ERISA FIDUCIARY DUTIES AND ESG FUNDS: CREATING A WORTHY RETIREMENT FUTURE

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Abstract

Environmental, Social, Governance (ESG) funds are investment vehicles that invest in companies that promote one or all three of these goals. ESG funds have been around since the early twentieth century. They gained prominence in the 1970s and have received increased attention since the late 1990s. Today, many investors are interested in ESG funds because of society's increased focus on climate change, diversity and inclusion, companies' compliance with regulations, and boards of directors' composition. However, much controversy surrounds ESG funds as investment options for retirement accounts, which hold a significant portion of U.S. market assets.

Many retirement plan fiduciaries are deterred from providing ESG funds as investment options because of the strict fiduciary standards required by the Employee Retirement Income Security Act of 1974 (ERISA). Under ERISA section 404(a), fiduciaries must act solely in the interest of plan participants and for the exclusive purpose of providing benefits to participants and defraying reasonable administrative expenses (known as the "duty of loyalty"); they must select investments with care, skill, prudence, and diligence, which generally requires a prudent investment analysis (known as the "duty of prudence"); they must diversify investments to minimize risks of large loss (known as the "duty to diversify"); and they must act in

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accordance with plan documents (known as the "duty to follow plan documents"). Opponents argue that ESG funds provide collateral benefits to third parties instead of financial benefits to plan participants, causing fiduciaries to breach the duty of loyalty. Additionally, opponents argue fiduciaries will breach the duty of prudence because ESG funds either underperform or do not consistently overperform the market. However, advocates argue that ESG funds have evolved from their original exclusionary strategy, and now utilize ESG factors to consider investment risks and returns and strengthen the traditional investment analysis.

This Note argues that Congress should amend the Financial Factors in Selecting Retirement Plan Investments Act to incorporate provisions from the Department of Labor's proposed rule on ESG funds in retirement plans.

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INTRODUCTION

One of the first Environmental, Social, Governance (ESG) funds, originally referred to as Socially Responsible Investing (SRI), was established in 1928 with an investment goal to maintain religious values by avoiding investments in alcohol, tobacco, and gaming companies.[1] In the 1970s, SRI became prominent as shareholders and religious organizations sought to avoid investing in companies contributing to the Vietnam War, particularly those producing chemical weapons like napalm and Agent Orange.[2] Later, when the South African apartheid took place, investors boycotted companies in South Africa to demonstrate their opposition to the segregation and oppression of the Black majority.[3] In the 1990s, society's focus shifted to environmental concerns due to universal recognition of increasing global temperatures and concern over the burning of fossil fuels.[4] Companies were pushed to focus on sustainable business practices, and nations began to recognize the "intersection of economic development and environmental protection."[5] By the 2000s, SRI had developed into what is commonly referred to as ESG investing,[6] focusing on issues such as human rights, climate change, and anticorruption.[7] In addition, as asset managers began incorporating ESG matters

1. Max M. Schanzenbach & Robert H. Sitkoff, *Reconciling Fiduciary Duty and Social Conscience: The Law and Economics of ESG Investing by a Trustee*, 72 STAN. L. REV. 381, 392–93 (2020); *Building on our History of Responsible Investing*, AMUNDI, https://www.amundi.com/usinvestors/Investment-Ideas/Responsible-Investing (last visited Nov. 4, 2022).

2. Jess Liu, *ESG Investing Comes of Age*, MORNINGSTAR, https://www.morningstar.com/features/esg-investing-history (Mar. 2021).

3. Schanzenbach & Sitkoff, *supra* note 1, at 393; *see also Apartheid*, HISTORY, https://www.history.com/topics/africa/apartheid (Nov. 2, 2022).

4. Liu, *supra* note 2. International recognition of climate change came about with the signing of the Kyoto Protocol, "an agreement among nations to reduce carbon emissions." *Id.*

5. *Id.* In response to the Exxon Valdez oil spill, "investors, business leaders, and public-interest groups" gathered "to speed the adoption of sustainable business practices and the transition to low-carbon economy." *Id.*

6. *See* Schanzenbach & Sitkoff, *supra* note 1, at 396; Liu, *supra* note 2.

7. Liu, *supra* note 2; *see also infra* pp. 131–33.

into investment analysis,[8] ESG goals became considerable driving factors for financially successful investments.[9]

Today, investors' interests in ESG investing have continued to grow rapidly, creating a high demand for ESG funds.[10] After the killing of George Floyd, the Black Lives Matter movement, and the increased frequency of natural disasters, ESG funds have experienced record-breaking inflows.[11] While ESG funds have increased in popularity among investors with personal investment accounts, the majority of investment assets in the United States come from retirement plans.[12] Retirement plans make up about $14.1 trillion of the U.S. market,[13] and yet, many retirement plans do not invest in ESG funds due to strict fiduciary requirements placed on employers who provide retirement plans.[14]

8. *See* Liu, *supra* note 2.

9. *See* Schanzenbach & Sitkoff, *supra* note 1, at 396.

10. *See* MSCI ESG RSCH. LLC, SWIPE TO INVEST: THE STORY BEHIND MILLENNIALS AND ESG INVESTING 2–3 (2020), https://www.msci.com/documents/10199/07e7a7d3-59c3-4d0b-b0b5-029e8fd3974b#page=2.

11. Liu, *supra* note 2.

12. *See* MORGAN STANLEY INST. FOR SUSTAINABLE INVESTING, SUSTAINABLE SIGNALS: INDIVIDUAL INVESTOR INTEREST DRIVEN BY IMPACT, CONVICTION AND CHOICE 11–12 (2019), https://www.morganstanley.com/pub/content/dam/msdotcom/infographics/sustainable-investing/Sustainable_Signals_Individual_Investor_White_Paper_Final.pdf; GARY MOTTOLA, FIN. INDUS. REGUL. AUTH., INSIGHTS: FINANCIAL CAPABILITY–A SNAPSHOT OF INVESTOR HOUSEHOLDS IN AMERICA 1 (2015), https://www.sec.gov/spotlight/fixed-income-advisory-committee/finra-investor-education-foundation-investor-households-fimsa-040918.pdf.

13. *See Release: Quarterly Retirement Market Data*, INV. CO. INST. (Dec. 16, 2021), https://www.ici.org/statistical-report/ret_21_q3 [https://web.archive.org/web/20220324060714/https://www.ici.org/statistical-report/ret_21_q3] (stating that total assets, as of the end of the third quarter in 2021, were $10.4 trillion for defined contribution plans and $3.7 trillion for private sector defined benefit plans). Only defined contribution plans and private sector defined benefit plans were included in this calculation since government plans, annuity reserves outside requirement accounts, and IRAs are subject to different legal regimes than ERISA's section 404(a) fiduciary rules, and therefore, have different rules on the permissibility of considering ESG in investment decisions. *See id.*; *Employee Retirement Income Security Act (ERISA)*, U.S. DEP'T OF LAB., https://www.dol.gov/general/topic/retirement/erisa (last visited Nov. 4, 2022); Jim Hitt, *An ERISA Primer – What You Need to Know About ERISA Retirement Plans*, AMERICAN IRA (June 12, 2020), https://americanira.com/2020/06/12/an-erisa-primer-what-you-need-to-know-about-erisa-retirement-plans/.

14. *See* LIA MITCHELL & ARON SZAPIRO, RETIREMENT PLAN LANDSCAPE REPORT: AN IN-DEPTH LOOK AT THE TRENDS AND FORCES RESHAPING U.S. RETIREMENT PLANS 29 (2022),

The Employee Retirement Income Security Act of 1974 (ERISA) governs retirement plans[15] and holds employers to strict fiduciary requirements.[16] These fiduciary standards have been interpreted to be unsupportive of ESG investing.[17] The Department of Labor has provided guidance regarding proper ESG investing within ERISA-governed retirement plans, but its guidance varies from one presidential administration to the next.[18] As a result, many employers are deterred from selecting ESG funds as retirement plan investment options.[19] Recently, the Department of Labor proposed a bill, the Financial Factors in Selecting Retirement Plan Investments Act, which would amend ERISA and allow ESG funds as retirement investments.[20] The Department of Labor also issued a proposed rule providing guidance on proper assessment of ESG factors.[21] However, the bill is unlikely to overcome a filibuster, and even if the proposed rule becomes final, it can easily be nullified by a new presidential administration.[22]

This Note proposes that Congress should amend the Financial Factors in Selecting Retirement Plan Investments Act and incorporate provisions from the Department of Labor's proposed rule, such as the use of ESG factors in the assessment

https://assets.contentstack.io/v3/assets/blt4eb669caa7dc65b2/bltb5ce33483d402d03/621e7a685662980e56b3bc1d/Retirement-Plan-Landscape-Report.pdf; Melanie Waddell, *Bill Would Allow ESG Criteria, Investments in Retirement Plans*, ThinkAdvisor (May 20, 2021, 3:12 PM), https://www.thinkadvisor.com/2021/05/20/bill-would-allow-esg-criteria-investments-in-retirement-plans/ (quoting Senator Tina Smith) ("[D]espite considerable demand for sustainable investment options, relatively few workplace retirement plans, such as pensions and 401(k) plans, take sustainable investing principles into account in their investment decisions or provide sustainable investment options to workers."); *infra* pp. 136–39.

15. Employee Retirement Income Security Act of 1974 (ERISA) § 2(a), 404(a), 29 U.S.C. § 1001(a).

16. *Id.* § 1104.

17. *See infra* Section I.B.

18. *See infra* Section I.B.

19. *See infra* Section I.B; *infra* text accompanying notes 201–04.

20. Financial Factors in Selecting Retirement Plan Investments Act, S. 1762, 117th Cong. (2021); *see infra* Part II.

21. Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights, 86 Fed. Reg. 57272 (proposed Oct. 14, 2021) (to be codified at 29 C.F.R. § 2550.404a-1); *see infra* Part III.

22. *See infra* pp. 151–52.

of an investment's risks and returns. Part I provides an overview of ERISA fiduciary duties and ESG funds. Part II and Part III examine the Financial Factors in Selecting Retirement Plan Investments Act and the Department of Labor's proposed rule, respectively. Part IV examines ESG fund strategies and performance. Part V discusses sections 404(a) and 404(c) of ERISA and courts' applications and interpretations of these provisions. Part VI applies current case law to ESG funds, offers a solution to the legal uncertainty regarding ERISA and ESG funds, and concludes with policy considerations for including ESG funds as retirement plan investment options.

I. Background: The Employee Retirement Income Security Act of 1974 and ESG Funds

Prior to ERISA, the Welfare and Pension Plans Disclosure Act (WPPDA) regulated private pension plans but failed to provide suitable protections for retirement plan participants.[23] The WPPDA only focused on plan disclosures and did not provide standards of conduct for those who administered pension plans or remedies for employees who were denied pension benefits.[24] In 1963, the financial downfall of the car manufacturing company, Studebaker, caused 4,400 workers to "los[e] some or all of their vested pensions."[25] This event, among others, indicated that pension plans contained many deficiencies, including a lack of legal protection for employees, restrictions on labor mobility, poor funding and management, and loss of

23. *See* Michael S. Gordon, *Overview: Why Was ERISA Enacted?*, *in* The Employee Retirement Income Security Act of 1974: The First Decade 1, 5–8 (1984); *see also History of EBSA and ERISA*, U.S. Dep't of Lab., https://www.dol.gov/agencies/ebsa/about-ebsa/about-us/history-of-ebsa-and-erisa (last visited Nov. 4, 2022); Welfare and Pension Plans Disclosure Act, Pub. L. No. 85-836, 72 Stat. 997 (1958).

24. *See* Gordon, *supra* note 23, at 6, 8; Welfare and Pension Plans Disclosure Act.

25. Gordon, *supra* note 23, at 8.

plan benefits due to plan terminations resulting from company mergers, dissolutions, or financial difficulties.[26]

As a result, Congress enacted ERISA to protect "the interests of [plan] participants,"[27] improving the "equitable character" and "financial soundness" of retirement plans.[28] Congress sought to achieve these ends by establishing reporting and disclosure requirements, rules governing fiduciaries' behavior, vesting standards, minimum funding standards, plan termination insurance, and available sanctions and remedies in federal courts.[29]

ERISA governs "employee benefit plans," which include retirement benefits and welfare benefits.[30] This Note focuses on retirement benefit plans, which are defined as "any plan, fund, or program" that "provide[s] retirement income to employees," and is "established or maintained by an employer or by an employee organization, or by both."[31] ERISA divides retirement plans into two categories: defined benefit plans and defined contribution plans.[32]

26. *See id.* at 8–9. The Great Depression caused many private pension plans to go bankrupt leaving many employees with no retirement savings. *See id.* at 2. In addition, plans had strict age and service requirements for employees to be eligible to join a plan. *Id.* at 2–3. Plans were also discriminatory, favoring higher paid employees at the expense of lower-ranked employees. *Id.* at 3. Many disputes arose between industrial labor unions and employers. *Id.* at 4–5. For example, Inland Steel "refused to bargain with the United Steelworkers of America" regarding its pension plan features. *Id.* at 4. The National Labor Relations Board's (NLRB) and Seventh Circuit found in favor for the union. *Id.* (first quoting Inland Steel Co. v. United Steelworkers of America, CIO, 77 NLRB 4 (1948); and then quoting Inland Steel Co. v. NLRB, 170 F.2d 251 (7th Cir. 1949)). In 1945, mineworkers went on strike in protest for "joint labor-management administration" of retirement funds, which subsequently became a requirement under the Taft-Hartley Act. *Id.*; Labor Management Relations (Taft-Hartley) Act § 302, 29 U.S.C. § 186.

27. Employee Retirement Income Security Act of 1974 (ERISA) § 2(b), 29 U.S.C. § 1001(b). Participants are employees of an employer and receive the benefits of the employee benefit plan. *Id.* § 3(7).

28. *Id.* § 2(a).

29. *Id.* § 2(b)–(c).

30. *Id.* § 3(3). An "employee benefit plan" is a plan that provides retirement benefits, welfare benefits, or both. *Id.*

31. *Id.* § 3(1)–(2)(A)(i). An "employee organization" is an organization or agency that represents an employee and "deal[s] with employers concerning an employee benefit plan." *Id.* § 3(4).

32. *Id.* § 3(34)–(35); *Types of Retirement Plans*, U.S. DEP'T OF LAB., https://www.dol.gov/general/topic/retirement/typesofplans (last visited Nov. 4, 2022).

A defined contribution plan, or individual account plan, is a retirement plan in which employees or employers, or both, make contributions to an employee's individual retirement account.[33] Under 401(k) and 403(b) plans, the most common types of defined contribution plans, employees elect to contribute a percentage of their salary to the plan, often with the employer matching the contribution as an added benefit.[34] The employee often has the ability to exercise control over the account by choosing how contributions are invested by selecting from a list of investment options provided by the plan.[35] There is no guaranteed payout upon retirement because retirement distributions are based on the account balance at retirement, which is subject to investment performance and market fluctuations that are not covered by employers.[36] Therefore, employees assume investment risks.[37]

A defined benefit plan is "a pension plan other than an individual account plan."[38] Because participants do not have individual accounts, their ultimate benefit upon retirement is based on a predetermined payout formula, which is defined in

33. *Types of Retirement Plans*, *supra* note 32*; see also* Barry Kozak, *The Two Broad Categories of Retirement Plan Designs*, *in* NEW YORK UNIVERSITY REVIEW OF EMPLOYEE BENEFITS AND EXECUTIVE COMPENSATION—2019, at § 10.02[1][a]–[b] (David Pratt ed., 2019).

