

# **DOL Proposes Restrictions on ESG Investing and Issues New Fiduciary “Investment Advice” Guidance**

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## **Proposed ERISA Restrictions on ESG Investing**

On June 23, 2020, the U.S. Department of Labor (the “DOL”) issued a [proposed rule](#) that would limit when and how fiduciaries of plans subject to the U.S. Employee Retirement Income Security Act of 1974, as amended (“ERISA”), may (i) consider non-pecuniary “environmental, social and corporate governance” (“ESG”)-type factors when making plan investment decisions, or (ii) offer an ESG-themed investment option under a 401(k)-type plan. This proposal generally only applies to fiduciaries and managers of ERISA-covered plans, entities or accounts, and does not apply to managers of, or advisers to, plans, vehicles and accounts that are not subject to ERISA.

In its commentary, the DOL noted that confusion persists for ERISA plan fiduciaries in regards to its ESG-investing rules, which the DOL acknowledged may be a result of varied statements it has made over the years in past guidance. In short, the proposed rule would codify the DOL’s view that the sole focus of ERISA plan fiduciaries must be the financial returns and risk to participants and beneficiaries, and that ERISA plan fiduciaries must not sacrifice investment returns, take on additional investment risk, or pay higher fees to promote non-pecuniary benefits or goals.

**Key Takeaway.** If finalized, the proposed rule would apply only to the investment of “plan assets” covered by ERISA. In light of the fact that the proposed rule generally would impose additional requirements to demonstrate the prudence of an investment that is an ESG-themed investment or an investment that references ESG factors, the proposed rule could have a chilling effect on the investment of ERISA “plan assets” in any type of investment fund or product that even mentions ESG considerations as part as its investment strategy or process.

For more information on this proposal, please see [here](#).

## **Fiduciary Rule “Investment Advice” Guidance**

On June 29, 2020, the DOL issued new guidance applicable to “investment advice” fiduciaries under

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ERISA and Section 4975 of the U.S. Internal Revenue Code of 1986, as amended (the “Code”). Importantly, this guidance generally only impacts advisers that provide investment guidance directly to ERISA-covered plans, individual retirements accounts and annuities (“IRAs”), and other entities or accounts that are subject to ERISA or Section 4975 of the Code (e.g., private investment funds deemed to be holding ERISA “plan assets”) (collectively, “Retirement Plans”). It should not impact managers of, or advisers to, plans, vehicles and accounts that are not subject to ERISA or Section 4975 of the Code, such as a non-plan asset private investment fund that is operated under the “ERISA 25% limit” or as a “VCOC” or “REOC.”

## 1. Reinstatement of the “Five-Part Test”

- Effective immediately, the DOL has [formally reinstated](#) its “five-part test” for determining whether a person is a “fiduciary” under ERISA and Section 4975 of the Code by reason of providing “investment advice” for a fee (this guidance does not cover fiduciaries that have discretionary investment authority). In April 2016, the DOL temporarily replaced the “five-part test” with a new fiduciary rule that significantly expanded the type of investment-related information that would be considered “investment advice” which affected certain marketing and other related activities directed at Retirement Plans common to the investment management industry (including the private investment fund industry). However, that rule was vacated by the Fifth Circuit in [March 2018](#). Shortly after that decision, the DOL issued [Field Assistance Bulletin 2018-02](#) which provided that the DOL would not enforce the 2016 fiduciary rule and instead would go back to the “five-part test,” so the ERISA industry has generally already been operating as if the “five-part test” was the governing rule. In any event, this new guidance is formal confirmation that the “five-part test” is applicable once again.
- Although the DOL made no changes to the text of the “five-part test”, the DOL did provide some additional information on the DOL’s current view about key elements of the test. Historically, service providers have often taken the position that certain investment guidance (such as guidance on whether or not to take a distribution from a retirement plan and roll it over to an IRA) was not “investment advice” under the “five-part test” because it was not provided on a “regular basis” and/or pursuant to a “mutual” agreement, arrangement or understanding that the advice would serve as a “primary basis” for the decision – negating several of the required prongs of the “five-part test.” In this regard, the DOL noted the following:
  - Although advice provided on an isolated basis may not satisfy the “regular basis” prong, such requirement may be satisfied if the advice is either part of an ongoing advisory relationship or the start of an ongoing advisory relationship (even where no advice was previously provided);
  - Whether advice satisfies the “mutual” understanding requirement will be based on the “reasonable” understanding of the parties. Written statements disclaiming a “mutual” understanding are not determinative, but may be considered;
  - Advice does not need to serve as “the” primary basis of investment decisions, but rather it only need to serve as “a” primary basis; and
  - If a recommendation is based on individualized needs or made in accordance with a best interest standard such as the SEC’s best interest standard, the parties “typically

should reasonably understand that the advice will serve as at least a primary basis for the investment decision.”

Key Takeaway: Even with this additional information from the DOL, it seems that general marketing of investment products to Retirement Plans and providing specific information to Retirement Plan investors or prospective investors concerning investment products that is not based on specific individualized needs of the investor will continue not to result in the provision of “investment advice” under ERISA.

## 2. Proposed Exemption for Conflicted “Investment Advice” and Principal Transactions

- The DOL has [proposed](#) a new prohibited transaction exemption for “investment advice” fiduciaries (again, not applicable to fiduciaries with discretionary investment authority) that would (i) give them more flexibility to provide otherwise “conflicted” advice (including with respect to IRA rollovers) that affects their compensation, and (ii) permit them to enter into and receive compensation from “riskless” and certain other “principal transactions,” provided that, in each case, the advice is provided in accordance with “impartial conduct” standards – namely, a best interest standard (which includes duties of prudence and loyalty) – that are intended to be aligned with the standards of conduct for investment advice professionals established and considered by other U.S. Federal and State regulators (in particular, the SEC and its Regulation Best Interest). The proposed exemption will not go into effect unless and until it is finalized.

This latest round of “fiduciary rule” guidance undoubtedly will not be the last word on this topic, and we will keep you posted on any new developments. For more information on this guidance package, please see [here](#).

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