ESG integrated assets in light of the clarification in paragraph (c)(2) of the proposal. In the Department's view, this would be net beneficial because compliant acquisitions of this type would be done with the aim of improving (by reducing) the plan's ESG-related financial risk. Thus, even if there are short-term costs associated with changed investment practices, the benefits to the plan of reduced ESG-related financial risk are expected to exceed these costs over time. The Department lacks data to estimate the likely size of this impact at this time and, therefore, solicits comments on the topic.

(c) Costs of Paragraphs (c)(1) and (2)

Paragraphs (c)(1) and (2) of the proposal address the application of the duty of loyalty under ERISA as applied to a fiduciary's consideration of an investment or investment course of action. Paragraph (c)(1) provides 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 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. Paragraph (c)(2) provides that a fiduciary's evaluation of an investment or investment course of action must be based on risk and return factors that the fiduciary prudently determines are material to investment value, using appropriate investment horizons consistent with the plan's investment objectives and taking into account the funding policy of the plan established pursuant to section 402(b)(1) of ERISA. These proposed provisions would require a fiduciary to perform an evaluation, including a rigorous analysis of risk-return factors, and they provide direction on what to include in that evaluation. Regardless of these proposed provisions, it is the Department's view that many plan fiduciaries already undertake such evaluations as part of their investment selection decision-making process, including documentation of their decisions, process, and reasoning. The Department does not intend to increase fiduciaries' burden of care attendant to such consideration; therefore, no additional costs are estimated for these requirements.

[132] DOL calculations are based on statistics from Private Pension Plan Bulletin: Abstract of 2018 Form 5500 Annual Reports, Employee Benefits Security Administration (2020), *https://www.dol.gov/sites/dolgov/files/EBSA/researchers/statistics/retirement-bulletins/private-pension-plan-bulletins-abstract-2018.pdf.* (52,965 + 25,342) = 78,307

[133] The Department estimated that there are 78,307 plans that will need to ensure compliance with the proposed rule's ESG components. The burden is estimated as follows: 78,307 plans * 4 hours = 313,228 hours. A labor rate of $138.41 is used for a lawyer. The cost burden is estimated as follows: 78,307 plans * 4 hours * $138.41S = $43,353,887. Labor rates are based on DOL estimates from *Labor Cost Inputs Used in the Employee Benefits Security Administration, Office of Policy and Research's Regulatory Impact Analyses and Paperwork Reduction Act Burden Calculation,* Employee Benefits Security Administration (June 2019), *www.dol.gov/sites/dolgov/files/EBSA/laws-and-regulations/rules-and-regulations/technical-appendices/labor-cost-inputs-used-in-ebsa-opr-ria-and-pra-burden-calculations-june-2019.pdf.*

[134] The burden is estimated as follows: 63,911 plans * 4 hours = 255,644 hours. A labor rate of $138.41 is used for a lawyer. The cost burden is estimated as follows: 63,911 plans * 4 hours * $138.41 = $35,383,617.

(d) Cost of Tie-Breaker

The proposal, at paragraph (c)(3), carries forward a more flexible version of the tie-breaker concept than is in the current regulation; the carried-forward version is comparable to and commensurate with the formulation previously expressed in Interpretive Bulletin 2015–1 (and first explained in Interpretive Bulletin 94–1). The proposal's tie-breaker provision is relevant and operable only once a prudent fiduciary determines that competing alternative investments equally serve the financial interests of the plan. In these circumstances, the plan fiduciary may focus on the collateral benefits of an investment or investment course of action to decide the outcome.

The tie-breaker test in paragraph (c)(3) of the proposal would impose minimal costs on plans. The provision implies analysis and documentation requirements, but the proposal attributes no costs to these requirements primarily because plans already carry out these activities as part of their process for selecting investments. Put differently, the Department's regulatory impact analysis assumes that the analytics and documentation requirements of the tie-breaker provision, and associated costs, are subsumed in the analytics and documentation requirements of the risk-return analysis required by paragraphs (c)(1) and (2) of the proposal. The analysis of risk-return factors under paragraphs (c)(1) and (2) of the proposal in the first instance would necessarily reveal any collateral benefits of an investment or investment course of action, which may then be used later on to break a tie pursuant to paragraph (c)(3) of the proposal. In this sense, paragraph (c)(3) of the proposal thus imposes no distinct process, and therefore no material additional costs, apart from a plan's ordinary investment selection process.

Some potential costs, however, are expected with respect to the requirement in paragraph (c)(3) to inform plan participants of the collateral benefits that influenced the selection of the investment or investment course of action, when such investment or investment course of action constitutes a designated investment alternative under a participant-directed individual account plan. These costs are expected to be minimal because disclosure regulations adopted in 2012 already entitle participants in participant-directed individual account plans to receive sufficient information regarding designated investment alternatives to make informed decisions with regard to the management of their individual accounts. The information required by the 2012 rule includes information regarding the alternative's objectives or goals and the alternative's principal strategies (including a general description of the types of assets held by the investment) and principal risks. *See* 29 CFR 2550.404a–5. This proposal, therefore, assumes these existing disclosures are, or perhaps with minor modifications or clarifications could be, sufficient to satisfy the disclosure element of the tie-breaker provision in paragraph (c)(3) of the proposal. The Department estimates that it will take a legal professional twenty minutes on average per year to update existing disclosures to meet this requirement. If each of the approximately 53,000 participated-directed individual account plans estimated to have at least one ESG-themed designated investment alternative used the tie-breaker provision in paragraph (c)(3) of the proposal, the result would be a cost of approximately $2.4 million.[135] This estimate likely is overstated because each such plan is unlikely to use the tie-breaker provision and because the ongoing costs of the disclosure requirement in paragraph (c)(3) of the proposal would be approximately zero absent changes to an affected designated investment alternative. At the same time, this estimate likely is understated to the extent that more plans use ESG criteria in the future and to the extent such plans have multiple designated investment options subject to paragraph (c)(3) of the proposed rule. Comments are solicited on this topic.

(e) Cost To Update Plan's Written Proxy Voting Policies

Paragraph (d)(3)(i) of the proposal provides that, for purposes of deciding whether to vote a proxy, plan fiduciaries may adopt proxy voting policies as long as the policies are prudently designed to serve the plan's interests in providing benefits to participants and their beneficiaries and defraying reasonable expenses of administering the plan. Paragraph (d)(3)(ii), in turn provides that plan fiduciaries shall periodically review these proxy voting policies.

The Department estimates that these provisions of the proposal could impose additional costs because such policies will need to be reviewed on an initial basis. However, the Department believes that the proposal largely comports with industry practice for ERISA fiduciaries. Therefore, the Department estimates that on average, it will take a legal professional just thirty minutes to update policies and procedures for each of the estimated 63,911 plans affected by the rule. This results in a cost of $4.4 million in the first year relative to the current rule.[136] The requirement in paragraph (d)(3)(ii) to periodically review proxy voting policies already is required for fiduciaries to meet their obligations under ERISA; therefore, the Department does not expect that plans will incur additional cost associated with the periodic review.

1.5. Transfers

The proposal could result in some transfers. If some portion of proposed rule-induced increases in returns would be associated with transactions in which other parties experience decreased returns of equal magnitude, then this portion of the proposal's impact would, from a societal perspective, be appropriately categorized as a transfer. For example, the outcome of a proxy vote capping executive compensation at a certain level could limit the income of executives while redounding to the benefit of the company's shareholders (and thus participants and beneficiaries of a plan invested in that company).

