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A cure for the "cooties"

New DOL guidance encourages more retirement plans to offer Responsible Investing options.

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The U.S. Department of Labor (DOL) recently replaced 2008 guidance that – in the words of Labor Secretary Tom Perez – had given "cooties" to including responsible investments (RI) in retirement plans. The Department's new framework enables retirement plan sponsors to more readily add RI options to Defined Contribution (DC) plan menus. Now employers can more readily satisfy participants' rapidly rising demand for responsible approaches, especially among women and Millennial participants.

How it all began

DOL has consistently stated that ERISA does not allow fiduciaries to sacrifice investment performance for the sake of achieving responsible investing goals. But in 1998, DOL confirmed that a fiduciary can consider an RI if it's expected to provide a return commensurate to other investments having similar risk characteristics. This standard is often called the "everything-being-equal" test.

A sudden cooties outbreak

In 2008, DOL issued a far more restrictive interpretation. In an Interpretive Bulletin, DOL said that to offer an RI option, a fiduciary must first determine that the investment "is truly equal [to alternative options], taking into account a quantitative and qualitative analysis of the economic impact on the plan." DOL stated that this can be achieved only in "very limited circumstances" – and even then, a fiduciary will "rarely" be able to demonstrate compliance with ERISA "absent a written record demonstrating that a contemporaneous economic analysis showed that the investment alternatives were of equal value." Needless to say, the bulletin's negative tone "unduly discouraged plan fiduciaries," in Secretary Perez's words, from considering RI options.

> The latest DOL guidance uses the term "economically targeted investing." Various terms have been used to describe this and related investment behaviors, such as socially responsible investing, sustainable and responsible investing, environmental, social and governance (ESG) investing, impact investing, and economically targeted investing (ETI).

The new RI guidance: Five key points to remember

Fortunately, with its latest move, DOL has essentially rescinded the 2008 bulletin. In its place, DOL has issued a new Interpretive Bulletin (2015-01) that reaffirms the old everything-being-equal test – but in a way that makes the test even more workable for retirement plan sponsors. Specifically, the new bulletin says:

1. In a reaffirmation of DOL's longstanding position, a "fiduciary may not use plan assets to promote social, environmental, or other public policy causes at the expense of the financial interests of the plan's participants and beneficiaries."
2. But RIs are not "inherently suspect" and plan fiduciaries need not undertake "special scrutiny merely because [investments] take into consideration environmental, social, or other such factors."
3. Indeed, fiduciaries can use RI goals as "tie-breakers" when choosing among different investment alternatives.
4. In fact, environmental, social and governance (ESG) factors can be integral parts of the economic analysis performed by plan fiduciaries when considering any investment. When they are, these factors are not mere tiebreakers, but rather, in DOL's words, "proper components of the fiduciary's analysis of the economic and financial merits of competing investment choices."
5. The guidance applies to a fiduciary's selection of mutual funds under a plan.

Time to give responsible investing another look

The world has changed dramatically in the past few years – and with its clarification, DOL is attempting to keep up. Today, RIs can no longer be considered niche products. They're available in a variety of asset classes and sectors, and many are suitable as core investments. Most importantly, their track record shows that investors don't need to sacrifice performance to take ESG factors into account.

Under the latest guidance, the rapid growth of responsible investing may accelerate, as RI becomes accepted as a mainstream and perhaps even essential component of today's retirement plans. The cooties have been cured for good.

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About the author

Derek Dorn is Managing Director and Head of Regulatory Engagement and Policy for TIAA. He leads TIAA's analysis of regulatory proposals and is responsible for developing and implementing TIAA's public policy agenda at the global, federal, and state levels.

Prior to joining TIAA, Dorn was a partner of Davis & Harman LLP, a Washington-based law firm, where he represented financial services providers on regulatory and legislative matters related to retirement and tax policy. He has significant experience in the public sector, having earlier served as Staff Director of a U.S. Senate Finance Subcommittee and as counsel to former Sens. Jeff Bingaman (NM) and Joe Lieberman (CT). Dorn's leadership on retirement policy has earned him recognition by 401(k) Wire as one of the nation's "100 Most Influential in Defined Contribution."

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