34. *See* Kozak, *supra* note 33, § 10.02[1][a] n.1, [1][b]; *Types of Retirement Plans*, *supra* note 32; *IRC 403(b) Tax-Sheltered Annuity Plans*, IRS, https://www.irs.gov/retirement-plans/irc-403b-tax-sheltered-annuity-plans (Feb. 18, 2022).

35. *Definitions*, IRS, https://www.irs.gov/retirement-plans/plan-participant-employee/definitions (Nov. 10, 2021) ("The contributions go into a 401(k) account, with the employee often choosing the investments based on options provided under the plan."); *Types of Retirement Plans*, *supra* note 32 ("Employees who participate in 401(k) plans assume responsibility for their retirement income by contributing part of their salary and, in many instances, by directing their own investments.").

36. *See* Kozak, *supra* note 33, § 10.02[1][d], § 10.02[1][d] n.24 (stating that upon retirement, plan participants may draw on "the account balance . . . plus all associated gains (or losses) based on the investment allocation of that account" with no external guarantees other than the possibility of suing the plan fiduciary for breach of fiduciary duties).

37. *Id.* ("[A]s long as the employer meets its fiduciary duties when selecting and monitoring the investment portfolio, all of the risk is on the employee.").

38. Employee Retirement Income Security Act of 1974 (ERISA), § 3(35), 29 U.S.C. § 1002(35).

the plan documents.[39] The normal form of benefit under such formula is usually a life annuity, which provides payments for the employee's life or the lives of the employee and their spouse.[40] These formulas often include a percentage of the participant's average or final pay multiplied by the number of years worked.[41] The employer funds the plan, and an actuary calculates the amount the employer must contribute each year considering investment risks and returns.[42] Defined benefit plan assets are pooled into an aggregate trust fund and invested in accordance with the decisions of plan fiduciaries, who typically engage the services of professional investment managers.[43] Any shortfalls in investment returns are covered by the employer.[44] Therefore, the employer assumes all investment and planning risk,[45] and employees are guaranteed retirement income.[46]

Plan fiduciaries have statutory responsibilities under ERISA section 404(a), which vary depending on whether the plan's investments are pooled or participant directed.[47] After ERISA was enacted, employers started providing more defined contribution plans than defined benefit plans.[48] As a result, there are more individual retirement accounts than pension

39. *See* Kozak, *supra* note 33, § 10.02[1][d] ("[T]he plan document describes and defines all aspects of the benefits that will ultimately be paid out to participants during their respective retirements.").

40. *See id.* For employees who are married, a joint and survivor annuity may be selected to provide payments for the employee's life and the life of the employee's spouse. *Id.*

41. *Id.* § 10.02[1][c].

42. *Id.* § 10.02[1][d].

43. Regina T. Jefferson, *Rethinking the Risk of Defined Contribution Plans*, 4 FLA. TAX REV. 607, 610, 628 (2000).

44. *See* Kozak, *supra* note 33, § 10.01[1][d].

45. *Id.* ("[S]ince the employer must contribute the amount the plan's . . . [a]ctuary calculates, which generally includes normal accruals plus an amount to replace any rates of return on plan assets that are lower than expected, and must also pay premiums to the [Pension Benefit Guaranty Corporation] for insurance, the employer will bear the risk.").

46. *Id.* (stating that upon retirement, plan participants receive "the benefit promised through the terms of the plan document" and "a portion of the benefit promised, up to a statutory limit, is insured by the Pension Benefit Guaranty Corporation").

47. *See* Employee Retirement Income Security Act of 1974 (ERISA), § 404(a), (c), 29 U.S.C. § 1104(a), (c).

48. Kozak, *supra* note 33, § 10.02[3].

plans today.[49] For individual retirement accounts, an issue arises as to whether ERISA fiduciary duties apply when employers provide a list of selected investments for employees to choose and invest their contributions.[50]

ERISA defines a fiduciary as a person who has discretionary authority or control over management of a plan or its assets, "renders investment advice for a fee" regarding plan assets, or has discretionary authority or responsibility over administration of a plan.[51] Fiduciaries include an "administrator, officer, trustee, or custodian" of a plan,[52] as well as "employers, . . . , fund managers, and all other individuals who provide investment advice for profit."[53] Section 404(a) provides that a fiduciary must act "solely in the interest of the participants,"[54] "for the exclusive purpose of providing benefits to participants,"[55] and "with the care, skill, prudence, and diligence" of a prudent man in a similar situation making retirement plan decisions.[56] In addition, section 404(a) requires a fiduciary to diversify plan investments "to minimize the risk of large losses,"[57] and a fiduciary must act "in accordance with [plan] documents . . . insofar as such documents . . . are consistent with [ERISA]."[58] If a fiduciary fails to comply with these standards, the fiduciary may face civil legal action brought by the Department of Labor, plan participants, another fiduciary, or the plan sponsor.[59]

49. *Id.*

50. *See* Jefferson, *supra* note 43, at 616; ERISA § 404(c)(1)–(2).

51. ERISA § 3(21)(A).

52. *Id.* § 3(14)(A); *see also id.* § 402(a)(1), (c) ("[O]ne or more named fiduciaries . . . shall have authority to control and manage the operation and administration of the plan.").

53. Jefferson, *supra* note 43, at 623.

54. ERISA § 404(a)(1).

55. *Id.* § 404(a)(1)(A).

56. *Id.* § 404(a)(1)(B).

57. *Id.* § 404(a)(1)(C).

58. *Id.* § 404(a)(1)(D).

59. *Id.* §§ 409, 504(a). Criminal penalties may be brought by the Attorney General against "[a]ny person who willfully violates any provision of [29 USCS §§ 1021, et seq. [the duty of disclosure and reporting,]] or any regulation or order issued under any such provision" or any person who makes false statements and representations "in connection with the marketing or sale of [retirement] plan[s]." *Id.* §§ 501, 101, 519.

In certain instances, a fiduciary may be protected from liability when participants direct their investments.[60] ERISA section 404(c) provides, for plans with "individual accounts [that] *permit[]* a participant or beneficiary to exercise control over the assets in [the] account" and "a participant or beneficiary *exercises* control over the assets in [the] account," the fiduciary is not liable for any breach of fiduciary duty that "results from [the] participant's or beneficiary's exercise of control."[61] A participant has the opportunity to exercise control over the account when he is provided with a broad range of investment options.[62] A participant exercises control over an account when the participant gives investment instructions and "make[s] informed investment decisions with regard to investment alternatives."[63] Therefore, plan fiduciaries are not responsible for the investment choices made by participants but must satisfy ERISA's fiduciary requirements when evaluating and selecting investments offered to participants and monitoring plan investments once selected.[64]

A. *Society's Current View on ESG Funds*

Investors' interests in ESG funds have significantly increased in recent years due to society's heightened awareness of ESG issues.[65] ESG funds are typically mutual funds or exchange-traded funds (ETFs) that base their investment selection on various environmental, social, and governance matters.[66] The environmental component may focus on companies that are conscious of climate change, seek to reduce pollution emission,

60. *Id.* § 404(c)(1).
61. *Id.* (emphasis added).
62. 29 C.F.R. § 2550.404c-1(b)(1)(ii), (b)(3)(i)(A)–(C).
63. *Id.* § 2550.404c-1(b)(2)(i)(A)–(B), (c)(ii).
64. *See* Kozak, *supra* note 33, § 10.02[1][d]; ERISA § 404(c)(1); Tibble v. Edison Int'l, 575 U.S. 523, 527–31 (2015).
65. *See* MSCI ESG Rsch. LLC, *supra* note 10, at 3; *Environmental, Social and Governance (ESG) Funds – Investor Bulletin*, U.S. Sec. & Exch. Comm'n (Feb. 26, 2021), https://www.sec.gov/oiea/investor-alerts-and-bulletins/environmental-social-and-governance-esg-funds-investor-bulletin [hereinafter *SEC Investor Bulletin*].
66. *SEC Investor Bulletin*, *supra* note 65.

or use more environmentally friendly energy means.[67] The social component focuses on a "company's relationship with people and society," such as diversity and inclusion in the workplace, human rights, religious issues, employee health and safety, customer privacy practices, the products a company sells (i.e., guns or tobacco), or whether the company invests in its community.[68] Lastly, the governance component may focus on "how the company is run" by considering "transparency and reporting, ethics, compliance, shareholder rights, and the composition and role of the board of directors."[69] ESG funds may focus on one or all three of these categories.[70] ESG funds have attracted a growing number of investors because they invest in companies that promote these socially positive goals, making investors feel they are contributing to improving society and promoting moral values.[71]

However, there are critics of ESG funds who believe that ESG funds are not financially acceptable investment options. First, some critics argue that ESG funds' performance may differ from non-ESG funds (either inconsistently overperforming or underperforming the market) because ESG funds focus on a limited number of factors.[72] ESG funds focus on collateral benefits and invest in securities for moral and ethical reasons that benefit third parties but may not financially benefit the investor.[73] Filtering investment products based on moral and

67. *Id.*

68. *Id.*; Bernard S. Sharfman, *ESG Investing Under ERISA*, 38 YALE J. ON REGUL. BULL. 112, 116 (2020).

69. *SEC Investor Bulletin*, *supra* note 65.

70. *Id.*

71. *See* MSCI ESG RSCH. LLC, *supra* note 10, at 2.

72. *See SEC Investor Bulletin*, *supra* note 65. Funds that outperform the market (i.e., actively managed funds) have higher risks than funds that seek to match the market (i.e., passive funds) because portfolio managers trade securities more often in an attempt to beat the market, which is largely influenced by speculation. *See Investment Products: Mutual Funds*, FIN. INDUS. REGUL. AUTH., https://www.finra.org/investors/investing/investment-products/mutual-funds#types (last visited Dec. 9, 2022); Kimberly Amadeo, *How to Outperform the Market: 5 Ways to Do It Without Too Much Risk*, THE BALANCE, https://www.thebalance.com/outperform-the-market-3305874 (Mar. 4, 2021).

73. *See* Sharfman, *supra* note 68, at 118 (citing Schanzenbach & Sitkoff, *supra* note 1, at 389–90).

ethical goals leads to concerns that "big winner" stocks, that is, stocks that have high performance and maximum return rates which lead to monetary growth and investment success, will be left out.[74] In other words, ESG funds may leave out high-performing stocks with low ESG ratings and instead include low-performing stocks with better ESG ratings.[75]

Second, opponents argue that ESG funds may not align with an investor's ESG definition or goals.[76] There is no uniform rating or score of environmental, social, and governance factors.[77] As a result, companies have different ratings and measures of ESG factors that lead to different types of stocks and bonds within an ESG fund.[78] For example, a fund may focus more on governance factors than environmental or social factors and, as a result, consist of stocks and bonds of companies that concentrate on their operations rather than environmental and social sustainability.[79] In addition, an ESG fund could include a company that has "a large carbon footprint [but has] demonstrated a commitment to improving its policies and practices on environmental issues."[80] This fund composition may be sufficient to satisfy a portfolio manager's environmental objectives but may not satisfy an investor whose goal is to invest in companies with low carbon emissions.[81] As a result, ESG ratings may be subjective, unreliable, and widely differ across investment companies.[82]

Despite these criticisms, supporters of ESG funds assert that there are ESG funds that use ESG factors to evaluate investment

74. *See id.* at 121–22.

75. *See id.* at 118, 121–22.

76. *See SEC Investor Bulletin*, *supra* note 65.

77. *See id.*; *see also* Aaron Yoon & Phillip Braun, *Should ESG Funds Be in Retirement Plans?*, WALL ST. J. (Sept. 16, 2021, 11:00 AM), https://www.wsj.com/articles/should-esg-funds-be-in-retirement-plans-11631729292 ("Determining whether a stock or a fund is truly advancing ESG goals is difficult because the investment industry lacks a comprehensive ESG measurement framework.").

78. *See SEC Investor Bulletin*, *supra* note 65.

79. *See id.*

80. *Id.*

81. *See id.*

82. *See id.*

risks and returns without considering the simultaneously present collateral benefits.[83] In other words, investors do not forfeit performance by investing in ESG funds.[84] Additionally, some of the world's largest investment management companies advocate for ESG funds.[85] Anna Hawley, a BlackRock active equity portfolio manager,[86] stated, "[ESG analysis] combines traditional investment analysis with the additional lens of environmental, social and governance (ESG) insights to provide portfolio managers a more complete view of the long-term risks and opportunities associated with a company."[87] Vanguard, another investment management company, has taken the position that "ESG strategies are a significant focus area in [its] current research efforts" and has "confidence in the merit of ESG investing broadly."[88] Fidelity also believes that "ESG factors are important inputs into the overall research process and can help identify companies that are best positioned to develop the most innovative products, manage resources more efficiently, and drive long-term value creation for their

83. *See, e.g.*, Sharfman, *supra* note 68, at 119 (citing Schanzenbach & Sitkoff, *supra* note 1, at 390, 438).

84. Anna Hawley, *The Truth About Sustainable Investing*, BLACKROCK (Apr. 22, 2021), https://www.blackrock.com/us/financial-professionals/investment-strategies/sustainable/anna-hawley-on-sustainable-investing [https://web.archive.org/web/20210817191055/https://www.blackrock.com/us/financial-professionals/investment-strategies/sustainable/anna-hawley-on-sustainable-investing].

85. *See infra* notes 86–89 and accompanying text. BlackRock, Vanguard, and Fidelity are some of the world's largest investment management companies that provide and manage mutual funds and other securities on behalf of investors. Tim Lemke, *The 10 Largest Investment Management Companies Worldwide*, THE BALANCE, https://www.thebalance.com/which-firms-have-the-most-assets-under-management-4173923 (Mar. 17, 2022); *Top 100 Asset Manager Managers by Managed AUM*, SOVEREIGN WEALTH FUND INST., https://www.swfinstitute.org/fund-manager-rankings/asset-manager (last visited Nov. 4, 2022).

86. A portfolio manager is a person who selects investments for a mutual fund or exchange-traded fund, determines the fund's investment strategy, and manages the day-to-day trading of the securities that comprise the fund. James Chen, *Portfolio Manager*, INVESTOPEDIA, https://www.investopedia.com/terms/p/portfoliomanager.asp (Mar. 18, 2021).