Transfers could also arise as a result of substantially greater confidence on the part of fiduciaries that they may consider *any* material factor in their risk-return analysis going forward, including climate change and other ESG factors. As discussed previously, the Department has heard from stakeholders that the current regulation has already had a chilling effect on appropriate integration of material climate change and other ESG factors into investment decisions. Although the current regulation acknowledges that climate change and other ESG factors can in some instances be taken into account by a fiduciary, it also includes multiple statements that have been interpreted as putting a thumb on the scale against their consideration. This conflicting guidance may have disincentivized fiduciaries from considering material climate change and other ESG factors in order to minimize potential legal liability. Such a disincentive could have a distortionary effect on the investment of ERISA plan assets well into the future by changing fiduciaries' investment decisions, if it were to prevent them from considering climate change and

[135] The burden is estimated as follows: 52,965 individual account plans * 20 minutes = 17,655 hours. A labor rate of $138.41 is used for a legal professional: (17,655 hours * $138.41 = $2,443,629).

[136] The burden is estimated as follows: 63,911 plans * 0.5 hour = 31,955.5. A labor rate of $138.41 is used for a legal professional: (33,955.5 * $138.41 = $4,422,961).

other ESG factors that they would otherwise find economically advantageous. We expect the clear guidance in this proposed rule to eliminate this potential market distortion. Although the Department is unable to quantify the transfers that might result, we expect that they are likely to exceed $100 million annually, given the very large size of the roughly $12.2 trillion invested in ERISA plan assets that could be potentially affected, and also given the rapidly growing use of ESG factors in mainstream financial analysis.[137]

Similarly, transfers also could arise as a result of the proposed changes to the proxy voting provisions in paragraph (e) of the current regulation (relocated to paragraph (d) of the proposal). For instance, if the provisions in paragraph (e) of the current regulation were permitted to go into effect fully, it is possible that fewer proxies in the future would be voted by plans as a result of the no-vote statement in paragraph (e)(2)(ii) of the current regulation and the two safe harbors in paragraphs (e)(3)(i)(A) and (B) of the current regulation. In these circumstances, the proposed rescission of these provisions, however, would effectively transfer some voting power from other shareholders back to ERISA plans (mainly by reversing the dilutive effect of these provisions). Similarly, as the number of ERISA plans voting on any particular proxy vote tends to increase, voting power will tend to shift to represent a broader set of concerns. The Department is unable to quantify the extent of this transfer because the safe harbors in the current regulation have been effectively stayed pursuant to the Department's establishment of the non-enforcement policy in March of 2021. For the same reason, the Department is unable to quantify the cost of paragraph (d) of the proposal, but estimates the cost would be relatively minimal and limited to the cost of reviewing and understanding the new rule. In addition, for plans that, but for the non-enforcement policy, might have adopted and implemented the safe harbors, some costs might be incurred in connection with revising the proxy voting policies to remove the safe harbors, as well as some additional costs related to increased voting. These costs, however, would be offset by the benefits of voting. The Department seeks comments on these impacts.

1.6. Uncertainty

The Department's economic assessment of this proposal's effects is subject to uncertainty. Special areas of uncertainty are discussed below:

Regarding paragraphs (c)(2) and (b)(4) of the proposal, it is unclear how many plan fiduciaries would use climate change or other ESG factors when selecting investments and the total asset value of investments that would be selected in this manner. This is particularly true for defined benefit (DB) plans. While there is some survey evidence on how many DB plans factor in ESG considerations, the surveys were based on small samples and yielded varying results. It is also difficult to estimate the degree to which the use of climate change and other ESG factors by ERISA fiduciaries would expand in the future absent this proposed rulemaking. The clarification provided by this proposal may encourage more plan fiduciaries to use climate change and other ESG factors. Trends in other countries suggest that pressure for such expansion may continue to increase.[138] Based on current trends, the Department believes that the use of climate change and other ESG factors by ERISA plan fiduciaries would likely increase in the future, although it is uncertain when or by how much.

Regarding paragraph (d) of the proposal, it is uncertain whether the proposal would create a demand for new or different services associated with proxy voting and if so, what alternate services or relationships with service providers might result and how overall plan expenses could be impacted. Similarly, uncertain is whether and the extent to which paragraph (d) of the proposal would cause plans to modify their securities holdings, for example, in favor of greater mutual fund holdings (to avoid management responsibilities with respect to holdings of individual companies) or in how they manage their mutual fund shares (in terms of exercising shareholder rights, including proxy voting, appurtenant to the mutual fund shares). Accordingly, the Department requests comments on these issues.

The Department has heard from stakeholders that the current regulation, and investor confusion about it, has already had a chilling effect on appropriate integration of climate change and other ESG factors in investment decisions. To increase clarity the Department solicits comments on the impacts the current regulation has on appropriate integration of climate change and other ESG factors in investment decisions.

1.7. Alternatives

In order to ensure a comprehensive review, the Department examined as an alternative leaving the current regulation in place without change. However, as explained in more detail earlier in this document, following informal outreach activities with a wide variety of stakeholders, including asset managers, labor organizations and other plan sponsors, consumer groups, service providers and investment advisers, the Department believes that uncertainty with respect to the current regulation may deter fiduciaries from taking steps that other marketplace investors might take in enhancing investment value and performance, or improving investment portfolio resilience against the financial risks and impacts associated with climate change. This could hamper fiduciaries as they attempt to discharge their responsibilities prudently and solely in the interests of plan participants and beneficiaries. The Department therefore chose not to take this alternative.

The Department also considered rescinding the *Financial Factors in Selecting Plan Investments* and *Fiduciary Duties Regarding Proxy Voting and Shareholder Rights* final rules. This alternative would remove the entire current regulation from the Code of Federal Regulations, including provisions that reflect the original 1979 Investment Duties regulation. The original Investment Duties regulation has been relied on by fiduciaries for many years in making decisions about plan investments and investment courses of actions, and complete removal of the provisions could lead to disruptions in plan investment activity. Accordingly, the Department rejected this alternative. As discussed in the Cost Savings section above, quantified costs for the current rule related to proxy voting totaled $19.35 million in the first year and $13.3 million in subsequent years for the current rule. Rescission of the current rule would save this quantified amount.

[137] EBSA projected ERISA covered pension, welfare, and total assets based on the 2018 Form 5500 filings with the U.S. Department of Labor (DOL), reported SIMPLE assets from the Investment Company Institute (ICI) Report: The U.S. Retirement Market, First Quarter 2021, and the Federal Reserve Board's Financial Accounts of the United States Z1 June 10, 2021.

[138] *See generally* Government Accountability Office Report No. 18–398, *Retirement Plan Investing: Clearer Information on Consideration of Environmental, Social, and Governance Factors Would Be Helpful* (May 2018) *https://www.gao.gov/products/gao-18-398*; Principles for Responsible Investment, *Fiduciary Duty in the 21st Century,* United Nations Environment Programme Finance Initiative (2019), *https://www.unepfi.org/wordpress/wp-content/uploads/2019/10/Fiduciary-duty-21st-century-final-report.pdf.*

As another alternative, the Department considered revising the current regulation by, in effect, reverting it to the original 1979 Investment Duties regulation. This would reduce the potential of disrupting plan investment activity that would be caused by complete rescission, as described above. However, because the Department's prior non-regulatory guidance on ESG investing and proxy voting was removed from the Code of Federal Regulations by the *Financial Factors in Selecting Plan Investments* and *Fiduciary Duties Regarding Proxy Voting and Shareholder Rights* final rules, this alternative would leave plan fiduciaries without any guidance on the consideration of ESG issues when material to plan financial interests. Similar to the first alternative described above, this could inhibit fiduciaries from taking steps that other marketplace investors might take in enhancing investment value and performance, or from improving investment portfolio resilience against the potential financial risks and impacts associated with climate change. The Department therefore rejected this alternative. As discussed in the Cost Savings section above, quantified costs for the current rule related to the tie-breaker totaled $122,000 annually. Rescission of the current rule would save this quantified amount.

