Environmental, Social and Corporate Governance (ESG)

In November 2022, President Biden's Labor Department issued a rule that explicitly allows Employee Retirement Income Security Act (ERISA) retirement plan fiduciaries to consider environmental, social and corporate governance (ESG) factors when selecting investments and exercising shareholder rights. The rule, which took effect on January 30, reversed a Trump-era ban on pension plan managers considering such factors, even if ESG investment considerations would improve investor returns and risk management. Republicans (with support from Senator Manchin) are already seeking to reverse the rule through two related attacks. First, a Congressional Review Act (CRA) resolution of disapproval in Congress, and 2) litigation.

What does the rule do?

The rule clarifies the long-standing duty of ERISA plan fiduciaries (pension managers) to focus on relevant risk-return factors in selecting investments. The rule clarifies that fiduciaries *may* reasonably conclude that the economic effects of various ESG factors are relevant to their risk-return analysis for a particular investment. Importantly, the rule is explicit that ESG considerations *alone* cannot justify sacrificing investment returns or taking on additional risk. The rule thus *permits* fiduciaries to consider ESG factors, but only when consistent with the requirement that all investments must serve investors' economic interests. It does not *require* consideration of ESG factors.

The rule also allows fiduciaries, consistent with their duty of loyalty, to take plan investors' preferences into account when constructing a menu of prudent investment options for individual investors to choose from. It thereby reverses a Trump-era rule that *prohibited* ERISA plan fiduciaries from allowing plan participants to choose investment funds or products if those products' investment objectives included even a single "non-pecuniary" objective. A pecuniary factor is narrowly defined to mean only "a factor that has a material effect on the risk/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(a)(1), of ERISA." This narrow requirement would have made it in an effective breach of fiduciary duty to consider any other factors that an investor prioritizes in its investing strategies, such as Economically Targeted Investment (ETI) projects.

Put simply, the current rule permits ERISA fiduciaries to consider all factors relevant to the risk/return analysis and emphasizes their paramount duty to focus on risk and return. It does not require consideration of ESG factors, nor does it weaken investment managers' duties to protect investors' financial interests.

Have any Labor Organizations weighed in previously?

Yes. Many labor unions have publicly engaged through the various rulemaking processes. IBEW for example supports the current rule and has opposed previous efforts to limit investment options. The labor movement has been both a thought leader and practitioner of ESG investing for decades in recognition of both the risk and opportunities ESG presents for pension fund management strategies. This includes important, targeted "non-pecuniary" investments in high-road projects that create good union jobs and strengthen communities.

What is the current status?
There are currently 50 co-sponsors on a Senate resolution to use the Congressional Review Act (CRA) to overturn the rule and there is a companion in the House. CRA resolutions serve as a legislative vehicle to disapprove a regulation that cannot be filibustered, meaning it can pass with only 51 votes in the Senate. Senator Manchin is currently the sole Democrat Senator co-sponsoring the Senate resolution. We anticipate action in the House on Tuesday and in the Senate perhaps as early as the end of this week.

Are there other related impacts to be concerned of?
Yes. Republicans in Congress and states Attorney Generals believe they can establish in court that the Labor Department does not have authority to make such a rule. If successful, this line of argument could then extend to other Biden administration rules and regulatory issues and might impact any number of other shared priorities.

What is the justification for Republican opposition?
Republicans are advancing a baseless and inaccurate argument that the ESG rule would harm investment funds, when in fact many of the current state-level efforts will end up costing taxpayers more money. For example, a recent study found that two Texas anti-ESG laws will result in Texas cities paying "an additional $303 million to $532 million in interest on $32 billion in bonds." Additionally, large asset management firms such as Blackrock, Vanguard and State Street have each emphasized the growing practitioner and academic evidence supporting the view that incorporating sustainability-related factors into investment decisions can improve risk-adjusted returns in portfolios over time. Chair Powell (appointed by Trump to chair the Federal Reserve), at his renomination hearing, shared his view that it is appropriate for the central bank to dig into climate change "...to the extent it fits within our existing mandates. I think it does in the sense that it's another risk, over time, that banks are going to run. Climate change poses significant challenges for the global economy and the financial system."

Recommendation
The strongest efforts should focus on a goal of stopping the resolution from passing either chamber of Congress.