87. Hawley, *supra* note 84.

88. *Our Product Design Principles and ESG*, VANGUARD (Oct. 20, 2021), https://advisors.vanguard.com/insights/article/ourproductdesignprinciplesandesg.

employees, communities, and shareholders."[89] In sum, there is a belief among ESG supporters that ESG factors correlate with positive financial performance.[90]

Regardless of this controversy, many investors are attracted to the ethical and moral values that ESG funds support.[91] Within the past few years, ESG investing has rapidly increased.[92] In 2020, $51.1 billion flowed into ESG funds.[93] Assets under management in ESG funds grew from $12 trillion in 2018 to $17.1 trillion in 2020.[94] However, the majority of ESG investing has occurred outside ERISA-governed retirement accounts, while most Americans hold the majority of their assets in retirement accounts.[95] Many Americans cannot afford to invest additional money in individual investment accounts, but many people save for retirement.[96] By the end of 2020, there were approximately six hundred thousand 401(k) plans that included

89. Nicole Connolly, David King, Sarah Pulsifer, Michael Robertson & Daniel Tremblay, Fidelity Invs., The Beliefs and Philosophical Underpinnings of Fidelity's Proprietary ESG Ratings 2 (2021), https://www.hvst.com/page/fidelity-institutional-asset-management/posts/the-beliefs-and-philosophical-underpinnings-of-fidelitys-proprietary-esg-ratings-EvrTnG7D/attachment/9901403-fnl-pdf-804003?download=True.

90. *See supra* notes 86–89 and accompanying text.

91. *See* Rachel Mann, *Solving Climate Change Through Retirement Plan Regulation*, The Regul. Rev. (Mar 11, 2021), https://www.theregreview.org/2021/03/11/mann-solving-climate-change-retirement-plan-regulation/.

92. *See* Yoon & Braun, *supra* note 77 ("According to fund researcher Morningstar Inc., a record $51.1 billion flowed into U.S. sustainable funds in 2020, more than double the amount in 2019 and nearly 10 times the total for 2018.").

93. Jon Hale, *A Broken Record: Flows for U.S. Sustainable Funds Again Reach New Heights*, Morningstar (Jan. 28, 2021), https://www.morningstar.com/articles/1019195/a-broken-record-flows-for-us-sustainable-funds-again-reach-new-heights.

94. U.S. F. for Sustainable & Responsible Inv. Found., 2020 Report on U.S. Sustainable and Impact Investing Trends (2020), https://www.ussif.org/files/Trends/2020_Trends_Highlights_OnePager.pdf.

95. *See ESG Investing Among ERISA Retirement Plans: The Latest Trends and Outlook*, Seeking Alpha (May 15, 2022, 4:26 PM), https://seekingalpha.com/article/4511815-esg-investing-among-erisa-retirement-plans-the-latest-trends-and-outlook; Morgan Stanley Inst. for Sustainable Investing, *supra* note 12, at 11–12; Mottola, *supra* note 12, at 1 (2015).

96. *See* Mann, *supra* note 91; *see also* Kim Parker & Richard Fry, *More Than Half of U.S. Households Have Some Investment in the Stock Market*, Pew Rsch. Ctr. (Mar. 25, 2020), https://www.pewresearch.org/fact-tank/2020/03/25/more-than-half-of-u-s-households-have-some-investment-in-the-stock-market/ (stating 52% of American families are invested in the market with most investments in retirement accounts).

active and retired employees.[97] As of March 31, 2021, there were about $6.9 trillion assets in 401(k) plans.[98] Despite the large volume of retirement accounts in the United States, many retirement plan participants do not have the option to invest in ESG funds.[99]

B. *Regulation of ESG Funds in Retirement Plans*

Employers are deterred from including ESG funds in retirement accounts because of ERISA's strict fiduciary requirements.[100] Employers are required to (1) act in the sole interest of plan participants and "for the exclusive purpose of providing benefits to participants"[101] (i.e., the "duty of loyalty"),[102] (2) act "with the care, skill, prudence, and diligence" of a reasonably "prudent man" in a similar situation,[103] (3) "diversify[] [plan] investments . . . to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so,"[104] and (4) act "in accordance with [plan] documents."[105] The Department of Labor has discretion to issue administrative interpretations of ERISA,[106] and has issued interpretive bulletins regarding ESG funds in retirement accounts and what ESG investing means for fiduciaries' duties

97. *Frequently Asked Questions About 401(k) Plan Research*, INV. CO. INST. (Oct. 11, 2021), https://www.ici.org/faqs/faq/401k/faqs_401k.

98. *Id.*

99. MITCHELL & SZAPIRO, *supra* note 14, at 29; Waddell, *supra* note 14 (quoting Senator Tina Smith) ("[D]espite considerable demand for sustainable investment options, relatively few workplace retirement plans, such as pensions and 401(k) plans, take sustainable investing principles into account in their investment decisions or provide sustainable investment options to workers.").

100. *See* Waddell, *supra* note 14 (quoting Lisa Woll, CEO of the Forum for Sustainable and Responsible Investment) ("Without this clarification, plan fiduciaries may remain reluctant to offer sustainable investment products in default options due to concerns about regulatory and litigation risks.").

101. Employee Retirement Income Security Act of 1974 (ERISA) § 404(a)(1)(A), 29 U.S.C. §1104(a)(1)(A).

102. HOWARD PIANKO, ERISA FIDUCIARY DUTIES: OVERVIEW (2022), Westlaw 5-504-0060.

103. ERISA § 404(a)(1)(B).

104. *Id.* § 404(a)(1)(C).

105. *Id.* § 404(a)(1)(D).

106. *See* Langbecker v. Elec. Data Sys. Corp., 476 F.3d 299, 309, 319 (5th Cir. 2007).

under ERISA.[107] However, over the years, these interpretive bulletins have provided mixed guidance to fiduciaries regarding ESG investing in retirement accounts.[108]

Conflicting opinions about ESG fund performance and returns have contributed to the mixed guidance that have deterred fiduciaries from providing ESG funds in retirement plans.[109] First, there is concern that a fiduciary who selects an ESG fund would not be acting prudently if the fund had a lower expected rate of return than a non-ESG fund with comparable risks.[110] When choosing retirement plan funds, "fiduciaries must always put first the economic interests of the plan in providing retirement benefits."[111] To do this, fiduciaries must "focus[] on financial factors that have a material effect on [investments' rates of return] and risk[s]."[112] As a result, opponents of ESG funds argue that fiduciaries must select investment options that are financially successful with low risk of poor performance, and ESG funds do not meet this criteria.[113]

Second, under the duty of loyalty, there is concern that fiduciaries who select investments that benefit third parties are not acting solely in the interest of plan participants and for participants' benefit.[114] For example, if a fund were to invest in

107. *See* Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights, 86 Fed. Reg. 57272, 57272–75 (proposed Oct. 14, 2021) (to be codified at 29 C.F.R. § 2550.404a-1).

108. *See, e.g.*, *id.*; *see also infra* pp. 138–41, 143.

109. "The Department has a similarly longstanding position that ERISA fiduciaries may not sacrifice investment returns or assume greater investment risks as a means of promoting collateral social policy goals." Memorandum from John J. Canary, Dir. of Reguls. & Interpretations, to Mabel Capolongo, Dir. of Enf't Reg'l Dirs., on Field Assistance Bulletin No. 2018-01, at 1 (Apr. 23, 2018), https://www.dol.gov/agencies/ebsa/employers-and-advisers/guidance/field-assistance-bulletins/2018-01 [hereinafter Memorandum from John J. Canary to Mabel Capolongo]. "[P]lan fiduciaries are not permitted to sacrifice investment return or take on additional investment risk as a means of using plan investments to promote collateral social policy goals." *Id.* at 2.

110. *See id.* at 2.

111. *Id.*

112. *Id.*

113. *See, e.g.*, Edward A. Zelinsky, Comment Letter on Proposed Rule to Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights, at 8–9 (Nov. 30, 2021); Sharfman, supra note 68, at 121–24.

114. *See* Schanzenbach & Sitkoff, *supra* note 1, at 403–05.

a company that builds houses in low-income areas, which has a positive social impact on communities but low financial performance, then the ultimate benefit is to the community and not the plan participant whose money is being invested.[115] As a result, fiduciaries who select funds that provide little benefit to plan participants' retirement accounts and more benefit to third parties are not acting in the sole interest and best interest of plan participants.[116] Additionally, there is concern that the lack of uniform ESG definitions, measures, and ratings will cause an employer to breach its fiduciary duty of loyalty because a fiduciary could choose an ESG fund that favors its own policy preferences, which may differ from a participant's ESG preferences.[117] As a result, many employers do not include ESG funds in their retirement plans.[118]

Nevertheless, investors' growing interest in ESG funds has led to increased debate on amending ERISA to allow ESG funds in retirement plans.[119] Historically, Democratic administrations have been supportive of ESG investing under ERISA, while Republican administrations have been skeptical of whether

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115. *See* DOUGLAS M. GRIM & DANIEL B. BERKOWITZ, VANGUARD, ESG, SRI AND IMPACT INVESTING: A PRIMER FOR DECISION-MAKING 5 (2018), https://perma.cc/42T2-K35T; *see also* Schanzenbach & Sitkoff, *supra* note 1, at 405–06 (applying the Supreme Court's interpretation of ERISA to investment decisions considering collateral benefits).

116. *See* Schanzenbach & Sitkoff, *supra* note 1, at 403–05.

117. *See* Sharfman, *supra* note 68, at 127–29; Memorandum from John J. Canary to Mabel Capolongo, *supra* note 109, at 3–4; *see also* Schanzenbach & Sitkoff, *supra* note 1, at 430–431 (explaining the various interpretations of environmental, social, governance factors).

118. *See* Greg Iacurci, *Climate Funds Hold Less Than 1% of 401(k) Money. Here's Why*, CNBC, https://www.cnbc.com/2020/12/11/heres-why-401k-plans-lag-in-green-investment-options.html (Dec. 14, 2020, 10:41 AM) [hereinafter *Climate Funds Hold Less than 1% of 401(k) Money*]; JON HALE, MORNINGSTAR, SUSTAINABLE FUNDS U.S. LANDSCAPE REPORT 28 (2018), https://cdn.ymaws.com/dciia.org/resource/collection/8606CD14-06A5-4277-9507-C397C1C8DEA0/Sustainable_Funds_Landscape_013018.pdf [hereinafter SUSTAINABLE FUNDS U.S. LANDSCAPE REPORT] ("Few defined-contribution retirement plans currently offer sustainable-fund options, less than 10% by one estimate."); *see also* Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights, 86 Fed. Reg. 57272, 57276 (proposed Oct. 14, 2021) (to be codified at 29 C.F.R. § 2550.404a-1) (discussing how changes to the Department of Labor's interpretation of "investment duties" under ERISA would bring clarity to fiduciaries ability to consider ESG factors when making investment decisions).

119. *See infra* pp. 138–43.

ESG funds satisfy ERISA fiduciary requirements.[120] In 1994, under the Clinton Administration,[121] the Department of Labor issued an interpretive bulletin that created what is commonly known as the "tie-breaker" standard.[122] This standard allowed fiduciaries to select ESG funds that had comparable expected rates of return to non-ESG funds with similar characteristics.[123] In 2008, under the Bush Administration,[124] the Department of Labor replaced the 1994 guidance with an interpretive bulletin that deterred "fiduciary consideration of collateral, non-economic factors in selecting plan investments," stating such consideration "should be rare and, when considered, should be documented in a manner that demonstrates compliance with ERISA's rigorous fiduciary standards."[125]

In 2015, under the Obama Administration,[126] the Department of Labor issued a new interpretive bulletin contradicting the Bush Administration's guidance and stated if "an investment is appropriate based solely on economic considerations, including

120. *See* Mann, *supra* note 91.

121. Bill Clinton, a member of the Democratic Party, was president from 1993 to 2001. *William J. Clinton*, WHITE HOUSE, https://www.whitehouse.gov/about-the-white-house/presidents/william-j-clinton/ (last visited Nov. 4, 2022).

122. *See* Interpretive Bulletin Relating to the Employee Retirement Income Security Act of 1974, 59 Fed. Reg. 32606, 32606–07 (June 23, 1994), https://archives.federalregister.gov/issue_slice/1994/6/23/32485-32611.pdf#page=122; Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights, 86 Fed. Reg. at 57273 (referring to the standard established in Interpretive Bulletin 94-1, 59 FR 32606, as the "tie-breaker" standard).

123. *See* Interpretive Bulletin Relating to the Employee Retirement Income Security Act of 1974, 59 Fed. Reg. at 32606–07; Interpretive Bulletin Relating to the Fiduciary Standard Under ERISA in Considering Economically Targeted Investments, 80 Fed. Reg. 65135, 65135 (Oct. 26, 2015) (to be codified at 29 C.F.R. pt. 2509), https://www.federalregister.gov/documents/2015/10/26/2015-27146/interpretive-bulletin-relating-to-the-fiduciary-standard-under-erisa-in-considering-economically#p-23.

124. George W. Bush, a member of the Republican Party, was president from 2001 to 2009. *George W. Bush*, BALLOTPEDIA, https://ballotpedia.org/George_W._Bush (last visited Nov. 4, 2022).

125. *See* Interpretive Bulletin Relating to the Fiduciary Standard Under ERISA in Considering Economically Targeted Investments, 80 Fed. Reg. at 65136 (quoting Interpretive Bulletin Relating to Investing in Economically Targeted Investments, 73 Fed. Reg. 61734, 61734 (Oct. 17, 2008) (to be codified at 29 C.F.R. pt. 2509)).

126. Barack Obama, a member of the Democratic Party, was president from 2009 to 2017. David Mendell, *Barack Obama*, BRITANNICA, https://www.britannica.com/biography/Barack-Obama (Oct. 18, 2022).

those that may derive from environmental, social and governance factors, the fiduciary may make the investment without regard to any collateral benefits the investment may also promote."[127] In 2018, the Department of Labor further elaborated on economic considerations stating, "[a] fiduciary's evaluation of the economics of an investment should be focused on financial factors that have a material effect on the *return and risk* of an investment based on appropriate investment horizons consistent with the plan's articulated funding and investment objectives."[128] As a result, the focus shifted toward investment risk and return rather than tie-breaker factors between an ESG fund and non-ESG fund.[129]

In November 2020, under the Trump Administration,[130] the Department of Labor issued a final rule, the "Financial Factors in Selecting Plan Investments,"[131] which required fiduciaries to choose retirement plan investments "based solely on financial considerations relevant to the risk-adjusted economic value of a particular investment or investment course of action."[132] The rule replaced the Department of Labor's prior interpretive bulletins and required fiduciaries to focus only on pecuniary factors, that is economic and financial factors, when choosing investments for retirement plans and avoid non-pecuniary factors, such as environment, social, and governance factors.[133] Secretary Eugene Scalia further explained the reason for the rule stating:

127. Interpretive Bulletin Relating to the Fiduciary Standard Under ERISA in Considering Economically Targeted Investments, 80 Fed. Reg. at 65135.

128. Memorandum from John J. Canary to Mabel Capolongo, *supra* note 109, at 2 (emphasis added).

129. *See id.* at 2–4.

130. Donald Trump, a member of the Republican Party, was president from 2017 to 2021. Brian Duignan, *Donald Trump*, BRITANNICA, https://www.britannica.com/biography/Donald-Trump (Oct. 21, 2022).

131. Financial Factors in Selecting Plan Investments, 85 Fed. Reg. 72846, 72851 (Nov. 13, 2020) (to be codified at 29 C.F.R. pt. 2509, § 2550.404a-1).