As a final alternative, the Department considered revising the current regulation by adopting similar changes to fiduciary responsibilities as proposed by the European Commission.[139] The European Commission (EC) is amending existing rules on fiduciary duties in delegated acts for asset management, insurance, reinsurance and investment sectors to encompass sustainability risks such as the impact of climate change and environmental degradation on the value of investments. Specifically, the EC has added the requirement that fiduciaries must proactively solicit client's sustainability preferences, in addition to existing requirements that a fiduciary obtain information about the client's investment knowledge and experience, ability to bear losses, and risk tolerance as part of the suitability assessment. Further, the European Union's guidelines for the supervision of institutions for occupational retirement provisions (IORPs) require member states to ensure that IORPs consider ESG factors related to investment assets in their investment decisions, as part of their prudential standards. Where ESG factors are considered, an assessment must be made of new or emerging risks, including risks related to climate change, use of resources and the environment, social risks and risks related to the depreciation of assets due to regulatory changes.[140] One estimate finds that 89% of European pension funds take ESG risks into account as of 2019.[141] Further, Japan's Government Pension Investment Fund, which has over $1.5 trillion in assets under management and is the world's largest single pension fund, requires its fund managers to integrate ESG decisions into security selection. Aligning a U.S. approach to European or other approaches would have benefits such as harmonizing taxonomy for asset and investment managers across jurisdictions.

Although this proposed rule clarifies that consideration of the projected return of the portfolio relative to the funding objectives of the plan may require an evaluation of the economic effects of climate change and other ESG factors on the particular investment or investment course of action, this proposed rule does not require ERISA fiduciaries to solicit preferences regarding climate change and other ESG factors. In the ERISA context, the analogy could be that a plan fiduciary (such as the plan sponsor) would solicit participants' preferences regarding ESG, including climate change. Alternatively, the analogy could be that that institutional ERISA fiduciaries, such as ERISA section 3(38) investment managers, would solicit plan sponsors' or plan participants' preferences regarding the same. Although the Department considers any requirement that fiduciaries proactively solicit sustainability preferences in these situations to be beyond the scope of this rulemaking project, the Department, nevertheless, welcomes comments that assess the likely impact, legality and appropriateness under ERISA of requiring that fiduciaries proactively solicit climate change and other ESG preferences as described herein.

1.8. Conclusion

In summary, a significant benefit of this proposal would be to ensure that plans do not overcautiously and improvidently avoid considering material climate change and other ESG factors when selecting investments or exercising shareholder rights, as they might otherwise be inclined to do under the current regulation. Acting on material climate change and other ESG factors in these contexts, and in a manner consistent with the proposal, will redound, in the first instance, to employee benefit plans covered by ERISA and their participants and beneficiaries, and secondarily, to society more broadly but without any detriment to the participants and beneficiaries in ERISA plans. Further, by ensuring that plan fiduciaries would not give-up investment returns or take on additional investment risk to promote unrelated goals, this proposal would lead to increased investment returns over the long run. The proposal would also make certain that proxy voting by plans would be governed by the economic interests of the plan and its participants. This would promote management accountability to shareholders, including the affected shareholder plans. These benefits, while difficult to quantify, are anticipated to outweigh the costs. The total cost of the proposed rule is approximately $85.6 million in the first year and a cost of $2.4 million in subsequent years. All of the burden in the first year is for plans to review their practices and ensure their compliance with the new rules.

2. Paperwork Reduction Act

As part of its continuing effort to reduce paperwork and respondent burden, the Department conducts a preclearance consultation program to allow the general public and federal agencies to comment on proposed and continuing collections of information in

[139] Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: EU Taxonomy, Corporate Sustainability Reporting, Sustainability Preferences and Fiduciary Duties: Directing finance towards the European Green Deal Brussels, 21.4.2021 COM(2021) 188 final.

[140] "It is essential that IORPs improve their risk management while taking into account the aim of having an equitable spread of risks and benefits between generations in occupational retirement provision, so that potential vulnerabilities in relation to the sustainability of pension schemes can be properly understood and discussed with the relevant competent authorities. IORPs should, as part of their risk management system, produce a risk assessment for their activities relating to pensions. That risk assessment should also be made available to the competent authorities and should, where relevant, include, inter alia, risks related to climate change, use of resources, the environment, social risks, and risks related to the depreciation of assets due to regulatory change ('stranded assets'). . . . Environmental, social and governance factors, as referred to in the United Nations-supported Principles for Responsible Investment, are important for the investment policy and risk management systems of IORPs. Member States should require IORPs to explicitly disclose where such factors are considered in investment decisions and how they form part of their risk management system. The relevance and materiality of environmental, social and governance factors to a scheme's investments and how such factors are taken into account should be part of the information provided by an IORP under this Directive."

[141] "ESG Becoming the New Normal for European Pensions," (August 31, 2020) *https://www.ai-cio.com/news/esg-becoming-new-normal-european-pensions/*.

accordance with the Paperwork Reduction Act of 1995 (PRA).[142] This helps to ensure that the public understands the Department's collection instructions, respondents can provide the requested data in the desired format, reporting burden (time and financial resources) is minimized, collection instruments are clearly understood, and the Department can properly assess the impact of collection requirements on respondents.

Currently, the Department is soliciting comments concerning the proposed information collection request (ICR) included in the ''Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights'' ICR. This ICR reflects elements of OMB Control Number 1210–0162 and OMB Control Number 1210–0165. The Department has decided to discontinue OMB Control Number 1210–0165 and revise OMB Control Number 1210–0162 to reflect this ICR. To obtain a copy of the ICR, contact the PRA addressee shown below or go to *www.RegInfo.gov*.

The Department has submitted a copy of the proposed rule to the Office of Management and Budget (OMB) in accordance with 44 U.S.C. 3507(d) for review of its information collections. The Department and OMB are particularly interested in comments that address the following:

• Whether the collection of information is necessary for the proper performance of the functions of the agency, including whether the information will have practical utility;

• The accuracy of the agency's estimate of the burden of the collection of information, including the validity of the methodology and assumptions used;

• The quality, utility, and clarity of the information to be collected; and

• The burden of the collection of information on those who are to respond, including through the use of appropriate automated, electronic, mechanical, or other technological collection techniques or other forms of information technology (*e.g.,* permitting electronic submission of responses).

Comments should be sent by mail to the Office of Information and Regulatory Affairs, Office of Management and Budget, Room 10235, New Executive Office Building, Washington, DC 20503 and marked ''Attention: Desk Officer for the Employee Benefits Security Administration.'' Comments can also be submitted by fax at 202–395–5806 (this is not a toll-free number), or by email at *OIRA_submission@omb.eop.gov*. OMB requests that comments be received within 30 days of publication of the proposed rule to ensure their consideration.

PRA Addresses: Address requests for copies of the ICR to James Butikofer, Office of Regulations and Interpretations, U.S. Department of Labor, Employee Benefits Security Administration, 200 Constitution Avenue NW, Room N–5718, Washington, DC 20210. Email: *ebsa.opr@dol.gov*. ICRs submitted to OMB also are available at *https://www.RegInfo.gov* (*www.reginfo.gov/public/do/PRAMain*).

