Expect Focus Life, Annuity, and Retirement Solutions, December2020

DOL to Plan Sponsors: "It's All About the Benjamins!"

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Dear Department of Labor: The fiduciary role of selecting 401(k) and 403(b) plan investment options based on diversification and projected risk and return is too easy. Can we sacrifice some returns in order to promote social responsibility?

After answering this question consistently in several prior bulletins, the DOL updated Regulation § 2550.404a-1 on October 30, 2020, to restate and reinforce its position, which remains, in essence:

Dear Plan Fiduciary: You can be socially conscientious with your own money, but base the selection of your plan's designated investment alternatives on economic grounds.

While that paraphrase is more economical than the DOL's approximately 140-page explanation, it does not fully convey the DOL's thinking. The DOL expressed concern with investments promoting themselves on non-economic grounds through terminology that is not clearly defined, monitored, or fact-checked. These terms include "socially responsible," "socially conscientious," and "environmental, social, and (corporate) governance" (ESG). The agency sidestepped the struggle to define these terms by updating the regulation to classify all investment considerations as "pecuniary" or "non-pecuniary," and making it clear that pecuniary issues are primary. This may relieve fiduciaries from pressure to balance economic performance with ESG factors. Furthermore, this classification system implies that ESG factors do not deserve greater consideration than other nonpecuniary considerations that arise. In acknowledging occasions when the social conscience of a fund is expected to positively affect returns, the DOL noted that this would make that factor a "pecuniary" consideration that should not involve any sacrifice through lower returns or higher fees.

The regulation is stricter with investments used for participants who fail to make investment elections (i.e., QDIAs). Not only is reliance on non-pecuniary factors prohibited; but, moreover, fiduciaries are expected to confirm that the underlying fund managers are pursuing pecuniary (and not non-pecuniary) goals.

Without completely abandoning its prior position that ESG characteristics can be "tiebreakers" between otherwise equal funds, the DOL warned that tiebreakers would be subject to scrutiny. Ties decided by non-pecuniary considerations must be documented with findings that (i) investments are indistinguishable on a pecuniary basis and (ii) the "non-pecuniary factor or factors are consistent with the interests of participants and beneficiaries in their retirement income or financial benefits under the plan." Skepticism of tiebreakers is further implied by the regulation's prohibition on non-pecuniary factors — even as a tiebreaker — to select QDIAs.

Although this documentation requirement focuses on the selection of designated investment alternatives, documenting other, non-investmentrelated decisions made on a nonpecuniary basis is a logical practice to consider. For example, the fiduciary practice of selecting investment advisers and other plan service providers does not demand the selection of the lowest-cost provider, even though the failure to select the lowest-cost provider could negatively affect retirement account balances. The updated regulation does not change this understanding, but since pecuniary considerations are often easier to understand, it may be wise for fiduciaries to document decisions based on non-pecuniary factors that could affect account balances.

In other words, when selecting investment providers, it is not always "all about the Benjamins," but fiduciaries basing decisions on non-pecuniary considerations should be prepared to defend those decisions.