132. *Id.* at 72846.

133. *See id.*

> Private employer-sponsored retirement plans are not vehicles for furthering social goals or policy objectives that are not in the financial interest of the plan . . . . Rather, ERISA plans should be managed with unwavering focus on a single, very important social goal: providing for the retirement security of American workers.[134]

This final rule has greater force of law than the Department of Labor's interpretative bulletins.[135] The Department of Labor's interpretative bulletins were communications to the public, had no force of law, and could easily be created through an informal process.[136] Nevertheless, courts could rely on the these interpretive bulletins to guide their judgment.[137] Conversely, this final rule has the force of law, making it binding and immediately enforceable on the public;[138] therefore, changing future procedures the Department of Labor will use to regulate ESG funds in retirement plans.[139]

In January 2021, President Biden issued an Executive Order titled "Protecting Public Health and the Environment and

134. *U.S. Department of Labor Proposes New Investment Duties Rule*, U.S. DEP'T OF LAB. (June 23, 2020), https://www.dol.gov/newsroom/releases/ebsa/ebsa20200623.

135. *See* Robert A. Anthony, *Interpretative Rules, Policy Statements, Guidances, Manuals, and the Like—Should Federal Agencies Use Them to Bind the Public?*, 41 DUKE L.J. 1311, 1315 (1992); *see also* 5 U.S.C. § 551(4) ("'[R]ule' means the whole or a part of an agency statement of general or particular applicability and future effect designed to implement, interpret, or prescribe law or policy or describing the organization, procedure, or practice requirements of an agency . . . .").

136. *See* Anthony, *supra* note 135, at 1312, 1315, 1322–23 (stating a legislative rule must go through the notice-and-comment phase and be published in the *Federal Register*, otherwise, it is a non-legislative rule and is not binding law); *see also* § 551(5) ("'[R]ule making' means agency process for formulating, amending, or repealing a rule."); § 553 (prescribing procedures for notice-and-comment rulemaking); § 552(a)(1) (setting forth requirements for agency publication in the *Federal Register*).

137. *See* Skidmore v. Swift & Co., 323 U.S. 134, 140 (1944) ("We consider that the rulings, interpretations and opinions of the Administrator under this Act, while not controlling upon the courts by reason of their authority, do constitute a body of experience and informed judgment to which courts and litigants may properly resort for guidance. The weight of such a judgment in a particular case will depend upon the thoroughness evident in its consideration, the validity of its reasoning, its consistency with earlier and later pronouncements, and all those factors which give it power to persuade, if lacking power to control.").

138. *See* Anthony, *supra* note 135, at 1315; § 551(4).

139. *See supra* pp. 138–41.

Restoring Science To Tackle the Climate Crisis."[140] This order required all executive departments and agencies to immediately review and suspend, revise, or rescind all agency actions and regulations implemented between January 20, 2017 and January 20, 2021 that are inconsistent with the Executive Order's purpose.[141] As a result, the Trump Administration's Financial Factors in Selecting Plan Investments rule was suspended.[142]

In May 2021, the Senate introduced the "Financial Factors in Selecting Retirement Plan Investments Act,"[143] a bill that would negate the Trump Administration's "Financial Factors in Selecting Plan Investments" rule.[144] The proposed Act provides legal certainty by allowing retirement plan fiduciaries to invest in ESG funds.[145] The Act would give ESG factors "equal status" to other non-ESG factors that employers and plan sponsors consider when choosing retirement plan investments.[146] The Act would amend ERISA and add a new subsection to the end of section 404(a), which would allow a fiduciary to consider environmental, social, and governance factors when "carrying out an investment decision, strategy, or objective, or other fiduciary act" and use collateral benefit factors for tie-breakers between ESG funds and non-ESG funds.[147] The bill's sponsors emphasized the reasons for the bill included the heightened

140. Exec. Order No. 13990, 86 Fed. Reg. 7037, 7037 (Jan. 20, 2021); *see also Joe Biden*, BALLOTPEDIA, https://ballotpedia.org/Joe_Biden (last visited Nov. 4, 2022) (stating Joseph Biden, a member of the Democratic Party, began his presidential term in 2021).

141. Exec. Order No. 13990, 86 Fed. Reg. 7037.

142. Press Release, U.S. Dep't of Lab., U.S. Department of Labor Statement Regarding Enforcement of Its Final Rules on ESG Investments and Proxy Voting by Employee Benefit Plans (Mar. 10, 2021), https://www.dol.gov/sites/dolgov/files/ebsa/laws-and-regulations/laws/erisa/statement-on-enforcement-of-final-rules-on-esg-investments-and-proxy-voting.pdf.

143. Financial Factors in Selecting Retirement Plan Investments Act, S. 1762, 117th Cong. (as introduced on May 20, 2021).

144. Pete Michaels & Alyssa Scruggs, *Call It a Comeback: The Likely Return of ESG Investing in ERISA Accounts*, JD SUPRA (June 7, 2021), https://www.jdsupra.com/legalnews/call-it-a-comeback-the-likely-return-of-1635185/; Financial Factors in Selecting Plan Investments, 85 Fed. Reg. 72846, 72851 (Nov. 13, 2020) (to be codified at 29 C.F.R. pt. 2509, § 2550.404a-1).

145. Michaels & Scruggs, *supra* note 144; S. 1762.

146. Michaels & Scruggs, *supra* note 144; S. 1762.

147. S. 1762 § 2(a).

interest in ESG funds and the need to end the legal uncertainty caused by constant changes in guidance from administration to administration.[148] However, the bill still has to pass through Congress, which will be a long and challenging process.[149]

On October 14th, 2021, the Department of Labor published a rule for notice-and-comment that would amend regulation 28 C.F.R. 2550.404a-1,[150] which elaborates on fiduciaries' investment duties under ERISA section 404(a).[151] The proposed rule adds new language to the regulation, acknowledging the need to evaluate the economic effects of ESG factors on investments' projected rates of return.[152] It also adds a new provision allowing "a fiduciary [to] consider *any* factor material to the risk-return analysis, including climate change and other ESG factors."[153] Lastly, the proposal completely changes section (c) of the regulation to state that ESG factors are appropriate "risk-return factors that fiduciaries should [consider] when selecting and monitoring plan investments."[154] The proposed rule includes the tie-breaker standard, allowing a fiduciary to select an investment "based on collateral benefits other than investment returns, so long as the requirements of the proposal are met."[155] Lastly, the proposal allows fiduciaries to use ESG funds as a qualified default investment alternative (QDIA).[156] If the bill and proposed rule are implemented, both will have a significant impact on retirement plans.

148. Michaels & Scruggs, *supra* note 144.

149. *Id.*

150. Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights, 86 Fed. Reg. 57272, 57276 (proposed Oct. 14, 2021) (to be codified at 29 C.F.R. § 2550.404a-1).

151. *See* 29 C.F.R. § 2550.404a-1.

152. Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights, 86 Fed. Reg. at 57285–86.

153. *Id.* at 57277.

154. *Id.* at 57277–78.

155. *Id.*

156. *Id.* at 57279–80.

II. The Bill: Financial Factors in Selecting Retirement Plan Investments Act

The Financial Factors in Selecting Retirement Plan Investments Act was introduced in both houses by Senators Tina Smith, Patty Murray, and Richard Blumenthal, and Representative Suzan DelBene.[157] The Act would amend ERISA and add a new section to the end of section 404(a) stating:

> (3)(A) Provided that a fiduciary discharges the fiduciary's duties with respect to a plan in a manner otherwise consistent with this subsection, a fiduciary may—
>
> (i) consider environmental, social, governance, or similar factors, in connection with carrying out an investment decision, strategy, or objective, or other fiduciary act; and
>
> (ii) consider collateral environmental, social, governance, or similar factors as tie-breakers when competing investments can reasonably be expected to serve the plan's economic interests equally well with respect to expected return and risk over the appropriate time horizon.[158]

The bill's sponsors indicated the bill was created due to investors' growing interests in ESG funds and the changing Department of Labor guidances causing few retirement plans to offer ESG funds.[159] Senator Murray stated, "[r]etirement security is all about planning for the future, and you can't truly

157. Lee Barney, *Bill Would Allow Retirement Plans to Use ESG Investments*, Plan Adviser (May 21, 2021), https://www.planadviser.com/bill-allow-retirement-plans-use-esg-investments/; Ted Godbout, *Bill Seeks to Provide Legal Certainty for ESG Factors*, Nat'l Ass'n of Plan Advisors (May 21, 2021), https://www.napa-net.org/news-info/daily-news/bill-seeks-provide-legal-certainty-esg-factors; Financial Factors in Selecting Retirement Plan Investments Act, S. 1762, 117th Cong. (as introduced on May 20, 2021).

158. S. 1762 § 2(a).

159. Barney, *supra* note 157.

do that if you aren't able to consider the environmental, social and governance factors that will shape the future."[160] Representative DelBene stated, "Americans deserve a secure retirement, and ESG investments are a key component in accomplishing that goal. This bill promises retirees a pathway not only to reach that secure retirement but a pathway to live in a world worth retiring in."[161]

Many industry groups support the bill.[162] The Securities Industry and Financial Markets Association (SIFMA), a "leading trade association for broker-dealers, investment banks[,] and asset managers" that promotes fair and orderly markets,[163] stated, "it is important for financial institutions to be able to consider all factors, including ESG factors, as part of an investment and risk management strategy . . . so long as they are evaluated in a manner consistent with a prudent process."[164] Other groups such as the CFA Institute,[165] the American Retirement Association,[166] and the Forum for Sustainable and Responsible Investment also support the bill.[167] Lisa Woll, CEO of the Forum for Sustainable and Responsible Investment, stated "investors consider ESG criteria because they are material to financial performance . . . it is prudent for QDIA investments to consider long-term threats like climate change to protect the long-term interests of plan participants."[168]

Despite this vast support, there are some who are critical of the proposed legislation.[169] Opponents of the bill argue that

160. *Id.*

161. *Id.*

162. *Id.*

163. *About*, SEC. INDUS. & FIN. MKTS. ASS'N, https://www.sifma.org/about/ (last visited Nov. 4, 2022).

164. Barney, *supra* note 157.

165. *Id.*

166. Letter from Brian H. Graff, Exec. Dir./CEO, Am. Ret. Ass'n to Hon. Suzan DelBene, U.S. House of Representatives, (May 20, 2021), https://araadvocacy.org/wp-content/uploads/2021/05/ARA-Advocacy-2021-Congressional-Updates-2021-05-20-ARA-Supports-the-Financial-Factors-in-Selecting-Retirement-Plan-Investment-Act-House.pdf.

167. Barney, *supra* note 157.

168. Waddell, *supra* note 14.

169. *See infra* notes 170–71 and accompanying text.

under ERISA's strict fiduciary requirements, retirement plans are designed to ensure employees' financial well-being for retirement by maximizing returns and should not be used for fostering participants' social and policy preferences.[170] Senators who hold this view will likely oppose the bill and make it difficult for the bill to overcome a filibuster.[171] In contrast, supporters of the bill argue ESG criteria have a significant impact on investments' performance.[172] Companies that have the ability to manage risks arising out of environmental and climate change concerns, social impacts on society, and corporate governance will perform best.[173] In addition, supporters "argue that a prudent investor should consider ESG criteria [when] investing" because factors such as climate change and diversity in the workplace are inherent matters of public concern that "can have a severe impact on the long-term performance of a fund" in a society that is raising heightened awareness of these issues.[174] Congress should enact the Financial Factors in Selecting Retirement Plan Investments Act because it will create an unambiguous standard for fiduciaries to follow, promote economic sustainability, and advance social well-being and societal development.

170. *See* discussion *supra* pp. 136–39; Press Release, Virginia Foxx & Rick Allen, House of Representatives, Comm. on Educ. & Lab., Foxx, Allen: Biden Administration's ESG Rule Will Hurt Americans' Retirement Accounts (Oct. 13, 2021), https://republicans-edlabor.house.gov/news/documentsingle.aspx?DocumentID=407775 ("The financial interests of workers and retirees should never take a backseat to the whims of the green lobby and Big Labor . . . . It is incumbent on the Department of Labor to ensure retirement savers are protected and that plan fiduciaries are not allowed to sacrifice retirement certainty in the name of non-financial goals.").

171. *See* Mark Schoeff Jr., *ESG Proponents Push for Legislation Addressing Retirement Investing*, InvestmentNews (Oct. 14, 2021), https://www.investmentnews.com/esg-proponents-push-for-legislation-addressing-retirement-investing-212803; Michaels & Scruggs, *supra* note 144.

172. Michaels & Scruggs, *supra* note 144.

173. *Id.*

174. *See id.* (emphasis omitted); *see also* Greg Iacurci, *Money Invested in ESG Funds More Than Doubles in a Year*, CNBC, https://www.cnbc.com/2021/02/11/sustainable-investment-funds-more-than-doubled-in-2020-.html (Feb. 11, 2021, 1:15 PM) [hereinafter *Money Invested in ESG Funds More Than Doubles*] (stating the millennial generation "have been animated by systemic issues like climate change and wealth inequality," "have more assets to invest[,] and are moving up into decision-making roles at institutions that make investments").

III. THE PROPOSED RULE: PRUDENCE AND LOYALTY IN SELECTING PLAN INVESTMENTS AND EXERCISING SHAREHOLDER RIGHTS

The Department of Labor has proposed a new rule, titled, "Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights," to resolve the uncertainty created by the Trump Administration's "Financial Factors in Selecting Plan Investments" rule.[175] The Department of Labor was concerned that fiduciaries may be deterred from making the same considerations as non-retirement plan investors to enhance investment performance and improve "resilience against the potential financial risks and impacts often associated with climate change and other ESG factors."[176] "[T]he proposal makes clear that climate change and other ESG factors are often material and that in many instances fiduciaries to [sic] should consider climate change and other ESG factors in the assessment of investment risks and returns."[177] The proposed rule will amend the current regulation 29 C.F.R. § 2550.404a-1 regarding fiduciaries' investment duties of prudence and loyalty.[178]

Under a fiduciary's duty of prudence, the Department of Labor will make two changes to section (b) of the regulation.[179] First, the Department of Labor will amend section (b)(2)(ii), which lists factors for fiduciaries to consider as they relate to portions of the portfolio including "[t]he projected return of the portfolio relative to the funding objectives of the plan."[180] The proposal will amend the provision to state, "[t]he projected

175. *See* Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights, 86 Fed. Reg. 57272, 57275 (proposed Oct. 14, 2021) (to be codified at 29 C.F.R. § 2550.404a-1); Financial Factors in Selecting Plan Investments, 85 Fed. Reg. 72846, 72846 (Nov. 13, 2020) (to be codified at 29 C.F.R. pt. 2509, § 2550.404a-1).

176. *See* Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights, 86 Fed. Reg. at 57275.

177. *Id.* at 57276.

178. *Id.* at 57276–80.

179. *Id.* at 57276–77.