The Department anticipates that all plans using ESG would be affected in some way by the proposal. With respect to participant-directed individual account plans, a small fraction offer at least one ESG-themed option among their designated investment alternatives. According to the Plan Sponsor Council of America, about three percent of 401(k) and/or profit sharing plans offered at least one ESG-themed investment option in 2019.[143] Vanguard's 2018 administrative data show that approximately nine percent of DC plans offered one or more ''socially responsible'' domestic equity fund options.[144] In a comment letter, Fidelity Investments reported that 14.5 percent of corporate DC plans with fewer than 50 participants offered an ESG option, and that the figure is higher for large plans with at least 1,000 participants. Considering these sources together, the Department estimates that nine percent of participant-directed individual account plans have at least one ESG-themed designated investment alternative. This represents 53,000 participant-directed individual account plans.[145]

According to a 2018 survey by the NEPC, approximately 12 percent of private pension plans have adopted ESG investing.[146] Another survey, conducted by the Callan Institute in 2019, found that about 19 percent of private sector pension plans consider ESG factors in investment decisions.[147] Both of these estimates are calculated from samples that include both defined benefit and defined contribution plans. For purposes of this analysis, the Department assumes that 19 percent of defined benefit plans and nonparticipant-directed defined contribution plans use ESG investing, which represents 25,300 defined benefit and nonparticipant-directed defined contribution plans.[148]

As a result, the Department estimates as a lower bound that approximately 11 percent of retirement plans, or 78,300 plans, would be affected by paragraph (c) of the proposal.[149] This is the weighted average of nine percent for participant-directed defined contribution plans and 19 percent for other plans and is the Department's best approximation of the number of plans that were using ESG under the prior non-regulatory guidance. The estimate is a lower bound because it is likely that more plans will start to use ESG. The proposal and its clarification of how to appropriately employ climate change and other ESG considerations in investing may make some ERISA plan fiduciaries feel more at ease to begin incorporating climate change and other ESG factors. Furthermore, ESG investing is generally increasing in popularity, and that may well carry over to ERISA plans and participants.[150]

2.1. Cost of Disclosure of Collateral Benefits Used in Tie-Breaker

The proposed rule requires that if a fiduciary prudently concludes that competing investments or investment courses of action equally serve the financial interests of the plan over the

[142] 44 U.S.C. 3506(c)(2)(A) (1995).

[143] *63rd Annual Survey of Profit Sharing and 401(k) Plans,* Plan Sponsor Council of America (2020).

[144] *How America Saves 2019,* Vanguard (June 2019), *https://pressroom.vanguard.com/nonindexed/Research-How-America-Saves-2019-Report.pdf*.

[145] DOL calculations are based on statistics from *Private Pension Plan Bulletin: Abstract of 2018 Form 5500 Annual Reports,* Employee Benefits Security Administration (2020), *https://www.dol.gov/sites/dolgov/files/EBSA/researchers/statistics/retirement-bulletins/private-pension-plan-bulletins-abstract-2018.pdf*. This estimate is calculated as 9% × 588,499 401(k) type plans = 52,965 rounded to 53,000.

[146] Brad Smith & Kelly Regan, *NEPC ESG Survey: A Profile of Corporate & Healthcare Plan Decisionmakers' Perspectives,* NEPC (Jul. 11, 2018), *https://cdn2.hubspot.net/hubfs/2529352/files/2018%2007%20NEPC%20ESG%20Survey%20Results%20.pdf?t=1532123276859*.

[147] *2019 ESG Survey,* Callan Institute (2019), *www.callan.com/wp-content/uploads/2019/09/2019-ESG-Survey.pdf*.

[148] DOL calculations are based on statistics from *Private Pension Plan Bulletin: Abstract of 2018 Form 5500 Annual Reports,* Employee Benefits Security Administration (2020), *https://www.dol.gov/sites/dolgov/files/EBSA/researchers/statistics/retirement-bulletins/private-pension-plan-bulletins-abstract-2018.pdf*.

[149] DOL calculations are based on statistics from *Private Pension Plan Bulletin: Abstract of 2018 Form 5500 Annual Reports,* Employee Benefits Security Administration (2020), *https://www.dol.gov/sites/dolgov/files/EBSA/researchers/statistics/retirement-bulletins/private-pension-plan-bulletins-abstract-2018.pdf*. This estimate is calculated as: (52,965 participant-directed individual account plans + 25,342 defined benefit and nonparticipant-directed defined contribution plans) = 78,307 plans rounded to 78,300. (78,307 affected pension plans/721,876 total pension plans) = 10.8% rounded to 11%.

[150] Morningstar, ''Sustainable Funds U.S. Landscape Report: More Funds, More Flows, and Impressive Returns in 2020,'' (February 10, 2021), *https://www.morningstar.com/lp/sustainable-funds-landscape-report*.

appropriate time horizon, the fiduciary is not prohibited from selecting the investment, or investment course of action, based on collateral benefits other than investment returns. Further, in the case of a designated investment alternative for an individual account plan, the plan fiduciary must ensure that the collateral-benefit characteristic of the fund, product, or model portfolio is prominently displayed in disclosure materials provided to participants and beneficiaries. The proposed rule provides flexibility in how plans may fulfill this requirement. One likely way is using the required disclosure under 29 CFR 2550.404a–4, covered under OMB Control Number 1210–0090.[151] The Department estimates that it will take a legal professional twenty minutes on average per year to update existing disclosures to meet this requirement. If each of the approximately 53,000 participated-directed individual account plans estimated to have at least one ESG-themed designated investment alternative used the tie-breaker provision in paragraph (c)(3) of the proposal, the result would be a cost of $2.4 million annually.[152] This estimate likely is overstated because each such plan is unlikely to use the tie-breaker provision and because the ongoing costs of the disclosure requirement in paragraph (c)(3) of the proposal would be approximately zero absent changes to an affected designated investment alternative. At the same time, this estimate likely is understated to the extent that more plans use climate change and other ESG criteria in the future and to the extent such plans have multiple designated investment options subject to paragraph (c)(3) of the proposed rule.

2.2. Summary

In summary, the total annual hour burden associated with this information collection is 17,655 hours with an equivalent cost of $2,443,629.

The paperwork burden estimates are summarized as follows:

Type of Review: Revision of an existing collection.

Agency: Employee Benefits Security Administration, Department of Labor.

Title: Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights.

OMB Control Number: 1210–0162.

Affected Public: Businesses or other for-profits.

Estimated Number of Respondents: 52,965.

Estimated Number of Annual Responses: 52,965.

Frequency of Response: Occasionally.

Estimated Total Annual Burden Hours: 17,655.

Estimated Total Annual Burden Cost: $0.

3. Regulatory Flexibility Act

The Regulatory Flexibility Act (RFA)[153] imposes certain requirements with respect to Federal rules that are subject to the notice and comment requirements of section 553(b) of the Administrative Procedure Act[154] and that are likely to have a significant economic impact on a substantial number of small entities. Unless the head of an agency determines that a proposed rule is not likely to have a significant economic impact on a substantial number of small entities, section 603 of the RFA requires the agency to present an initial regulatory flexibility analysis of the proposed rule.

For purposes of analysis under the RFA, the Employee Benefits Security Administration (EBSA) continues to consider a small entity to be an employee benefit plan with fewer than 100 participants.[155] The basis of this definition is found in section 104(a)(2) of ERISA, which permits the Secretary of Labor to prescribe simplified annual reports for pension plans that cover fewer than 100 participants. Under section 104(a)(3), the Secretary may also provide for exemptions or simplified annual reporting and disclosure for welfare benefit plans. Pursuant to the authority of section 104(a)(3), the Department has previously issued—at 29 CFR 2520.104–20, 2520.104–21, 2520.104–41, 2520.104–46, and 2520.104b–10—certain simplified reporting provisions and limited exemptions from reporting and disclosure requirements for small plans. Such plans include unfunded or insured welfare plans covering fewer than 100 participants and satisfying certain other requirements. Further, while some large employers may have small plans, in general small employers maintain small plans. Thus, EBSA believes that assessing the impact of these proposed amendments on small plans is an appropriate substitute for evaluating the effect on small entities. The definition of small entity considered appropriate for this purpose differs, however, from a definition of small business that is based on size standards promulgated by the Small Business Administration (SBA)[156] pursuant to the Small Business Act.[157] The Department requests comments on the appropriateness of the alternative size standard used in evaluating the impact of the proposed rule on small entities.

The Department has determined that this proposal could have a significant impact on a substantial number of small entities. Therefore, the Department has prepared an Initial Regulatory Flexibility Analysis that is presented below.

