Podcast

ESG: Considerations for Retirement Investments

By Laura A. Mitchell & Kellie M. Thomas

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The Biden Administration's prudence in selecting plan investments and exercising shareholder rights rule allows plan fiduciaries to consider environmental, social, and governance (ESG) factors when selecting retirement plan investments.

As anticipated in the podcast, President Biden vetoed the legislation blocking his administration's rule regarding ESG and employer-sponsored retirement plan investments. It is not expected that the Senate or House will have the 2/3 majority votes to override such veto. The House, in attempting to override the veto, fell short of the required 2/3 majority required so the rule stands.

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Transcript

Alitia Faccone:

Welcome to Jackson Lewis' podcast, We get work. Focused solely on workplace issues, it is our job to help employers develop proactive strategies, strong policies, and business oriented solutions to cultivate an engaged, stable, and inclusive workforce. Our podcast identifies issues that influence and impact the workplace and its continuing evolution, and helps answer the question on every employer's mind: How will my business be impacted?

The Biden administration's prudence in selecting plan investments in exercising shareholder rights rule allows plan fiduciaries to consider environmental, social, and governance, ESG factors, when selecting retirement plan investments. The rule reverses much of the previous administration's guidance on the issue. On this episode of We get work, Jackson Lewis' ESG group members discuss what employers need to know about the final rule.

Our hosts today are Laura Mitchell and Kellie Thomas, principals in the Denver and Baltimore offices of Jackson Lewis. Laura leads the firm's ESG group and partners with her clients to evaluate, set, achieve, and monitor their organizational, culture, and human capital goals. She works with companies across all industries to realize this vision for her clients' ongoing success.

Kellie's goal with every client is to provide practical and straightforward advice that breaks down and makes accessible the myriad issues and considerations arising under the various federal and state laws and regulations affecting benefit plans.

Laura and Kellie, the question on everyone's mind today is, what should employers consider when selecting retirement plan investments, and how does that impact my business?

Laura Mitchell:

Hello everyone, this is Laura Mitchell. I'm happy to be speaking with you today. I'm speaking with my colleague Kellie Thomas who is a member of our ESG Client Services group and a principal in our employee benefits practice. This time around, I actually get to be the one asking the questions. I'm usually on the receiving end, so this is going to be really fun.

Kellie, I think that's a great place to start. Before we dig in though, ESG is a really hot topic right now and there's a lot of conversation going on in everything that we're reading. One of the hottest trends that we're seeing, or one of the hottest topics is around ESG investing. Our purposes here at Jackson Lewis involves retirement planning, and the current headlines are focused on rules for fiduciaries. We have this new law. But before we get into the details of that, can we take a step back and can you give us a little bit of a primer on the concept of fiduciary duty and investment planning, retirement planning, and why we're actually talking about this today?

Kellie Thomas:

Yes, thank you so much, Laura. That's a wonderful tee up for one of my favorite topics, fiduciary duties under ERISA. So yeah, I do think it's helpful because there are a lot of headlines to sort of think about where does this all come from, and what are the baseline considerations that planned fiduciaries have? So essentially, ERISA comes from old trust law and the concept of fiduciaries. And really at core that's about putting participants and their interests first, making decisions in accordance with the terms of the plan. It's separate from what a plan sponsor might be able to do when they're actually setting a plan up and making plan design decisions. Once that plan is in place, once you have participants investing through the plan, at core you have to make decisions in the best interests of participants. So that's a lot of where we see the discussion focused on what does that really mean, and when you're talking about ESG considerations for investments, how does that all fit together with those basic fiduciary duties that apply to all plans?

Laura Mitchell:

Yeah, fantastic. That leads me to my next thought is, fiduciary duties, retirement planning have been around for decades. Why now is it such a hot topic? Why are we seeing so many headlines? Why are we spending so much time on it? And how does it really fit into, from your perspective, this notion of ESG, and what we're seeing across the country right now with the focus on it?

Kellie Thomas:

Sure. I think just as you obviously see in your practice as well, the values based investing, those types of topics are really coming to the forefront. I hate to throw another thing on Gen Z and the millennials, but they are working and they want their employer to reflect the values that they have. They want to feel like they have a say in these types of things. And it's not just them of course, but they're the ones that are always in the headlines. And so that comes into 401(k) plans as well. Employers and plan sponsors do have employees coming to them and asking questions about investment philosophy and those types of things that weren't necessarily a consideration a decade or so ago. So it really adds a layer onto what needs to be managed when it comes to the plate of investments that's put there for people to use in their retirement funds.

Laura Mitchell:

Yes, certainly. I mean, from my own perspective, when I entered the workforce, the last thing on my mind is what is making up my 401(k) portfolio. I didn't give it a second thought as to where those dollars were being invested for me. I think it's a fascinating evolution to the workplace and to employees, and just the power that they wield to really make an impact, both within what they're doing in their job and also just in the societal movements. So I think it's fantastic.