180. *Id.* at 57276; 29 C.F.R. § 2550.404a-1(b)(2)(ii)(C).

return of the portfolio relative to the funding objectives of the plan, *which may often require an evaluation of the economic effects of climate change and other environmental, social, or governance factors on the particular investment or investment course of action*."[181] This amendment reflects the importance of evaluating economic effects on investments which was illustrated in Interpretive Bulletin 2015-01 and 2018-01.[182]

Second, the proposal will add a new section, section (b)(4), which states:

> A prudent fiduciary may consider *any* factor in the evaluation of an investment or investment course of action that, depending on the facts and circumstances, is material to the risk-return analysis, which might include, for example:
>
> (i) Climate change-related factors, such as a corporation's exposure to the real and potential economic effects of climate change including exposure to the physical and transitional risks of climate change and the positive or negative effect of Government regulations and policies to mitigate climate change;
>
> (ii) Governance factors, such as those involving board composition, executive compensation, and transparency and accountability in corporate decision-making, as well as a corporation's avoidance of criminal liability and compliance with labor, employment, environmental, tax, and other applicable laws and regulations; and

181. Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights, 86 Fed. Reg. at 57302 (emphasis added).

182. *See id.* at 57276 (first citing Interpretive Bulletin Relating to the Fiduciary Standard Under ERISA in Considering Economically Targeted Investments, 80 Fed. Reg. 65135, 65136 (Oct. 26, 2015) (to be codified at 29 C.F.R. pt. 2509); and then citing Memorandum from John J. Canary to Mabel Capolongo, *supra* note 109).

> (iii) Workforce practices, including the corporation's progress on workforce diversity, inclusion, and other drivers of employee hiring, promotion, and retention; its investment in training to develop its workforce's skill; equal employment opportunity; and labor relations.[183]

This list is not exclusive and clarifies that fiduciaries may consider ESG factors when evaluating the economic effects and risk-return rates of investments.[184]

Regarding a fiduciary's duty of loyalty, the proposed rule will rewrite section (c), currently titled, "Investments Based on Pecuniary Factors."[185] The existing regulation requires fiduciaries' investments to be "based only on pecuniary factors," unless "choosing between or among investment alternatives that the plan fiduciary is unable to distinguish on the basis of pecuniary factors alone."[186] The proposed rule will rename section (c) to "Investment Loyalty Duties" and remove the distinction between pecuniary and non-pecuniary factors,[187] implicitly recognizing that ESG factors may be appropriate pecuniary factors in certain circumstances.[188] The first subsection of the proposal states, "[a] fiduciary may not subordinate the interests of the participants and beneficiaries in their retirement income or financial benefits under the plan to other objectives, and may not sacrifice investment return or take on additional investment risk to promote benefits or goals unrelated to interests of the participants," which is similar to

183. *Id.* at 57302–03 (emphasis added).

184. *Id.* at 57277.

185. 29 C.F.R. § 2550.404a-1(c); *see* Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights, 86 Fed. Reg. at 57303–05.

186. 29 C.F.R. § 2550.404a-1(c).

187. Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights, 86 Fed. Reg. at 57277–78, 57302–03; 29 C.F.R. § 2550.404a-1(c).

188. *See* Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights, 86 Fed. Reg. at 57278.

what is currently stated in 29 C.F.R. § 2550.404a-1(c)(1).[189] The second section requires "[a] fiduciary's evaluation of an investment or investment course of action [to] be based on risk and return factors that the fiduciary prudently determines are material to investment value," which is similar to what is also stated in 29 C.F.R. § 2550.404a-1(c)(1).[190] However, the proposed rule elaborates on the type of assessments that constitute a prudent evaluation and adds that such risk-return evaluation will vary on a case-by-case basis and include the ESG factors stated in section (b)(4).[191] It notes that "[t]he weight given to any factor by a fiduciary should appropriately reflect a prudent assessment of its impact on risk-return."[192] The third section addresses the "tie-breaker" standard, allowing fiduciaries to choose investments with collateral benefits that have equivalent risk-return rates to competing investments.[193] In addition, the "fiduciary may not . . . accept expected reduced returns or greater risks to secure such additional benefits."[194] This section removes the additional documentation requirement regarding pecuniary and non-pecuniary factors in the current regulation, but fiduciaries will still be subject to ERISA's reporting and disclosure requirements.[195]

The Department urges the proposal because there is a "positive relationship between the financial performance of investments that address or account for climate change."[196] For

189. *Id.* at 57303; *see* 29 C.F.R. § 2550.404a-1(c)(1) ("A fiduciary may not subordinate the interests of the participants and beneficiaries in their retirement income or financial benefits under the plan to other objectives, and may not sacrifice investment return or take on additional investment risk to promote non-pecuniary benefits or goals.").

190. Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights, 86 Fed. Reg. at 57303; *see* 29 C.F.R. § 2550.404a-1(c)(1) ("[A] fiduciary's evaluation of an investment or investment course of action must be based only on pecuniary factors . . . .").

191. *See* Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights, 86 Fed. Reg. at 57277–78.

192. *Id.* at 57303.

193. *Id.* at 57278, 57303.

194. *Id.* at 57303.

195. *Id.* at 57279, 57303; *see* 29 U.S.C. § 1021.

196. Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights, 86 Fed. Reg. at 57277 (citation omitted).

example, climate change can cause severe weather damage to businesses, disrupting productivity, supply chains, and business operations.[197] The long-term investment horizon of retirement plans matches the long-term objectives of environmental sustainability.[198] The implementation of new government policies to combat climate change that divert investors from high-carbon emission investments can have a positive impact on retirement plan assets, but only if fiduciaries are able to assess the financial risks of such investments and trade securities to "reduc[e] volatility and mitigat[e] the longer-term economic risks to plans' assets."[199] In addition, while not all ESG funds are equal and not all ESG factors are material to the risk-return analysis, ESG funds may still be selected under the tie-breaker standard in order to consider participants' investment interests, which may increase retirement plan savings, as long as investments are "selected in accordance with ERISA's duties of prudence and loyalty."[200]

Even if the rule is finalized, fiduciaries may be reluctant to include ESG funds in their retirement plans.[201] While the rule has a greater force of law than prior interpretive bulletins,[202] a change in administration after President Biden has completed his term could result in a new rule that would replace the Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights rule, reversing its promotion of ESG funds as retirement plan investment options.[203] Fiduciaries may not see the value in selecting ESG funds even if the rule is

197. *Id.* at 57276.

198. *See id.* at 57276–77.

199. *See id.* at 57277.

200. *See id.* at 57279.

201. William Pollak, *Despite DOL Proposed Rule, ESG Investing Faces Barriers*, LAW360 (Dec. 14, 2021, 1:05 PM), https://www.law360.com/articles/1447811/despite-dol-proposed-rule-esg-investing-faces-barriers.

202. *See supra* pp. 138–41.

203. *See* Pollak, *supra* note 201 ("[S]ome fiduciaries may be reluctant to make a significant change to their plan's investment lineup or QDIA given the DOL's flip-flop over the last year and the uncertainty surrounding the permanence of the current rules if a new administration is elected in 2024.").

finalized because of the potential change in guidance in the future that could expose fiduciaries to liability.[204] Nevertheless, the Department of Labor should finalize its proposed rule because it is a step toward providing a standard for retirement plans to access ESG funds and allow fiduciaries relying on the rule to provide ESG funds in their retirement plans. In addition, the rule would be solidified by the enactment of the Financial Factors in Selecting Retirement Plan Investments Act and would provide the appropriate framework for evaluating ESG funds alongside the Act.

IV. ESG FUND STRATEGIES AND PERFORMANCE

Opponents of ESG funds as retirement investments argue that ESG funds provide lower returns or do not consistently outperform the market, and therefore, breach the duty of prudence.[205] However, studies show that ESG funds perform well and even outperform their benchmarks or non-ESG fund counterparts.[206] A study by Jon Hale, head of sustainability research for the Americas at Sustainalytics, a Morningstar company,[207] showed that in 2020, "three out of four sustainable equity funds beat their Morningstar Category average,[208] and

204. *See id.*

205. *See* Sharfman, *supra* note 68, at 113, 121–24; *see, e.g.*, Zelinsky, *supra* note 113, at 8–9.

206. *See, e.g.*, Jon Hale, *Sustainable Equity Funds Outperform Traditional Peers in 2020*, MORNINGSTAR (Jan. 8, 2021), https://www.morningstar.com/articles/1017056/sustainable-equity-funds-outperform-traditional-peers-in-2020 [hereinafter *Sustainable Equity Funds Outperform Traditional Peers in 2020*]; TENSIE WHELAN, ULRICH ATZ, TRACY VAN HOLT & CASEY CLARK, N.Y.U. STERN CTR. FOR SUSTAINABLE BUS., ESG AND FINANCIAL PERFORMANCE: UNCOVERING THE RELATIONSHIP BY AGGREGATING EVIDENCE FROM 1,000 PLUS STUDIES PUBLISHED BETWEEN 2015 – 2020, at 5, 8–9 (2021).

207. *Jon Hale*, MORNINGSTAR, https://www.morningstar.com/authors/1855/jon-hale (last visited Nov. 4, 2022); *see Who We Are*, MORNINGSTAR: SUSTAINALYTICS, https://www.sustainalytics.com/about-us (last visited Nov. 4, 2022).

208. The term "Morningstar Category" is explained as follows:

> The Morningstar Category™ classification system for funds lets institutions, advisers and investors effectively compare like funds . . . [by] group[ing] funds which can be reasonably considered to be close investment alternatives, and for which performance and other statistical measures, such as fees, [benchmarks, asset classes,

twenty-five of twenty-six ESG equity index funds . . . beat index funds tracking the most common traditional benchmarks in their categories."[209] The study concluded that "[l]ike any investment approach, sustainable investing will not always outperform over short-term periods. But over the longer term, ESG insights can help investors develop a more complete picture of a company, one not reliant only on financial indicators."[210]

Over time, ESG funds have consistently performed well.[211] A study by the NYU Stern Center for Sustainable Business examined one thousand ESG research reports between 2015 and 2020.[212] The study had six key takeaways: (1) ESG factors have positive financial effects on funds in the long-term; (2) ESG integration funds perform better than negative screening funds; (3) ESG funds outperform their conventional counterparts during social and economic crises; (4) sustainability initiatives at corporations drive financial performance, such as "more innovation, higher operational efficiency, [and] better risk management"; (5) companies focused on decarbonization have better financial performance; and (6) ESG disclosure alone does not improve financial performance.[213] These studies show that ESG funds' strong performance history and positive financial

exposure to various sectors, investment styles, and market capitalization,] are comparable.

MORNINGSTAR AUSTRALASIA PTY LTD, MORNINGSTAR CATEGORY DEFINITIONS 3 (2021), https://www.morningstar.com/content/dam/marketing/apac/au/pdfs/Legal/category-definitions-2020.pdf.

209. *Sustainable Equity Funds Outperform Traditional Peers in 2020*, *supra* note 206. The study found that "[f]or 2020 overall, 11 of 12 [U.S. Large Cap] sustainable funds beat the S&P 500 index fund, ... [and] all 11 [Developed Markets-Ex U.S.] sustainable funds beat the MSCI EAFE fund." *See id.* "Two of the three sustainable emerging-markets index funds outperformed iShares Core MSCI Emerging Markets ETF (IEMG) for the [first] quarter . . . . [with] late-year gains of cyclical value and traditional energy stocks hinder[ing] sustainable funds' relative performance in the fourth quarter." *See id.*

210. *Id.*

211. *See* WHELAN ET AL., *supra* note 206, at 2.

212. *Id.*

213. *Id.* at 7–9.

effects make them eligible to comply with ERISA's duty of prudence and financial benefits requirement.[214]

However, the use of different ESG strategies raises concerns regarding compliance with ERISA's duty of loyalty and prudence.[215] There are no universal definitions or practices for ESG strategies.[216] As a result, different companies may use similar terms that have different meanings and may prefer a particular ESG strategy over another.[217] For example, investment management companies, such as Vanguard,[218] Fidelity,[219] and BlackRock,[220] believe that ESG funds are important components of a portfolio,[221] but apply different ESG strategies.[222] Vanguard primarily uses the exclusionary

214. *See* Schanzenbach & Sitkoff, *supra* note 1, at 426–27; *infra* notes 258–60 and accompanying text. *Contra* Zelinsky, *supra* note 113, at 5–9; Sharfman, *supra* note 68, at 127–29.

215. *See* Sharfman, *supra* note 68, at 127–29 (stating funds using a collateral benefits strategy will not comply with the duty of loyalty); Schanzenbach & Sitkoff, *supra* note 1, at 428 (stating certain "active investment strategies," including ESG strategies, "usually 'entail investigation and analysis expenses [that] tend to increase general transaction costs,' and a stock-picking strategy [that] tends to reduce diversification" which must be offset by unexpected returns to comply with the duty of prudence).

216. *See, e.g.*, RAKHI KUMAR, NATASHA DAYARAMANI, & JAMES D. ROCHA, STATE ST. GLOB. ADVISORS, UNDERSTANDING & COMPARING ESG TERMINOLOGY 2 (2018), https://www.ssga.com/investment-topics/environmental-social-governance/2018/10/esg-terminology.pdf ("[T]he terms used to describe the various ESG strategies are not universally defined and can mean different things to different investors."); RICCARDO BOFFO & ROBERT PATALANO, ORGANISATION FOR ECON. CO-OPERATION & DEV., ESG INVESTING: PRACTICES, PROGRESS AND CHALLENGES 12 (2020), https://www.oecd.org/finance/ESG-Investing-Practices-Progress-Challenges.pdf ("ESG terms and practices have not been clearly defined, and meanings differ across stakeholders, particularly across borders.").

217. *See* KUMAR ET AL., *supra* note 216, at 2 (finding a "variation in the nomenclature" of ESG strategies but a general market consensus "for five dominant and distinct ESG strategies"); BOFFO & PATALANO, *supra* note 216, at 32 ("ESG investment approaches tend to conform to at least six distinct forms, depending on the comprehensiveness through which the asset manager seeks to utilise the ESG framework."); *see infra* notes 218–33 (discussing the different ESG strategies primarily used by Vanguard, Fidelity, and BlackRock).

218. *Our Product Design Principles and ESG*, *supra* note 88.

219. CONNOLLY ET AL., *supra* note 89, at 1–2.

220. *See Investment Funds*, BLACKROCK, https://www.blackrock.com/us/individual/products/investment-funds (last visited Nov. 4, 2022).

221. *See supra* p. 134–35.

222. *See infra* text accompanying notes 223–33.

method,[223] also known as "screened investing."[224] The exclusionary method screens out or omits companies that do not align with ESG values.[225] Fidelity applies an "ESG integration" (also referred to as "broad sustainability") and "thematic investing approach."[226] "ESG [i]ntegration" funds "[i]ntegrat[e] ESG factors into investment due diligence and analysis to identify a company's risks and opportunities" to "[e]nhance returns and mitigate risks."[227] "Thematic investing" funds invest in companies that focus on a specific ESG goal and overall "long-term transformative industry or societal trends,"[228] "rather than specific companies or sectors,"[229] "such as low carbon/renewable energy (E) or diversity (S)."[230] BlackRock primarily applies a broad ESG approach,[231] which "do[es] not choose between E, S, or G, but rather target[s] outcomes across all three" and "may include a targeted quantifiable ESG outcome."[232] These different types of ESG strategies cause some to question whether particular ESG fund strategies follow a prudent investment analysis and the duty of loyalty under ERISA.[233]

223. *See Our Product Design Principles and ESG*, *supra* note 88; *Investment Products: ESG Investing*, VANGUARD, https://investor.vanguard.com/investment-products/esg (last visited Nov. 4, 2022) (listing four ESG exclusionary index products and one active inclusionary product).