3.1. Need for and Objectives of the Rule

In late 2020, the Department published two final rules including obligations for the selection of plan investments and the exercise of shareholder rights to address concerns that some investment products may be marketed to ERISA fiduciaries on the basis of purported benefits and goals unrelated to financial performance. Responses to the 2020 rules, however, suggest that the final rules created further uncertainty and may have the undesirable effect of discouraging fiduciaries' consideration of financially material climate change and other ESG factors in investment decisions. Therefore, as stakeholders noted, the final rules may lead plans to act contrary to the interest of participants and beneficiaries.

The Department is concerned that uncertainty may deter 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. In some cases, this may hamper fiduciaries as they attempt to discharge their responsibilities prudently and solely in

[151] 29 CFR 2550.404a–5 *Fiduciary Requirements for Disclosure in Participant-directed Individual Account Plans* (When the documents and instruments governing an individual account plan provide for the allocation of investment responsibilities to participants or beneficiaries, the plan administrator, as defined in section 3(16) of ERISA, must take steps to ensure, consistent with section 404(a)(1)(A) and (B) of ERISA, that such participants and beneficiaries, on a regular and periodic basis, are made aware of their rights and responsibilities with respect to the investment of assets held in, or contributed to, their accounts and are provided sufficient information regarding the plan, including fees and expenses, and regarding designated investment alternatives, including fees and expenses attendant thereto, to make informed decisions with regard to the management of their individual accounts.).

[152] The burden is estimated as follows: 52,965 individual account plans * 20 minutes = 17,655 hours. A labor rate of $138.41 is used for a legal professional: (17,655 hours * $138.41 = $2,443,629).

[153] 5 U.S.C. 601 *et seq.* (1980).

[154] 5 U.S.C. 551 *et seq.* (1946).

[155] The Department consulted with the Small Business Administration's Office of Advocacy before making this determination, as required by 5 U.S.C. 603(c) and 13 CFR 121.903(c). Memorandum received from the U.S. Small Business Administration, Office of Advocacy on July 10, 2020.

[156] 13 CFR 121.201.

[157] 15 U.S.C. 631 *et seq.*

the interests of plan participants and beneficiaries. The Department is particularly concerned that the regulations issued in 2020 created a perception that fiduciaries are at risk if they include any climate change or other ESG factors in the financial evaluation of plan investments, and that they may need to have special justifications for even ordinary exercises of shareholder rights.

The amendments proposed in this document are intended to address uncertainties regarding certain aspects of the 2020 regulations and related preamble discussions regarding the consideration of climate change and other ESG issues by fiduciaries in making investment and proxy voting decisions, and to increase fiduciaries' clarity about their obligations, which will safeguard the interests of participants and beneficiaries in plan benefits. The Department believes that the changes being proposed will improve the current regulations and further promote retirement income security and retirement savings.

3.2. Affected Small Entities

The clarifications in the proposed amendment would affect two subsets of small ERISA-covered plans and their participants and beneficiaries. Due to the nature of the proposed amendments, these subsets likely overlap. Some plans would be in both subsets, some in only one subset, and some in neither. However, the Department does not have the information or data necessary to estimate the extent of the overlap. The two subsets are described below.

(a) Small Plans Affected by Proposed Modifications of Paragraph (c) of § 2550.404a–1

The subset of plans affected by the proposed modifications of paragraph (c) of § 2550.404a–1 would include those ERISA-covered plans whose fiduciaries consider or will begin considering climate change or other ESG factors when selecting investments and the participants in those plans.

As discussed in the affected entities section in the regulatory impact analysis above, the Department estimates that 25,342 defined benefit plans and nonparticipant-directed defined contribution plans and 52,965 individual account plans would be affected by the proposed amendments in this manner. As discussed in the regulatory impact analysis, these estimates are based on surveys of ESG investment practices. To estimate the number of small affected entities, the Department assumes that the proportions of plans participating in ESG investment practices applies uniformly across plan size. Applying these proportions uniformly to plans with fewer than 100 participants, the Department estimates that 21,311 small defined benefit plans and nonparticipant-directed defined contribution plans and 46,551 small individual account plans will be affected by the rule. This results in an estimate of 67,862 total small plans affected by the proposed amendments regarding investment practices.

The Department believes this is likely an overestimate. For instance, less than 0.1 percent of total DC plan assets are invested in ESG funds.[158] In addition, one survey found that among 401(k) plans with fewer than 50 participants, approximately 4.4 percent offered an ESG investment option.[159] Accordingly, the Department offers this estimate as an upper bound.

(b) Subset of Plans Affected by Proposed Modifications of Paragraph (e) of § 2550.404a–1

Paragraph (d) of the proposal would affect small ERISA-covered pension, health, and other welfare plans that hold shares of corporate stock, directly or through ERISA-covered intermediaries, such as common trusts, master trusts, pooled separate accounts, and 103–12 investment entities.

In 2018, there were 629,397 small pension plans.[160] There is minimal data available about small plans' stock holdings. The primary source of information on assets held by pension plans is the Form 5500. Using the various asset schedules filed, only 3,862 small plans can be identified as holding stock, of which 3,431 report holding only employer securities and the other 431 plans report holding common stock.[161] While the majority of participants and assets are in large plans, most plans are small plans. The Department lacks sufficient data to estimate the number of small plans that hold common stock, but it assumes that small plans are significantly less likely to hold common stock than larger plans. Many small plans may hold stock only through mutual funds, and consequently would not be significantly affected by the proposed amendments in paragraph (d).

For purposes of illustrating the number of small plans that could be affected, the Department assumes that five percent of small plans, or 31,470 small pension plans hold stock. The Department requests comment on this assumption.

While paragraph (d) of this proposal rule would directly affect ERISA-covered plans that possess the relevant shareholder rights, the activities covered under paragraph (d) would be carried out by responsible fiduciaries on plans' behalf. Many plans hire asset managers to carry out fiduciary asset management functions, including proxy voting. The Department recognizes that service providers, including small service providers who act as asset managers, could also be impacted indirectly by this rule. However, service providers likely would pass any compliance costs incurred onto plans.

3.3. Impact of the Rule

Paragraphs (a)–(c) of the proposed rule would provide guidance on the investment duties of a plan fiduciary when selecting an investment or investment course of action. It is the Department's belief that many plan fiduciaries for small plans already conduct themselves in a manner that would comport, in whole or in part, with the requirements in these provisions. The Department, therefore, estimates that the incremental costs of the proposal would be minimal on a per-plan basis.

(a) Cost of Reviewing NPRM and Reviewing Plan Practices

Plans, plan fiduciaries, and their service providers would incur costs associated with the time needed to read the proposal and to evaluate how it would impact current documents and practices. With respect to the investment duties of a plan fiduciary when selecting an investment or investment course of action, as set forth in paragraphs (a)–(c) of the proposal, the Department estimates that 67,862 plans have exposure to investments selected using ESG factors.

Fiduciaries of each of these types of plans would need to spend time reviewing the proposal, evaluating how it might affect their investment practices, and what would be needed to implement any necessary changes. The Department estimates that this review process would require a lawyer to spend approximately four hours to complete,

[158] *63rd Annual Survey of Profit Sharing and 401(k) Plans,* Plan Sponsor Council of America (2020).

[159] *Id.*

[160] DOL calculations of plans with fewer than 100 participants based on statistics from U.S. Department of Labor, Employee Benefits Security Administration: *Private Pension Plan Bulletin: Abstract of 2018 Form 5500 Annual Reports* (2020).