Can we now turn to what's going on from a regulatory standpoint? There've been a number of changes over the last several years, some very recently. Talk us through where we have actually seen the changes in the law.

Kellie Thomas:

In a nutshell, again, the sort of fiduciary duties to make investment decisions, thinking about the best interest of the participants, which encompasses a lot. So it has to do with when you're thinking about an investment menu, who's in your plan, how investment savvy and are they, making sure to give them enough options, making sure not to give them too many options. All those things come into play, and as we've said, they have for decades.

During President Obama's administration, there was a movement toward allowing consideration of ESG factors, although I don't even know that they were called it that necessarily back then, but that was sort of a topic. The rule under the Obama administration was essentially that when you were making decisions as a planned fiduciary, there was the ability if you were taking two investments that basically side by side were equal, you could use that ESG factor as a tiebreaker. You'll hear that maybe referred to the tie-breaker rule under the Obama administration. To be honest with you, I don't know how often that really came into play in practical terms because I'm not sure how often you have two investments that are identical, and then that's really all that's left when taking into account just the financial factors. So that, again, would be things like risk return fees, all those pieces that go into what makes an investment decision.

Under the Trump administration, they pulled back on that rule and essentially said that only those financial factors, the pecuniary factors is the word that they use, could be taken into consideration. There really couldn't be ESG given any weight when you were looking at plan investments. And with that, if there was sort of a green investment, because a lot of times this comes up in the context of climate change funds, sort of green funds, that type of thing, if that was in an investment, there was a heightened rule regarding disclosures. So we really saw kind of a 180 from what was allowed under the Obama administration.

And then probably not surprisingly, when President Biden came into office, very early on he kind of went back and so reversed the Trump rule. There was a proposed rule in place for about a year, which was finalized in October and went into effect at the end of last year. That was controversial in the sense that at first when the proposed rule was out, there was a concern in certain circles that had actually mandated considering ESG factors when choosing retirement funds, which would be contrary to sort of that, again, that base level ERISA fiduciary duty that's there.

So when they put the final rule in place, that was one of the things that's actually in the preamble of the final rule. They make it very clear and they adjusted some of the language in that final rule to make it clear that it falls short of being a tie-breaker test, where you don't necessarily have to say, "These two investments are equal before you can even consider ESG factors," but it definitely opens the door for ESG to be considered. Because the concern was there was a chilling effect when you essentially said you couldn't consider it at all, you had these extra disclosure requirements. But that all being said, in no way does it mandate that ESG be considered. So it opens a door that was previously closed in terms of considering these for investments.

And as expected this week, the House passed a resolution by 216 to 2 0 4 to block the Biden ESG rule for retirement plan investing. This was followed pretty shortly by the Senate passing a similar resolution 50 to 46. In response to this, the Biden administration did issue an administrative policy statement, which essentially teed up the fact that it will veto these resolutions. And for that reason, the rule will likely remain in place. What this really means is that the landscape doesn't change much for retirement plan investors, but I think it does continue to make people a little bit wary about these types of investments. That's the feedback that we're hearing from both investment advisors and plan fiduciaries. So once again, potentially more to come on this, but that's the latest.

Laura Mitchell:

Interesting. What strikes me is in this evolving space of ESG as we're seeing it today, it's really encompassing a lot more than I think what the initial ESG concept was years ago, really tied to financial performance of stocks for publicly traded companies and that context. Do you find that in this space the concept of what an ESG factor is kind of amorphous? Or are there clearer delineations and definitions of what really would be an ESG factor that a fiduciary could or could not be considering for their investments?

Kellie Thomas:

I don't think it's entirely clear. And I'm outside of my lane a little bit because this is exactly the type of thing that clients are really relying on their financial advisors for. Because a lot of these companies, they have their ESG reports, there are sort of SEC rules and things like that that kind of go into the ESG space. What I'm seeing now when I sit in on committee meetings is that is one of the topics. And so it might be like, "Here's kind of an ESG analysis of funds."

But I agree. I think that it isn't always entirely clear and that the definition has broadened. What's interesting to kind of watch now, so we do have the final rule in place under the Biden administration, but we also have two active rather high profile cases that have been brought. One of them is 25ish attorneys general in Texas, State Attorneys General, that threw a Texas suit to get the rule enjoined. And then you also have two retirement plan participants in Wisconsin that recently brought a case as well. So you're sort of seeing that. I think part of what is a consideration there is exactly what does it mean when you consider ESG factors in a retirement plan? Are people clear on that and are plan participants clear on that? So that's definitely a hot topic.

Laura Mitchell:

That's a great segue to my next question. What are plan sponsors to do? What really are some practical steps that they should be thinking about or should be doing now in the anticipation of either the rule going forward, and even in the absence that the rule is enjoined? It seems as though there's going to be pressure internally from employees regardless of regulations to make ESG investments or to have an ESG focus. So what really can we provide as guidance here?