224. Hawley, *supra* note 84 ("[P]ortfolio managers would screen out companies or sectors based on a client's personal values (think tobacco, weapon manufacturers, etc.). . . . This practice, [is] known as 'screened investing,' . . . .").

225. *Our Product Design Principles and ESG*, *supra* note 88.

226. *See* FIDELITY, SUSTAINABLE INVESTING (2022), https://institutional.fidelity.com/app/literature/view?itemCode=9905277&renditionType=pdf&pos=na.

227. *Id.*

228. *Sustainable Investing*, BLACKROCK, https://www.blackrock.com/institutions/en-us/solutions/sustainable-investing#solutions (last visited Nov. 4, 2022).

229. *Thematic Investing with BlackRock and iShares*, BLACKROCK, https://www.blackrock.com/lu/individual/themes/thematic-investing/why-invest-thematically (last visited Nov. 4, 2022).

230. *Sustainable Investing*, *supra* note 228.

231. *See id.*; *Investment Funds*, *supra* note 220.

232. *Sustainable Investing*, *supra* note 228.

233. *See* Schanzenbach & Sitkoff, *supra* note 1, at 405, 426, 448–49 (stating a fund using "a risk-return ESG investing strategy" may comply with the duty of prudence while a fund using a collateral benefits strategy will not comply with the duty of loyalty); Sharfman, *supra* note 68, at 127–29 (stating funds using a collateral benefits strategy will not comply with the duty of loyalty); *see also SEC Investor Bulletin*, *supra* note 65.

Nevertheless, these various ESG strategies should not deter fiduciaries from selecting ESG funds if they perform well. While some studies show that ESG exclusionary funds do not perform as well as other ESG strategies,[234] there are still exclusionary funds with high performance. A study by Vanguard's Investment Strategy Group found 44% of non-exclusionary and 27% of exclusionary funds had high rates of return and high volatility, but only 14% of non-exclusionary and 18% of exclusionary funds had high rates of return and low volatility.[235] While more non-exclusionary funds had high rates of return and high volatility, more exclusionary funds had high rates of return and low volatility.[236] In total, 45% of exclusionary funds still maintained high rates of return.[237] Thus, while non-exclusionary products may perform better as a whole, there are still exclusionary funds that have high rates of return.

As an example, consider the Vanguard FTSE Social Index Fund (VFTNX), Fidelity U.S. Sustainability Index (FITLX), and BlackRock Sustainable Advantage Large Cap Fund (BIRIX), which are all U.S. equity large cap ESG funds.[238] VFTNX uses the exclusionary screening approach,[239] FITLX uses the ESG

234. Whelan et al., *supra* note 206, at 8.

235. Jan-Carl Plagge & Douglas M. Grim, *Have Investors Paid a Performance Price? Examining the Behavior of ESG Equity Funds*, J. Portfolio Mgmt.: Ethical Investing, Feb. 2020, at 1, 7, https://eprints.pm-research.com/17511/25030/index.html?74183.

236. *Id.* at 6–7.

237. *Id.* at 7.

238. *ESG Screener: What's the Morningstar Sustainability Rating?*, Morningstar, https://www.morningstar.com/esg-screener (last visited Nov. 4, 2022) (filtering for VFTNX, FITLX, and BIRIX); *FTSE Social Index Fund Institutional Shares*, Vanguard, https://institutional.vanguard.com/investments/product-details/fund/0223 [https://web.archive.org/web/20221013001348/https://institutional.vanguard.com/investments/product-details/fund/0223] (Dec. 31, 2021) [hereinafter *FTSE*]; *Fidelity U.S. Sustainability Index Fund*, Fidelity, https://fundresearch.fidelity.com/mutual-funds/summary/31635V398 (last visited Jan. 30, 2022) (archived page on file with author); *BlackRock Sustainable Advantage Large Cap Core Fund*, BlackRock, https://www.blackrock.com/us/individual/products/279569/blackrock-advantage-esg-us-equity-class-institutional-fund [https://web.archive.org/web/20220131000925/https://www.blackrock.com/us/individual/products/279569/blackrock-advantage-esg-us-equity-class-institutional-fund] (Dec. 31, 2021).

239. *See FTSE*, *supra* note 238.

integration approach,[240] and BIRIX uses the broad ESG approach.[241] All three funds have Morningstar Ratings ("star ratings")[242] and Morningstar Sustainability Ratings[243] of four or five.[244] These funds invest primarily in the technology industry with their top ten holdings at the end of 2021 including Microsoft, Tesla, Alphabet Inc. (parent company of Google),[245] Nvidia, and Home Depot.[246] While all three funds use different ESG approaches,[247] they have all performed well, either closely matching or beating their benchmarks.[248] When compared to

240. *See* FIDELITY, *supra* note 226. Fidelity categorizes broad sustainability as an example or subcategory of ESG integration and FITLX falls under the broad sustainability subcategory. *See id.*

241. *Investment Funds*, *supra* note 220 (filtering for Broad ESG funds).

242. Morningstar Ratings ("star ratings") are "a measure of risk-adjusted return relative to Morningstar Category and requires at least a three-year record." SUSTAINABLE FUNDS U.S. LANDSCAPE REPORT, *supra* note 118, at 20. The star rating is on a scale from one star to five stars, with five being the best performance and one being the worst performance. *What Is the Star Rating?*, MORNINGSTAR, https://news.morningstar.com/classroom2/course.asp?docId=2943&page=2&CN (last visited Nov. 4, 2022).

243. The Morningstar Sustainability Rating provides an ESG score on a scale from one to five (one being high ESG risk and five being low ESG risk). The rating is based on companies' economic value driven by ESG factors and sovereign entities' socioeconomic management. *See* CLARK BARR, DAYNA DOMAN & VIOLET REDENSEK, MORNINGSTAR: SUSTAINALYTICS, MORNINGSTAR SUSTAINABILITY RATING METHODOLOGY 1–2 (2021), https://www.morningstar.com/content/dam/marketing/shared/research/methodology/744156_Morningstar_Sustainability_Rating_for_Funds_Methodology.pdf.

244. VFTNX has a Morningstar Sustainability Rating of 4 and FITLX and BIRIX have a rating of 5. *See ESG Screener*, *supra* note 238 (filtering for VFTNX, FITLX, and BIRIX). VFTNX, FITLX, and BIRIX have a Morningstar Rating of 4. *See id.*

245. Avery Hartmans & Mary Meisenzahl, *All the Companies and Divisions Under Google's Parent Company, Alphabet, Which Just Made Yet Another Shake-up to Its Structure*, INSIDER, https://www.businessinsider.com/alphabet-google-company-list-2017-4 (Feb. 12, 2020, 10:58 AM).

246. *See FTSE*, *supra* note 238; *Fidelity U.S. Sustainability Index Fund*, *supra* note 238; *BlackRock Sustainable Advantage Large Cap Core Fund*, *supra* note 238.

247. *See supra* notes 239–41 and accompanying text.

248. VFTNX was issued in 2003 and its average annual returns were 27.77% one year after its inception (only 0.12% below its benchmark, the FTSE4Good US Select Index), 28.05% three years after inception (again only 0.12% below its benchmark), 20.29% five years after inception (0.12% below its benchmark), 18.18% ten years after inception (0.13% below its benchmark), and its total return since inception is 10.94% (0.10% below its benchmark). *See FTSE*, *supra* note 238 (providing total returns as of December 31, 2021). FITLX was issued in 2017 and its average annual returns were 31.57% one year after its inception (0.16% below its benchmark, MSCI USA ESG Leaders), 27.11% three years after inception (0.16% below its benchmark). *See Fidelity U.S.*

each other, Vanguard's exclusionary fund has performed similar to Fidelity and BlackRock's non-exclusionary ESG products.[249]

Name	Ticker	Last Close Price	Morningstar Sustainability Rating™	Yield (%)	Morningstar Rating™	Morningstar Category	Low Carbon Designation™
Vanguard FTSE Social Index I	VFTNX	27.65	🌐🌐🌐🌐	1.17	★★★★	US Equity Large Cap Blend	?
Fidelity® U.S. Sustainability Index	FITLX	18.23	🌐🌐🌐🌐🌐	0.95	★★★★	US Equity Large Cap Blend	?
BlackRock Sustainable Adg Lg Cp Cr Instl	BIRIX	17.66	🌐🌐🌐🌐🌐	0.61	★★★★	US Equity Large Cap Blend	?

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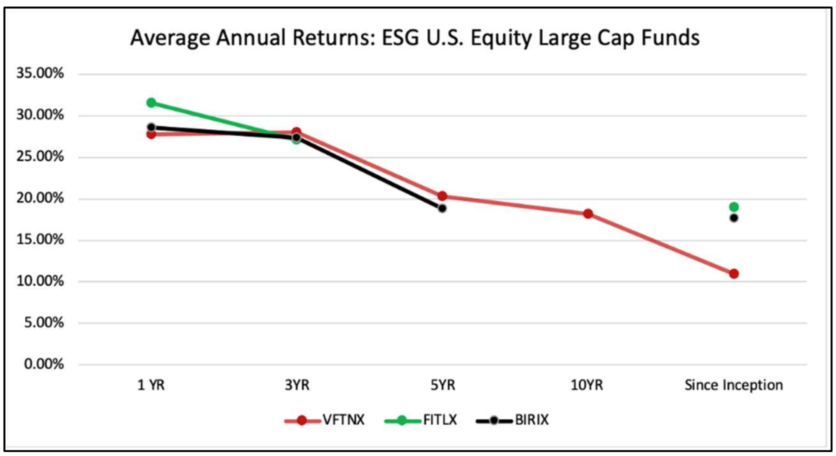

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Sustainability Index Fund, *supra* note 238 (providing total returns as of December 31, 2021). BIRIX was issued in 2015 and its average annual returns are 28.58% one year after its inception (2.13% above its benchmark, the Russell 1000 Index), 27.34% three years after inception (1.13% above its benchmark), 18.86% five years after inception (0.43% above its benchmark), and its total return since inception is 17.66% (0.5% above its benchmark). *See BlackRock Sustainable Advantage Large Cap Core Fund*, *supra* note 238 (providing total returns as of December 31, 2021).

249. *See infra* note 250 and accompanying chart.

250. *ESG Screener*, *supra* note 238 (filtering for VFTNX, FITLX, and BIRIX).

251. *See FTSE*, *supra* note 238 (providing total returns as of December 31, 2021); *Fidelity U.S. Sustainability Index Fund*, *supra* note 238 (providing total returns as of December 31, 2021); *BlackRock Sustainable Advantage Large Cap Core Fund*, *supra* note 238 (providing total returns as of December 31, 2021); *see also supra* note 248. The data displayed in this chart may differ from the funds' current performance and does not guarantee future results. *See FTSE*, *supra* note 238; *Fidelity U.S. Sustainability Index Fund*, *supra* note 238; *BlackRock Sustainable Advantage Large Cap Core Fund*, *supra* note 238.

In sum, there is no "correct" ESG strategy. Studies show that ESG funds as a whole have a strong performance history by closely matching or outperforming their benchmarks or fund counterparts.[252] While non-exclusionary funds outperform exclusionary funds as a whole, there are still exclusionary funds that have high return rates.[253] The Vanguard, Fidelity, and BlackRock funds discussed above use different ESG approaches,[254] have similar fund performance,[255] and invest in "big winner" companies.[256] As a result, ESG funds' strong performance history and ESG factors' positive financial effects provide robust support that ESG funds can comply with ERISA's duties of loyalty and prudence, regardless of the type of ESG strategy employed.

V. COURT OPINIONS ON ERISA FIDUCIARY DUTIES

Congress intended for a body of common law to develop over time establishing rights and obligations concerning employee benefit plans.[257] A violation of any of the four fiduciary requirements under section 404(a) would be a breach of an employer's fiduciary duty.[258] First, the duty of loyalty requires a fiduciary to act in the sole interest of plan participants and "for the exclusive purpose of . . . providing *benefits* to participants."[259] Benefits in this context means *financial* benefits.[260] Second, the prudent man standard of care requires a

252. *See, e.g.*, *Sustainable Equity Funds Outperform Traditional Peers in 2020*, *supra* note 206; WHELAN ET AL., *supra* note 206, at 8.

253. *See* Plagge & Grim, *supra* note 235, at 7, 15; *Sustainable Equity Funds Outperform Traditional Peers in 2020*, *supra* note 206.

254. *See supra* notes 223–32, 239–41 and accompanying text.

255. *See supra* note 251 and accompanying chart.

256. *See supra* pp. 132–35; *supra* note 246 and accompanying text.

257. 120 CONG. REC. 29942 (1974) (remarks of Sen. Javits), *reprinted in* III SUBCOMM. ON LAB. OF THE COMM. ON LAB. & PUB. WELFARE, 94TH CONG. 2D SESS., LEGISLATIVE HISTORY OF THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974, at 4771 (1976) ("It is also intended that a body of Federal substantive law will be developed by the courts to deal with issues involving rights and obligations under private welfare and pension plans.").

258. *See* Employee Retirement Income Security Act of 1974 (ERISA) § 404, 29 U.S.C. § 1104.

259. *Id.* § 404(a)(1)(A)(i) (emphasis added).

260. Fifth Third Bancorp v. Dudenhoeffer, 573 U.S. 409, 420–21 (2014).

fiduciary to act "with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims."[261] When choosing investments, a fiduciary must consider whether

> the particular investment or investment course of action is reasonably designed, as part of the portfolio . . . to further the purposes of the plan, taking into consideration the risk of loss and the opportunity for gain (or other return) associated with the investment or investment course of action compared to the opportunity for gain (or other return) associated with reasonably available alternatives with similar risks . . . .[262]

A fiduciary's duty of prudence under ERISA applies to "making investments" and to "monitoring and reviewing investments, which is to be done in a manner that is reasonable and appropriate to the particular investments."[263] "[T]he courts measure section [404(a)(1)(B)'s] 'prudence' requirement according to an objective standard, focusing on a fiduciary's conduct in arriving at an investment decision, not on its results, and asking whether a fiduciary employed the appropriate methods to investigate and determine the merits of a particular investment."[264] Third, the duty of prudence includes the duty to diversify.[265] The duty to diversify requires a fiduciary to "diversify[] the investments [in a] plan . . . to minimize the risk of large losses."[266] Diversification means a fiduciary should not

261. ERISA § 404(a)(1)(B).

262. 29 C.F.R. § 2550.404a-1(b)(2)(i) (2021).

263. Tibble v. Edison Int'l, 575 U.S. 523, 529 (2015) (citing RESTATEMENT (THIRD) OF TRUSTS § 90 cmt. b at 295 (AM. L. INST. 2007)) (applying trust law fiduciary requirements to ERISA fiduciaries).