[161] 2018 Form 5500. All plans that hold employer stock are identified. Only the 3,832 small plans that filed schedule H would report a separate line item for stock holdings. The small plans filing the Form 5500–SF (566,718) or file schedule I (58,401) do not report stock as a separate line item, therefore these plans cannot be identified as to whether they hold common stock.

resulting in a cost burden per plan of approximately $553.64.[162]

Similarly, plans would need to spend time reviewing paragraph (d) of the proposal, evaluating how it affects their proxy voting practices, and implementing any necessary changes. The Department estimates that this review process would require a lawyer to spend approximately four hours to complete, resulting in a cost burden per plan of approximately $553.64.[163] The Department believes that these processes would likely be performed for most plans by a service provider that likely oversees multiple plans.

The Department believes that these costs likely reflect an overestimate of the costs faced by small plans, as small plans are likely to rely on service providers. The Department believes these service providers offer economies of scale in meeting the requirements of the proposed amendments; however, the Department does not have data that would allow it to estimate the number of service providers acting in such a capacity for these plans.

(b) Cost To Update Written Proxy Voting Policies

Paragraph (d)(3)(i) of the proposal provides that, for purposes of deciding whether to vote a proxy, plan fiduciaries may adopt proxy voting policies providing that the authority to vote a proxy shall be exercised pursuant to specific parameters prudently designed to serve the plan's interests in providing benefits to participants and their beneficiaries and defraying reasonable expenses of administering the plan. Paragraph (d)(3)(ii), in turn provides that plan fiduciaries shall periodically review these proxy voting policies.

The Department estimates that these provisions of the proposal would impose additional costs because such policies will need to be reviewed initially. The Department believes that the proposal largely comports with industry practice for ERISA fiduciaries; therefore, the Department estimates that on average, it will take a legal professional 30 minutes to update policies and procedures for each of the estimated 31,470 plans affected by the rule. This results in a cost per plan of $69.21 in the first year.[164] The requirement in paragraph (d)(3)(ii) to periodically review proxy voting policies already is required for fiduciaries to meet their obligations under ERISA; therefore, the Department does not expect that plans will incur additional cost associated with the periodic review.

(c) Cost of Disclosure of Collateral Benefits Used in Tie-Breaker

The proposal, at paragraph (c)(3), carries forward a more flexible version of the tie-breaker concept than is in the current regulation; the carried-forward version is comparable to and commensurate with the formulation previously expressed in Interpretive Bulletin 2015–1 (and first explained in Interpretive Bulletin 94–1). The proposal's tie-breaker provision is relevant and operable only once a prudent fiduciary determines that competing alternative investments equally serve the financial interests of the plan. In these circumstances, the plan fiduciary may focus on the collateral benefits of an investment or investment course of action to decide the outcome.

Some individual account plans may incur costs with respect to the requirement in paragraph (c)(3) to inform plan participants of the collateral benefit characteristics of the investment or investment course of action, when such investment or investment course of action constitutes a designated investment alternative under a participant-directed individual account plan. These costs are expected to be minimal because disclosure regulations adopted in 2012 already entitle participants in participant-directed individual account plans to receive sufficient information regarding designated investment alternatives to make informed decisions with regard to the management of their individual accounts. The information required by the 2012 rule includes information regarding the alternative's objectives or goals and the alternative's principal strategies (including a general description of the types of assets held by the investment) and principal risks. *See* 29 CFR 2550.404a–5.

This proposal, therefore, assumes these existing disclosures are, or with minor modifications or clarifications could be, sufficient to satisfy the disclosure element of the tie-breaker provision in paragraph (c)(3) of the proposal. The Department estimates that it will take a legal professional twenty minutes on average per year to update existing disclosures for each of the 46,551 small individual account plans with participant direction that are anticipated to utilize this provision. This results in a per-plan cost of $46.14 annually relative to the pre-2020 final rule baseline.[165]

(d) Summary of Costs

As illustrated in Table 2 below, the Department estimates a cost of $1,222.62 per affected plan in year 1 and $46.14 per affected plan in the following years if a plan both holds stock and invests in ESG investments and utilizes the tie breaker.

TABLE 2—COSTS FOR PLANS TO COMPLY WITH THE REQUIREMENTS

Requirement	Labor rate	Hours	Year 1 cost	Year 2 cost
Plans considering ESG factors when selecting investments:				
Review of Plan Investment Practices: *Lawyer*	$138.41	4	$553.64	$0.00
Update Disclosures to Include Character of Collateral Benefits Used in Tie-Breaker: *Lawyer*	138.41	0.333	46.14	46.14
Total	....	....	599.78	46.14
Plans holding corporate stock, directly or through ERISA-covered intermediaries:				
Review of Proxy Voting Practices: *Lawyer*	138.41	4	553.64	0.00

[162] The Department estimated that there are 67,862 plans that will need to ensure compliance with the proposal. A labor rate of $138.41 is used for a lawyer. The cost burden is estimated as follows: 4 hours * $138.41 = $553.64. Labor rates are based on DOL estimates from *Labor Cost Inputs Used in the Employee Benefits Security Administration, Office of Policy and Research's Regulatory Impact Analyses and Paperwork Reduction Act Burden Calculation,* Employee Benefits Security Administration (June 2019), *www.dol.gov/sites/dolgov/files/EBSA/laws-and-regulations/rules-and-regulations/technical-appendices/labor-cost-inputs-used-in-ebsa-opr-ria-and-pra-burden-calculations-june-2019.pdf.*

[163] A labor rate of $138.41 is used for a lawyer. The cost burden is estimated as follows: 4 hours * $138.41 = $553.64.

[164] A labor rate of $138.41 is used for a plan fiduciary: (0.5 hours * $138.41 = $69.21).

[165] The burden is estimated as follows: 20 minutes per year * $138.41 per hour = $46.14. A labor rate of $138.41 is used for a legal professional.

TABLE 2—COSTS FOR PLANS TO COMPLY WITH THE REQUIREMENTS—Continued

Requirement	Labor rate	Hours	Year 1 cost	Year 2 cost
Update Proxy Voting Policies: *Lawyer*	138.41	0.5	69.21	0.00
Total			662.85	0.00
Plans that both consider ESG factors when selecting investments and hold corporate stock, directly or through ERISA-covered intermediaries:				
Total		8.833	1,222.62	46.14

Source: DOL calculations based on statistics from *Labor Cost Inputs Used in the Employee Benefits Security Administration, Office of Policy and Research's Regulatory Impact Analyses and Paperwork Reduction Act Burden Calculation,* Employee Benefits Security Administration (June 2019), *www.dol.gov/sites/dolgov/files/EBSA/laws-and-regulations/rules-and-regulations/technical-appendices/labor-cost-inputs-used-in-ebsa-opr-ria-and-pra-burden-calculations-june-2019.pdf.*

The Department believes that this is likely an overestimate of the costs faced by small plans, as small plans are likely to rely on service providers. The Department believes these service providers offer economies of scale in meeting the requirements of paragraph (d) of the proposal; however, the Department does not have data that would allow it to estimate the number of service providers acting in such a capacity for these plans. The Department believes the requirements in this proposal closely resemble existing prior guidance and industry best practices. Accordingly, the Department believes that, on average, the marginal cost to meet the additional requirements, would be small.

3.4. Regulatory Alternatives

The proposed rule seeks to provide clarity and certainty regarding the scope of fiduciary duties surrounding in investment and proxy voting policies. These standards apply to all affected entities, both large and small; therefore, the Department's ability to craft specific alternatives for small plans is limited.

In order to ensure a comprehensive review, the Department examined as an alternative leaving the current regulation in place without change, and rescind its non-enforcement statement issued on March 3, 2021. However, as explained in more detail earlier in this notice, following informal outreach activities with a wide variety of stakeholders, including asset managers, labor organizations and other plan sponsors, consumer groups, service providers and investment advisers, the Department believes that uncertainty with respect to the current regulation may deter fiduciaries of small and large plans alike from taking steps that other marketplace investors might take in enhancing investment value and performance, or improving investment portfolio resilience against the potential financial risks and impacts associated with climate change. This could hamper fiduciaries as they attempt to discharge their responsibilities prudently and solely in the interests of plan participants and beneficiaries. The Department therefore chose not to take this alternative.