Kellie Thomas:

That's a great question, and I think it's exactly the way you framed it. It's twofold. So from the plan administrator investment committee, whomever the plan fiduciary is, from that perspective, in many ways the duty has not changed. And that's something that the DOL has a lot of statements out there to say. They are not mandating something new. They're not changing the core that you have to look at these investments in the best interest of participants.

I think the best thing to do is get an investment advisor to help. And it's the same analysis. You're looking at fees. You're looking at returns over the short, mid, and long term. You're looking at how your plan participants are participating in the plan. All of those pieces still factor in. So really I think other than the fact that there's more information coming in and there may be a little bit more that they're considering, the ultimate duty is the same, and that's okay. There's nothing saying that they have to make any movements on this yet while this is all shaking down, even as you say, as ESG is getting more well-defined and exactly what that means is being discussed.

The other side of that, of course, is just what you said, which are the participants. We're definitely hearing feedback that participants are asking about this, sometimes favorably and sometimes not. So that's a piece to be considered as well. And it kind of actually dovetails into other requests that we've seen from participants over the last few years. Maybe not so much right now, but cryptocurrency was a big hot topic even a year ago with participants wanting to be able to invest in that in their retirement plan. And just sort of figuring out balancing that, because you obviously, as a planned fiduciary, you want to listen to your participants and what they need. Retirement plans aren't necessarily meant to be on the cutting edge of things; it's a more cautious set of investments.

So there are things like brokerage windows if it's appropriate for a population that might be utilized as a way to open up space for participants who want something a little unique. But even putting one of those into place is a fiduciary decision. You almost hate to say it, but there is a level of wait and see here. And ultimately, finding and working with an investment advisor that's really savvy and can speak to these issues, that's keeping up with what's going on and sort of the latest guidance on everything, is probably the best bet for any kind of plan fiduciary.

Laura Mitchell:

That makes a lot of sense. I certainly don't envy that job right now. But what about with respect to employers needing to communicate with their participants or with employees? Do we have advice? Should they be addressing these concerns directly? What can we do to help employers come up with a communication strategy to deal with these questions when they get them? Or maybe proactively; is that a good idea?

Kellie Thomas:

Sure, and I think that's a great question also, because we always want participants to feel heard. I think that's important. We want participants to participate in the plan. And so one of the arguments for ESG investments is sometimes it can increase plan participation. If you're looking at that, if it's a way to engage and incentivize your workforce, then that may really be something that you want to take a really close look at and communicate.

It's also fine as a plan fiduciary if you've looked at it and that investment strategy is not ultimately found to be in the best interest of the plan. I think it's okay to kind of be upfront about that. I would never say, "Ignore your participants," so you want to address concerns as they come in. It might feel a little early, potentially, to go out very proactively on some of this stuff, but I think for the employee populations that are interested in it, we're already seeing that movement and questions being asked and requests being made.

Laura Mitchell:

Yeah. I think it's probably likely that we'll see what we've seen in other areas where progressive companies or companies that feel very comfortable or strong about these issues or who have already defined their corporate identity, know what they want to stand for, may feel more comfortable being more proactive with these communications, or kind of educating participants about the position that the company would be taking. And on the other side, that there may be others who are still really early on in evaluating their stance on ESG matters, including this, and will take on a more cautious approach to communicating and investing and all of those things. I bet you there's going to be a spectrum like we see with other things in this area.

Kellie Thomas:

That's exactly right. And really when you get down to it, that happens anyway when it comes to the plate of investments that's offered. We may have some clients with very savvy, investment happy participants who want to be really active managing their accounts. They can put some investments in there that may be, for example, higher risk, higher reward; giving them all the appropriate disclosures and sort of running through that analysis. And then you have other clients who want to take a much more conservative approach just based on the nature of their employee population. So this is just another manifestation of that sort of balancing that occurs, and exactly why it makes a lot of sense to have those investment advisors come in who can give the benchmarking and really let an employer sort of where they sit in comparison to peer companies, and help them make decisions weighing all of those factors.

Laura Mitchell:

Yeah. Again, I know I've said it before, but this is just fascinating. Kellie, thank you so much for your time today and answering the questions. I know I've learned a lot, so I hope our listeners have as well. We definitely will be watching for developments. Hopefully if we have the opportunity again to chat about what's new and different in this space in six months, because I have a feeling it's going to be a lot.

Kellie Thomas:

Absolutely. Absolutely. I feel like, keep your eye on the headlines over the next week. We may have some more news. We may see the first Biden administration veto. You never know.

Laura Mitchell:

It's going to be exciting. Well, thanks so much, Kellie. It was a pleasure as always.

Kellie Thomas:

Thank you, Laura.

Alitia Faccone:

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