264. Meinhardt v. Unisys Corp., 74 F.3d 420, 434 (3d Cir. 1996).

265. Stegemann v. Gannett Co., 970 F.3d 465, 473 (4th Cir. 2020); Armstrong v. LaSalle Bank Nat'l Ass'n, 446 F.3d 728, 732 (7th Cir. 2006).

266. ERISA § 404(a)(1)(C).

"invest all or an unduly large portion of plan funds in a single security, or in any one type of security, or even in various types of securities that depend on the success of one enterprise."[267] Fourth, a fiduciary must act "in accordance with [plan] documents" that are consistent with ERISA's requirements.[268]

Even if a fiduciary violates section 404(a), it may nonetheless be shielded from liability under 404(c).[269] Section 404(c) protects a fiduciary from liability when (1) an individual account "*permits* a participant or beneficiary to exercise control over the assets in [the] account;" (2) the participant *actually* exercised control over the account; and (3) the participant's exercise of control *caused* the loss.[270] A participant has exercised control over an account when the participant can:

> (1) choose from a broad range of investment alternatives . . . each of which has materially different risk and return characteristics;
>
> (2) give investment instructions with a frequency appropriate in light of the volatility of the investment alternatives . . . ;
>
> (3) diversify investments within the investment alternatives; and
>
> (4) obtain sufficient information to make informed investment decisions with respect to investment alternatives available under the plan.[271]

Therefore, in instances when a participant exercises control over an account and the loss or breach occurred because of the

267. Bruner v. Boatmen's Trust Co., 918 F. Supp. 1347, 1353 (E.D. Mo. 1996) (citing ERISA § 404(c)).

268. ERISA § 404(a)(1)(D).

269. DiFelice v. U.S. Airways, Inc., 397 F. Supp. 2d. 758, 775 (E.D. Va. 2005); ERISA § 404(c)(1).

270. *DiFelice*, 397 F. Supp. 2d at 775–76; ERISA § 404(c)(1) (emphasis added).

271. *DiFelice*, 397 F. Supp. 2d at 775 (citing 29 C.F.R. § 2550.404c-1).

participant's control, a fiduciary may not be liable for the loss or breach of fiduciary duty.[272]

A. *ERISA Section 404(a)*

The Supreme Court case, *Fifth Third Bancorp v. Dudenhoeffer*, demonstrated an instance when ERISA may be flexible to certain types of investments regarding its diversification provision while maintaining its strict fiduciary requirements.[273] Fifth Third Bancorp maintained a defined contribution retirement plan for its employees.[274] Employees were able to invest their contributions in any of the twenty funds provided by the plan, which comprised of mutual funds and an Employee Stock Ownership Plan (ESOP).[275] Fifth Third Bancorp's matching contributions were invested in the ESOP and employees could then reallocate the proceeds as they chose.[276] While ESOPs lack diversification by investing in a single company, the Supreme Court held that "the same standard of prudence applies to all ERISA fiduciaries, including ESOP fiduciaries, except that an ESOP fiduciary is under no duty to diversify the ESOP's holdings."[277] The Court recognized Congress' intent to create a diversification exception for ESOPs because Congress "made clear its interest in encouraging [ESOPs] as a bold and innovative method of strengthening the free private enterprise system which will solve the dual problems of securing capital funds for necessary capital growth and of bringing about stock ownership by all corporate employees."[278] *Fifth Third Bancorp* is an example of Congress' and the Court's willingness to allow participants to invest in certain types of securities that do not meet all requirements

272. ERISA § 404(c)(1).

273. *See* Fifth Third Bancorp v. Dudenhoeffer, 573 U.S. 409, 418–19 (2014).

274. *Id.* at 412.

275. *See id.* "[A]n 'employee stock ownership plan' (ESOP), [is] a type of pension plan that invests primarily in the stock of the company that employs the plan participants." *Id.*

276. *Id.*

277. *Id.* at 418–19 (alteration in original).

278. *Id.* at 416, 422 (alteration in original).

under section 404(a) of ERISA but have an important impact on economic growth and development leading to justifications for creating exceptions for specific securities.[279]

While the duty of loyalty requires fiduciaries to make decisions "with an eye single to the interests of the participants and beneficiaries," there are instances when collateral benefits may be acceptable.[280] In *Donovan v. Bierwirth*, Grumman Corporation's Chairman of the Board and two officers, who were also the company's pension plan trustees,[281] refused to accept a tender offer[282] of the company's stock when 525,000 company shares were owned by Grumman's pension plan.[283] The Second Circuit held that trustees of a pension plan do not violate ERISA fiduciary duties, even if there are "incidental[] benefits" to a third party, in this case the corporation, if "after careful and impartial investigation," their decision is made in the best interest of plan participants.[284] However, the court found that the plan trustees did not act solely in the interest of plan participants because they did not "take every feasible precaution to . . . carefully consider[] the other side" and their "resignation [as plan trustees] was the only proper course" of action.[285] As a result, collateral benefits can be feasible if, after careful consideration and thorough evaluation of an investment decision, the fiduciary determines the course of action is in the best interest of plan participants.[286]

279. *See id.*

280. *See, e.g.*, Donovan v. Bierwirth, 680 F.2d 263, 271 (2d Cir. 1982).

281. *Id.* at 264–68.

282. A tender offer is an offer to pay a price, usually higher than the market price (i.e., a premium), in exchange for purchasing a large portion of company shares to gain significant ownership, and therefore, control of the company. *Tender Offer*, CORP. FIN. INST., https://corporatefinanceinstitute.com/resources/knowledge/deals/tender-offer/ (Oct. 22, 2019).

283. *Donovan*, 680 F.2d at 264. A conflict of interest arises regarding directors' loyalty to the company in their capacity as directors and the directors' loyalty to the pension plan in their capacity as plan trustees. *See id.* at 271.

284. *Id.* at 271.

285. *Id.* at 276.

286. *See id.*

An investment's underperformance does not always lead to a breach of fiduciary duty.[287] In *Divane v. Northwestern University*, participants argued that Northwestern breached its fiduciary duty by providing investments that underperformed and offered too many investment options.[288] First, plaintiffs alleged that Northwestern imprudently chose the TIAA CREF Traditional Annuity, a fixed annuity, as an investment option because TIAA then required Northwestern to offer its CREF Stock Account, a variable annuity,[289] as an investment option as well.[290] The Seventh Circuit held that Northwestern did not breach its fiduciary duty by providing investments that underperformed because participants were not required to invest in the product and could choose from many other investments offered by the plan.[291] The court explained that Northwestern had valid reasons for choosing the traditional annuity as an investment option because participants who already invested in traditional annuities were allowed to retain the annuity without being subject to a withdrawal fee.[292] 403(b) accounts were originally only allowed to hold traditional annuities, and if Northwestern did not provide the TIAA CREF Traditional Annuity as an investment option, participants invested in traditional annuities would have been forced to withdraw from their annuity and incur a 2.5% withdrawal penalty.[293] In addition, the traditional annuity offered a "contractually-specified minimum rate of return" making it an attractive investment option.[294] Therefore, the court concluded

287. Divane v. Nw. Univ., 953 F.3d 980, 992 (7th Cir. 2020).

288. *See* Divane v. Nw. Univ., No. 16 C 8157, 2018 U.S. Dist. LEXIS 87645, at *18, 26–27 (N.D. Ill. May 25, 2018) (discussing plaintiff's Count 1 claim for underperformance of the TIAA-CREF Stock Account and Count 4 claim for too many investment options).

289. TCHRS. INS. & ANNUITY ASS'N OF AM., CREF STOCK ACCOUNT: CLASS R1, at 1 (2022), https://fluenttech.tiaa.org/pdf/factsheet/194408803.pdf.

290. *Divane*, 2018 U.S. Dist. LEXIS 87645, at *18.

291. *Divane*, 953 F.3d at 988 (stating Northwestern provided "valid reasons for the plans to use TIAA as a recordkeeper and to keep the Stock Account as an *option* for participants").

292. *Id.* at 988–89.

293. *Divane*, 2018 U.S. Dist. LEXIS 87645, at *20.

294. *Id.* at *19–20.

that while plaintiffs preferred other investment options that may have performed better than the traditional annuity, Northwestern did not breach its fiduciary duty by providing the traditional annuity as an investment option.[295] The Seventh Circuit in *Divane v. Northwestern University* demonstrates the court's focus on a fiduciary's course of action and that "the ultimate outcome of an investment is not proof of imprudence."[296]

As for the plaintiff's claim of too many investment options, the Seventh Circuit followed the Third Circuit's reasoning in *Sweda v. University of Pennsylvania*.[297] In *Sweda*, the Third Circuit held "that a meaningful mix and range of investment options [does not] insulate[] plan fiduciaries from liability for breach of fiduciary duty," but must be considered as a "backdrop" for examining the fiduciary's actions.[298] As a result, the court considered "the range of investment options and the characteristics of those included options—including the risk profiles, investment strategies, and associated fees," but declined to establish a bright line rule to determine whether a range of investment options complies with ERISA's fiduciary requirement.[299] The Third Circuit reasoned that, "fiduciaries have a duty to act prudently according to current practices," and "[p]ractices change over time, and bright line rules would hinder courts' evaluation of fiduciaries' performance against contemporary industry practices."[300] The Seventh Circuit followed the same line of reasoning and concluded that "plans may generally offer a wide range of investment options and fees

295. *Divane*, 953 F.3d at 989, 991–92 (citing Loomis v. Exelon Corp., 658 F.3d 667, 673–74 (7th Cir. 2011)) ("[The plan sponsor] offered participants a menu that includes high-expense, high-risk, and potentially high-return funds, together with low-expense, low-risk, modest-return bond funds. It has left choice to the people who have the most interest in the outcome, and it cannot be faulted for doing this.").

296. *See id.* at 992 (citing DeBruyne v. Equitable Life Assurance Soc'y of the U.S., 920 F.2d 457, 465 (7th Cir. 1990)).

297. *Id.* (citing Sweda v. Univ. of Pa., 923 F.3d 320 (3rd Cir. 2019)).

298. *Sweda*, 923 F.3d at 330.

299. *Id.* (citing Renfro v. Unisys Corp., 671 F.3d 314, 327 (3d Cir. 2011)).

300. *Id.*

without breaching any fiduciary duty."[301] Therefore, while the exact number of investment options is unknown, including a proper variety of investment funds as retirement plan options may satisfy ERISA's diversification requirements.[302]

However, the Supreme Court recently overturned the Seventh Circuit's ruling, stating that the court incorrectly relied on participants' ability to choose their investments, and remanded the case for further consideration of the plan fiduciary's duty to "monitor all plan investments and remove any imprudent ones."[303] On remand, the Seventh Circuit must consider "the circumstances . . . prevailing at the time" Northwestern acted, requiring a "context specific" inquiry into whether the traditional annuity was "prudently included in the plan's menu of options."[304] While the Supreme Court invalidated the Seventh Circuit's reliance on participants' ability to choose among various investment options, Northwestern's reason for allowing the annuity to remain an investment option may succeed on remand.[305] Northwestern could argue that it prudently included the annuity in the plan's menu of investment options, because, under the prevailing circumstances, allowing the annuity to remain an investment option protects current participants from incurring a withdrawal penalty.[306]

B. *ERISA Section 404(c) Defense*

In *DiFelice v. U.S. Airways, Inc.*, a district court declined to apply section 404(c)'s defense provision to U.S. Airways because the company's breach of fiduciary duty was not caused

301. *Divane*, 953 F.3d at 992 (first citing Loomis v. Exelon Corp., 658 F.3d 667, 673–74 (7th Cir. 2011); and then citing Hecker v. Deere & Co., 556 F.3d 575, 586 (7th Cir. 2009)).

302. *See Sweda*, 923 F.3d at 330; *Divane*, 953 F.3d at 992.

303. Hughes v. Nw. Univ., 142 S. Ct. 737, 740, 742 (2022) (citing Tibble v. Edison Int'l, 575 U.S. 523, 530 (2015)).

304. *Id.* at 742 (internal quotation marks omitted) (quoting Fifth Third Bancorp v. Dudenhoeffer, 573 U.S. 409, 425 (2014)).

305. *See supra* text accompanying notes 288–96.

306. *See supra* text accompanying notes 288–96.

by participants' exercise of control over their retirement accounts.[307] U.S. Airways' 401(k) Savings Plan provided retirement income for employees, in which U.S. Airways, as the plan administrator and fiduciary, and Fidelity, as the plan trustee, selected thirteen different investments for participants to choose from including the Company Stock Fund.[308] U.S. Airways experienced financial losses which led to a decline in the Company Stock Fund.[309] Plan participants sued U.S. Airways and Fidelity for breach of fiduciary duty under ERISA.[310] The court held that U.S. Airways breached its fiduciary duty to act prudently when selecting and managing the Company Stock Fund notwithstanding its knowledge of the company's financial difficulties because a plethora of events made U.S. Airways aware of the fund's financial downfall.[311] These circumstances included long-term financial problems, the possibility of bankruptcy, downgraded debt rating, and investment managers halting investments in the Company Stock Fund.[312] As a result, section 404(c) did not apply because U.S. Airways' decision to keep the Company Stock Fund in the Plan was the reason for financial losses rather than participants' exercise of control over their accounts.[313] The court reasoned that it was not Congress' intent to exempt employers from liability when an employer has "sole and plenary authority under the Plan to select and retain the various Plan investment

307. DiFelice v. U.S. Airways, Inc., 397 F. Supp. 2d. 758, 777–78 (E.D. Va. 2005).

308. *Id.* at 762–64.

309. *Id.* at 764–66.

310. *Id.* at 766–67.

311. *Id.* at 773–74.

312. *Id.* at 762, 774 (stating that U.S. Airways ignored unresolved long-term financial problems after its "merger with United was blocked by the Department of Justice," management warnings of possible bankruptcy, continual downgraded debt rating of its parent company (US Air Group), "cash flow problems," the September 11th terrorist attack's impact on the business, acquiring a third of US Air Group shares—which had diminished in demand—in the Company Stock Fund, and the new, independent fiduciary immediately halted investments in US Air Group shares within the Company Stock Fund, indicating that U.S. Airways acted imprudently).

313. *Id.* at 775–76.

options that [are] in no way contingent on Plan participants' acts."[314]

A similar situation arose in *Langbecker v. Electric Data Systems Corp.*, in which plan participants alleged Electric Data Systems violated ERISA fiduciary duties of selecting and monitoring investments when it continued to allow participants to invest in the company's stock despite knowing the company was experiencing financial difficulties.[315] However, unlike the outcome in *DiFelice*,[316] the Fifth Circuit determined the section 404(c) defense should have applied to Electric Data Systems.[317] The Fifth Circuit stated, while plan fiduciaries have a responsibility to offer a "diversified array of investments; provide adequate information concerning the investments to the participants; and authorize flexible and autonomous control by the participants,"[318] section 404(c) of ERISA "recognizes that participants are not helpless victims of every error."[319] Participants had access to information in order to make informed investment decisions and had a variety of "risk-diversified investment options."[320] The court stated that some participants will buy more stock that is doing poorly,[321] while other participants will buy and sell their stock in order to make

314. *Id.* at 776.