The Department also considered rescinding the *Financial Factors in Selecting Plan Investments* and *Fiduciary Duties Regarding Proxy Voting and Shareholder Rights* final rules. This alternative would remove the entire current regulation from the Code of Federal Regulations, including provisions that reflect the original 1979 Investment Duties regulation. The original Investment Duties regulation has been relied on by fiduciaries for many years in making decisions about plan investments and investment courses of actions, and complete removal of the provisions could lead to potential disruptions in plan investment activity. The Department rejected this alternative.

Another alternative considered was revising the current regulation by, in effect, reverting it to the original 1979 Investment Duties regulation. As explained in more detail earlier in this notice, this alternative would reduce the potential of disrupting plan investment activity that would be caused by complete rescission, but would leave plan fiduciaries without any guidance published in the Code of Federal Regulations on the consideration of ESG issues when material to plan financial interests. Similar to the first alternative described above, this could inhibit fiduciaries from taking steps that other marketplace investors might take in enhancing investment value and performance, or from improving investment portfolio resilience against the potential financial risks and impacts associated with climate change. The Department therefore rejected this alternative.

3.5. Duplicate, Overlapping, or Relevant Federal Rules

For the requirements relating to investment practices, the Department is issuing this proposal under sections 404(a)(1)(A) and 404(a)(1)(B) of Title I under ERISA. The Department has sole jurisdiction to interpret these provisions as they apply to plan fiduciaries' consideration in selecting plan investment funds. Therefore, there are no duplicate, overlapping, or relevant Federal rules.

For the requirements relating to proxy voting policies, the Department is monitoring other federal agencies whose statutory and regulatory requirements overlap with ERISA. In particular, the Department is monitoring SEC rules and guidance to avoid creating duplicate or overlapping requirements with respect to proxy voting.

4. Unfunded Mandates Reform Act

Title II of the Unfunded Mandates Reform Act of 1995 [166] requires each federal agency to prepare a written statement assessing the effects of any federal mandate in a proposed or final agency rule that may result in an expenditure of $100 million or more (adjusted annually for inflation with the base year 1995) in any one year by state, local, and tribal governments, in the aggregate, or by the private sector. For purposes of the Unfunded Mandates Reform Act, as well as Executive Order 12875, this proposal does not include any federal mandate that the Department expects would result in such expenditures by state, local, or tribal governments, or the private sector.

5. Federalism Statement

Executive Order 13132 outlines fundamental principles of federalism and requires the adherence to specific criteria by Federal agencies in the process of their formulation and implementation of policies that have ''substantial direct effects'' on the states, the relationship between the National Government and the states, or on the distribution of power and responsibilities among the various

[166] 2 U.S.C. 1501 *et seq.* (1995).

levels of government.[167] Federal agencies promulgating regulations that have federalism implications must consult with state and local officials, and describe the extent of their consultation and the nature of the concerns of state and local officials in the preamble to the proposed amendment.

In the Department's view, these proposed amendments would not have federalism implications because they would not have direct effects on the states, the relationship between the National Government and the states, or on the distribution of power and responsibilities among various levels of government. Section 514 of ERISA provides, with certain exceptions specifically enumerated, that the provisions of Titles I and IV of ERISA supersede any and all laws of the states as they relate to any employee benefit plan covered under ERISA. The requirements implemented in the proposed amendments do not alter the fundamental reporting and disclosure requirements of the statute with respect to employee benefit plans, and as such have no implications for the states or the relationship or distribution of power between the national government and the states.

The Department welcomes input from states regarding this assessment.

Statutory Authority

This regulation is proposed pursuant to the authority in section 505 of ERISA (Pub. L. 93–406, 88 Stat. 894; 29 U.S.C. 1135) and section 102 of Reorganization Plan No. 4 of 1978 (43 FR 47713, October 17, 1978), effective December 31, 1978 (44 FR 1065, January 3, 1979), 3 CFR, 1978 Comp., p 332, and under Secretary of Labor's Order No. 1–2011, 77 FR 1088 (Jan. 9, 2012).

List of Subjects in 29 CFR Part 2550

Employee benefit plans, Employee Retirement Income Security Act, Exemptions, Fiduciaries, Investments, Pensions, Prohibited transactions, Reporting and recordkeeping requirements, Securities.

For the reasons set forth in the preamble, the Department is proposing to amend part 2550 of subchapter F of chapter XXV of title 29 of the Code of Federal Regulations as follows:

PART 2550—RULES AND REGULATIONS FOR FIDUCIARY RESPONSIBILITY

■ 1. The authority citation for part 2550 continues to read as follows:

[167] Federalism, 64 FR 43255 (Aug. 10, 1999).

Authority: 29 U.S.C. 1135 and Secretary of Labor's Order No. 1–2011, 77 FR 1088 (January 9, 2012). Sec. 102, Reorganization Plan No. 4 of 1978, 5 U.S.C. App. at 727 (2012). Sec. 2550.401c–1 also issued under 29 U.S.C. 1101. Sec. 2550.404a–1 also issued under sec. 657, Pub. L. 107–16, 115 Stat 38. Sec. 2550.404a–2 also issued under sec. 657 of Pub. L. 107–16, 115 Stat. 38. Sections 2550.404c–1 and 2550.404c–5 also issued under 29 U.S.C. 1104. Sec. 2550.408b–1 also issued under 29 U.S.C. 1108(b)(1). Sec. 2550.408b–19 also issued under sec. 611, Pub. L. 109–280, 120 Stat. 780, 972. Sec. 2550.412–1 also issued under 29 U.S.C. 1112.

■ 2. Revise § 2550.404a–1 to read as follows:

§ 2550.404a–1 Investment duties.

(a) *In general.* Sections 404(a)(1)(A) and 404(a)(1)(B) of the Employee Retirement Income Security Act of 1974, as amended (ERISA or the Act) provide, in part, that a fiduciary shall discharge that person's duties with respect to the plan solely in the interests of the participants and beneficiaries; for the exclusive purpose of providing benefits to participants and their beneficiaries and defraying reasonable expenses of administering the plan; and with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person 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.

(b) *Investment prudence duties.* (1) With regard to the consideration of an investment or investment course of action taken by a fiduciary of an employee benefit plan pursuant to the fiduciary's investment duties, the requirements of section 404(a)(1)(B) of the Act set forth in paragraph (a) of this section are satisfied if the fiduciary:

(i) Has given appropriate consideration to those facts and circumstances that, given the scope of such fiduciary's investment duties, the fiduciary knows or should know are relevant to the particular investment or investment course of action involved, including the role the investment or investment course of action plays in that portion of the plan's investment portfolio with respect to which the fiduciary has investment duties; and

(ii) Has acted accordingly.

(2) For purposes of paragraph (b)(1) of this section, "appropriate consideration" shall include, but is not necessarily limited to:

(i) A determination by the fiduciary that the particular investment or investment course of action is reasonably designed, as part of the portfolio (or, where applicable, that portion of the plan portfolio with respect to which the fiduciary has investment duties), 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 compared to the opportunity for gain (or other return) associated with reasonably available alternatives with similar risks; 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, which may often require an evaluation of the economic effects of climate change and other environmental, social, or governance factors on the particular investment or investment course of action.

(3) An investment manager appointed, pursuant to the provisions of section 402(c)(3) of the Act, to manage all or part of the assets of a plan, may, for purposes of compliance with the provisions of paragraphs (b)(1) and (2) of this section, rely on, and act upon the basis of, information pertaining to the plan provided by or at the direction of the appointing fiduciary, if:

(i) Such information is provided for the stated purpose of assisting the manager in the performance of the manager's investment duties; and

(ii) The manager does not know and has no reason to know that the information is incorrect.

(4) A prudent fiduciary may consider any factor in the evaluation of an investment or investment course of action that, depending on the facts and circumstances, is material to the risk-return analysis, which might include, for example:

(i) Climate change-related factors, such as a corporation's exposure to the real and potential economic effects of climate change including exposure to the physical and transitional risks of climate change and the positive or negative effect of Government regulations and policies to mitigate climate change;

(ii) Governance factors, such as those involving board composition, executive compensation, and transparency and accountability in corporate decision-making, as well as a corporation's avoidance of criminal liability and compliance with labor, employment, environmental, tax, and other applicable laws and regulations; and

(iii) Workforce practices, including the corporation's progress on workforce diversity, inclusion, and other drivers of employee hiring, promotion, and retention; its investment in training to develop its workforce's skill; equal employment opportunity; and labor relations.

(c) *Investment loyalty duties.* (1) 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.

(2) A fiduciary's evaluation of an investment or investment course of action must be based on risk and return factors that the fiduciary prudently determines are material to investment value, using appropriate investment horizons consistent with the plan's investment objectives and taking into account the funding policy of the plan established pursuant to section 402(b)(1) of ERISA. Whether any particular consideration is such a factor depends on the individual facts and circumstances and may include the factors in paragraph (b)(4) of this section. The weight given to any factor by a fiduciary should appropriately reflect a prudent assessment of its impact on risk-return.

(3) If, after the analysis in paragraph (c)(2) of this section, a fiduciary prudently concludes that competing investments, or competing investment courses of action, equally serve the financial interests of the plan over the appropriate time horizon, the fiduciary is not prohibited from selecting the investment, or investment course of action, based on collateral benefits other than investment returns. However, if the plan fiduciary makes such a selection in the case of a designated investment alternative for an individual account plan, the plan fiduciary must ensure that the collateral-benefit characteristic of the fund, product, or model portfolio is prominently displayed in disclosure materials provided to participants and beneficiaries. A fiduciary may not, however, accept expected reduced returns or greater risks to secure such additional benefits.

(d) *Proxy voting and exercise of shareholder rights.* (1) The fiduciary duty to manage plan assets that are shares of stock includes the management of shareholder rights appurtenant to those shares, such as the right to vote proxies.

(2)(i) When deciding whether to exercise shareholder rights and when exercising such rights, including the voting of proxies, fiduciaries must carry out their duties prudently and solely in the interests of the participants and beneficiaries and for the exclusive purpose of providing benefits to participants and beneficiaries and defraying the reasonable expenses of administering the plan.

(ii) When deciding whether to exercise shareholder rights and when exercising shareholder rights, plan fiduciaries must:

(A) Act solely in accordance with the economic interest of the plan and its participants and beneficiaries, in a manner consistent with paragraph (c)(2) of this section;

(B) Consider any costs involved;

(C) Not subordinate the interests of the participants and beneficiaries in their retirement income or financial benefits under the plan to any other objective, or promote benefits or goals unrelated to those financial interests of the plan's participants and beneficiaries;

(D) Evaluate material facts that form the basis for any particular proxy vote or other exercise of shareholder rights; and

(E) Exercise prudence and diligence in the selection and monitoring of persons, if any, selected to exercise shareholder rights or otherwise advise on or assist with exercises of shareholder rights, such as providing research and analysis, recommendations regarding proxy votes, administrative services with voting proxies, and recordkeeping and reporting services.

(iii) A fiduciary may not adopt a practice of following the recommendations of a proxy advisory firm or other service provider without a determination that such firm or service provider's proxy voting guidelines are consistent with the fiduciary's obligations described in paragraphs (d)(2)(ii)(A) through (E) of this section.

(3)(i) In deciding whether to vote a proxy pursuant to paragraphs (d)(2)(i) and (ii) of this section, fiduciaries may adopt proxy voting policies providing that the authority to vote a proxy shall be exercised pursuant to specific parameters prudently designed to serve the plan's interest in providing benefits to participants and their beneficiaries and defraying reasonable expenses of administering the plan.

(ii) Plan fiduciaries shall periodically review proxy voting policies adopted pursuant to paragraph (d)(3)(i) of this section.

(iii) No proxy voting policies adopted pursuant to paragraph (d)(3)(i) of this section shall preclude submitting a proxy vote when the fiduciary prudently determines that the matter being voted upon is expected to have a material effect on the value of the investment or the investment performance of the plan's portfolio (or investment performance of assets under management in the case of an investment manager) after taking into account the costs involved, or refraining from voting when the fiduciary prudently determines that the matter being voted upon is not expected to have such a material effect after taking into account the costs involved.

(4)(i)(A) The responsibility for exercising shareholder rights lies exclusively with the plan trustee except to the extent that either:

(*1*) The trustee is subject to the directions of a named fiduciary pursuant to ERISA section 403(a)(1); or

(*2*) The power to manage, acquire, or dispose of the relevant assets has been delegated by a named fiduciary to one or more investment managers pursuant to ERISA section 403(a)(2).

(B) Where the authority to manage plan assets has been delegated to an investment manager pursuant to ERISA section 403(a)(2), the investment manager has exclusive authority to vote proxies or exercise other shareholder rights appurtenant to such plan assets in accordance with this section, except to the extent the plan, trust document, or investment management agreement expressly provides that the responsible named fiduciary has reserved to itself (or to another named fiduciary so authorized by the plan document) the right to direct a plan trustee regarding the exercise or management of some or all of such shareholder rights.

(ii) An investment manager of a pooled investment vehicle that holds assets of more than one employee benefit plan may be subject to an investment policy statement that conflicts with the policy of another plan. Compliance with ERISA section 404(a)(1)(D) requires the investment manager to reconcile, insofar as possible, the conflicting policies (assuming compliance with each policy would be consistent with ERISA section 404(a)(1)(D)). In the case of proxy voting, to the extent permitted by applicable law, the investment manager must vote (or abstain from voting) the relevant proxies to reflect such policies in proportion to each plan's economic interest in the pooled investment vehicle. Such an investment manager may, however, develop an investment policy statement consistent with Title I of ERISA and this section, and require participating plans to accept the investment manager's investment policy statement, including any proxy voting policy, before they are allowed to invest. In such cases, a fiduciary must assess whether the investment manager's investment policy statement and proxy voting policy are consistent with Title I of ERISA and this section before deciding to retain the investment manager.

(5) This section does not apply to voting, tender, and similar rights with respect to shares of stock that are passed through pursuant to the terms of an individual account plan to participants and beneficiaries with accounts holding such shares.

(e) *Definitions.* For purposes of this section:

(1) The term *investment duties* means any duties imposed upon, or assumed or undertaken by, a person in connection with the investment of plan assets which make or will make such person a fiduciary of an employee benefit plan or which are performed by such person as a fiduciary of an employee benefit plan as defined in section 3(21)(A)(i) or (ii) of the Act.

(2) 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.

(3) The term *plan* means an employee benefit plan to which Title I of the Act applies.

(4) The term *designated investment alternative* means any investment alternative designated by the plan into which participants and beneficiaries may direct the investment of assets held in, or contributed to, their individual accounts. The term ''designated investment alternative'' shall not include ''brokerage windows,'' ''self-directed brokerage accounts,'' or similar plan arrangements that enable participants and beneficiaries to select investments beyond those designated by the plan.

(f) *Severability.* If any provision of this section is held to be invalid or unenforceable by its terms, or as applied to any person or circumstance, or stayed pending further agency action, the provision shall be construed so as to continue to give the maximum effect to the provision permitted by law, unless such holding shall be one of invalidity or unenforceability, in which event the provision shall be severable from this section and shall not affect the remainder thereof.

Signed at Washington, DC, this 7th day of October, 2021.

Ali Khawar,

Acting Assistant Secretary, Employee Benefits Security Administration, U.S. Department of Labor.

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