315. Langbecker v. Elec. Data Sys. Corp., 476 F.3d 299, 304 (5th Cir. 2007).

316. *See DeFelice*, 397 F. Supp. 2d at 776 ("[T]he alleged breach in this instance is not the type envisioned by Congress when it drafted section 404(c)'s exemption from liability for breach . . . .").

317. *Langbecker*, 476 F.3d at 313.

318. *Id.* at 309.

319. *Id.* at 312.

320. *Id.*

321. *Id.* Buying stock when its price is down allows investors to purchase more shares for less money. *See* Inyoung Hwang, *What You Need to Know When the Market Is Down*, SOFI (Oct. 19, 2022), https://www.sofi.com/learn/content/investing-when-market-is-down/. The market fluctuates, and when the price goes back up, so will the value of the purchased shares, resulting in financial gains. *See How to Avoid Costly Mistakes When the Market Is Down*, RAMSEY (Sept. 27, 2021), https://www.ramseysolutions.com/retirement/how-to-avoid-costly-mistakes-when-market-is-down.

profits.[322] Section 404(c) takes into consideration these self-directed transactions and does not require an employer to guarantee against loss of actions that were taken by participants.[323]

Meinhardt v. Unisys Corp. "predate[s] the DOL regulations but embodies a common sense interpretation" of ERISA section 404(c).[324] The Third Circuit in *Meinhardt* explained that section 404(c) requires a "*causal nexus* between a participant's or a beneficiary's exercise of control and the claimed loss . . . demonstrated."[325] A "causal nexus" is "established [by] proof that a participant's or a beneficiary's control was a cause-in-fact, as well as a substantial contributing factor in bringing about the loss incurred."[326] The Third Circuit listed factors to consider when determining whether a causal nexus exists:

> For Unisys to prevail under section 1104(c), . . . it must establish that the Plan[] provided information sufficient for the average participant to understand and assess: the control the Plan[] permitted a participant to exercise and the financial consequences he or she assumed by exercising that control; the rights that ERISA provided to participants and the obligations that the Act imposed upon fiduciaries; the Plan['s] terms and operating procedures; the alternative funds the Plan[] offered; the investments in which assets in each fund were placed; the financial condition and performance of the investments;

322. *Langbecker*, 476 F.3d at 312. This is consistent with the standard investment strategy to buy low and sell high in order to earn profits. *See generally A Look at the Buy Low, Sell High Strategy*, INVESTOPEDIA, https://www.investopedia.com/articles/investing/081415/look-buy-low-sell-high-strategy.asp (Mar. 24, 2022) (describing the buy low, sell high investment strategy).

323. *See Langbecker*, 476 F.3d at 312.

324. *Id.* at 311 (citing Meinhardt v. Unisys Corp., 74 F.3d 420, 444–45 (3d Cir. 1996)).

325. *Meinhardt*, 74 F.3d at 445 (emphasis added).

326. *Id.*

> and developments which materially affected the financial status of the investments.[327]

The court considered alternative investment options to determine whether participants were able to exercise control over the account.[328] If a Plan does not offer acceptable alternative investment options, then participants do not have the ability to control an account and decide how to invest their assets.[329] The Third Circuit held that even if plaintiffs proved a breach of prudence or diversification, Unisys was not liable for losses caused by participants if it proved participants had the ability to place assets in any investment vehicles available under the plan.[330] *Meinhardt v. Unisys Corp*. establishes factors to consider when determining whether a participant was able to exercise control over an account and demonstrates the relevance of alternative investment options when making such determination.[331]

VI. A New Approach: ESG Funds Applied to Current Law

Fiduciaries should not be deterred from providing ESG funds as retirement plan investment options. Fiduciaries will not breach their fiduciary duty under section 404(a) by providing ESG funds that use a risk-return analysis in conjunction with evaluating ESG criteria[332]—such an approach provides financially sound investments with long-term growth and high returns.[333] Even approaches that rely on ESG criteria for non-pecuniary considerations should not be categorically barred from being included as investment options because ESG funds

327. *Id.* at 447.
328. *Id.* at 446–47.
329. *Id.*
330. *Id.* at 448.
331. *See id.* at 446–47.
332. Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights, 86 Fed. Reg. 57272, 57272, 57302–03 (proposed Oct. 14, 2021) (to be codified at 29 C.F.R. § 2550.404a-1); Employee Retirement Income Security Act of 1974 (ERISA) § 404(a), 29 U.S.C. 1104(a).
333. *See supra* Part IV.

using various ESG approaches have generally outperformed their benchmarks and non-ESG fund counterparts.[334] Proper weight should be given to all factors considered to ensure a prudent assessment of retirement plan investments.[335]

Under the narrow rule established in *Donovan v. Bierwirth*, an ESG fund that has collateral benefits but is chosen solely in the interest of plan participants and is financially beneficial may preclude fiduciaries from breaching the duty of loyalty when no alternative investment methods are present.[336] Fiduciaries can act in the sole interest of participants by selecting ESG funds that perform well and benefit third parties so long as fiduciaries' "eyes" are directed toward positive financial returns that benefit participants.[337] In addition, participants can be provided information about ESG funds' objectives (i.e., exclusion of tobacco or alcohol companies, or focus on companies that promote climate change), their history of performance, and the types of companies selected.[338] Providing this information to participants permits fiduciaries to comply with the duty of loyalty by allowing participants to choose funds that align with their investment goals.[339] This gives participants the ability to exercise control over their accounts and make an informed decision when selecting plan investments.[340] Following the reasoning in *Langbecker v. Electric Data Systems Corp.*, fiduciaries can be protected under section 404(c) of ERISA for a breach of the duty of loyalty and prudence because participants should not be "helpless victims of every

334. *See supra* Part IV.

335. Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights, 86 Fed. Reg. at 57303.

336. *See* Donovan v. Bierwirth, 680 F.2d 263, 271 (2d Cir. 1982). *But see supra* pp. 136–39.

337. *See Donovan*, 680 F.2d at 271. *But see supra* pp. 136–39.

338. *See* Employee Retirement Income Security Act of 1974 (ERISA) § 101, 29 U.S.C. § 1021; Langbecker v. Elec. Data. Sys. Corp., 476 F.3d 299, 309, 312 (5th Cir. 2007); *see also supra* pp. 131–33, 156–58.

339. *See* ERISA § 404(a); *Langbecker*, 476 F.3d at 309, 312. *But see supra* pp. 133–34, 137–39.

340. *See* ERISA § 404(a); *Langbecker*, 476 F.3d at 309, 312. *But see supra* pp. 137–39.

error" caused by a lack of understanding of financially successful funds' investment objectives.[341]

While not all ESG funds will outperform their non-ESG counterparts, many ESG funds have had a strong performance history.[342] Similar to the reasons given in *Divane v. Northwestern University*, in which the Seventh Circuit held that Northwestern had valid reasons for allowing the TIAA CREF Traditional Annuity as an investment option to prevent participants from incurring a withdraw penalty, fiduciaries have valid reasons for selecting ESG funds as retirement plan investments.[343] ESG factors can impact: (1) companies' performance and financial success, such as severe weather conditions affecting business operations and supply chains;[344] (2) diversity, equity, and inclusion in the workplace, affecting employees' ability to perform and support a business' operations;[345] and (3) companies' compliance with regulations and ethics, affecting a business' legitimacy and relationships with other companies.[346] As a result, ESG factors help identify companies best positioned to develop innovative, efficient, and long-term value creation funds.[347] ESG factors add an additional lens to the traditional fund analysis so that fiduciaries can have a "complete view of the long-term risks and opportunities associated with a company,"[348] which can affect investment performance, and therefore, allow fiduciaries to "reduc[e] volatility and mitigat[e] the longer-term economic risks to plans' assets."[349] Accordingly, a fiduciary's actions, not an investment's outcome in a

341. *See Langbecker*, 476 F.3d at 312.

342. *See supra* Part IV.

343. *See* Divane, v. Nw. Univ., 953 F.3d 980, 989 (7th Cir. 2020); *see also* Divane v. Nw. Univ., No. 16 C 8157, 2018 U.S. Dist. LEXIS 87645, at *19 (N.D. Ill. May 25, 2018).

344. *See supra* notes 196–99 and accompanying text.

345. *See supra* note 68 and accompanying text.

346. *See supra* note 69 and accompanying text.

347. *See supra* notes 87–90 and accompanying text.

348. Hawley, *supra* note 84.

349. Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights, 86 Fed. Reg. 57272, 57277 (proposed Oct. 14, 2021) (to be codified at 29 C.F.R. § 2550.404a-1).

particular circumstance, should be controlling when determining a fiduciary's acts of prudence.[350]

In addition, the Seventh Circuit in *Divane v. Northwestern University* found that the annuity's fixed rate of return made it a favorable investment option; similarly here, ESG funds have average rates of return that perform close to their benchmarks and outperform non-ESG funds in similar asset classes.[351] While participants having the ability to choose between a list of ESG and non-ESG funds would not protect a fiduciary from liability of its prudence requirements, the circumstances surrounding the importance of ESG factors for conducting a comprehensive risk-return analysis and mitigating volatility and long-term economic risks indicate that ESG funds may be "prudently included in [a] plan's menu of options."[352]

Unlike the Company Stock Fund in *DiFelice v. U.S. Airways, Inc.*, which experienced a financial downturn due to external events and the company's bankruptcy,[353] ESG funds have a history of high performance,[354] and fiduciaries can prevent imprudent acts by evaluating ESG funds' projected performance[355] and resolving financial problems in a timely manner.[356] While ESG funds can experience short-term downfalls like any other investment (due to market fluctuations or specific sector fluctuations),[357] similar to the company stock in *Langbecker v. Electronic Data Systems Corp.*,[358] information about the risks associated with ESG funds can be provided in

350. *See, e.g.*, Divane v. Nw. Univ., 953 F.3d 980, 992 (7th Cir. 2020); Hughes v. Nw. Univ., 142 S. Ct. 737, 742 (2022) (citation omitted).

351. *See Divane*, 953 F.3d at 988–89; *supra* pp. 152–54.

352. *Hughes*, 142 S. Ct. at 742 (citation omitted).

353. *See* DeFelice v. U.S. Airways, 397 F. Supp. 2d 758, 764–66 (E.D. Va. 2005).

354. *See supra* Part IV.

355. When considering ESG funds Vanguard considers how an ESG fund may perform relative to an unconstrained parent index, Fidelity uses a forward-looking approach, and BlackRock considers expected future returns. *See Our Product Design Principles and ESG*, *supra* note 88; CONNOLLY ET AL., *supra* note 89, at 3; Hawley, *supra* note 84.

356. *See Hughes*, 142 S. Ct. at 741–42 (citation omitted).

357. *See Sustainable Equity Funds Outperform Traditional Peers in 2020*, *supra* note 206.

358. *See* Langbecker v. Elec. Data Sys. Corp., 476 F.3d 299, 303–04, 312 (5th Cir. 2007).

plan disclosure documents distributed to participants.[359] ESG funds allow fiduciaries to provide a "diversified array of investment[]" options so that participants can reduce the risk of loss by investing in various types of funds that cover different types of industries, asset classes, and markets.[360] Under the *Unisys* framework, if fiduciaries use ESG factors when evaluating investments and participants are provided information about the fund's investment strategy, "financial condition and performance," and "developments which materially affect[] [its] financial status," then fiduciaries may not breach the duty of loyalty when participants exercise control and invest in ESG funds.[361]

As a result, ESG factors that are used in a risk-return analysis[362] or are considered collateral benefits alongside a traditional investment analysis[363] may comply with ERISA's fiduciary requirements.[364] Under the risk-return approach, ESG integration, thematic investing, and broad investing funds, all of which focus on ESG criteria alongside financial returns,[365] are likely to comply with fiduciary requirements under section 404(a).[366] However, exclusionary products, which screen out companies that do not align with ESG values,[367] are more likely to be noncompliant with ERISA's fiduciary requirements since collateral benefits may be considered over financial benefits.[368] The most common ESG approaches used "by money managers are ESG integration and exclusionary screening."[369] Therefore, while some ESG strategies may comply with section 404(a) of

359. *See supra* pp. 132–35, 168–70.

360. *See Langbecker*, 476 F.3d at 309, 312; *see also supra* pp. 131–33, 154–55, 156–58.

361. *See* Meinhardt v. Unisys Corp., 74 F.3d 420, 447 (3d Cir. 1996); Employee Retirement Income Security Act of 1974 (ERISA) §§ 101(a), 404(c)(1), 29 U.S.C. §§ 1021(a), 1104(c)(1).

362. *See* Sharfman, *supra* note 68, at 119.

363. *See id.* at 118.

364. *See supra* pp. 159–63.

365. *See supra* p. 155.

366. *See* ERISA § 404(a); *see also* Schanzenbach & Sitkoff, *supra* note 1, at 385–86, 397–99.

367. *See supra* pp. 154–55.

368. *See* ERISA § 404(a); Schanzenbach & Sitkoff, *supra* note 1, at 385–86, 397–99.

369. U.S. F. for Sustainable & Responsible Inv. Found., *supra* note 94, at 1.

ERISA, others may not.[370] ERISA's silence on ESG funds[371] and the ongoing changes in the Department of Labor's guidance[372] causes uncertainty regarding the legality of ESG funds as investment options for retirement plans.[373] Therefore, Congress should enact the Financial Factors in Selecting Retirement Plan Investments Act but modify its provisions in order to pass the bill through the Senate and overcome a filibuster.

A. *The Proposal: Revise the Financial Factors in Selecting Retirement Plan Investments Act*

Congress should amend the Financial Factors in Selecting Retirement Plan Investments Act to allow an evaluation of ESG criteria alongside a traditional investment analysis, with the financial analysis controlling, and allow ESG factors to be used for assessing funds' financial performance and risk-returns.[374] The standards established in the Department of Labor's proposed rule should be incorporated into the bill to strengthen it and alleviate opponents' concerns who believe that ESG funds "are not in the financial interest of [retirement] plan[s]."[375]

First, section (3)(A)(i) of the bill should be amended to include more specific language pertaining to financial performance and risk-return analysis. Section (3)(A)(i) contains broad language stating that "a fiduciary may . . . consider environmental, social, governance, or similar factors, in connection with carrying out an investment decision, strategy, or objective, or other fiduciary act."[376] The phrase "investment decision, strategy, or objective, or other fiduciary act" encompasses not only a risk-return

370. *See supra* pp. 154–55, 159–62.

371. *See* ERISA § 404.

372. *See supra* pp. 138–43.

373. *See, e.g.*, Pollak, *supra* note 201.

374. *See supra* notes 362–68 and accompanying text.

375. *U.S. Department of Labor Proposes New Investment Duties Rule*, U.S. DEP'T OF LAB. (June 23, 2020), https://www.dol.gov/newsroom/releases/ebsa/ebsa20200623; *see supra* pp. 141, 147–52.

376. Financial Factors in Selecting Retirement Plan Investments Act, S. 1762, 117th Cong. § 2 (as introduced on May 20, 2021).

analysis but can include other considerations of a fund's composition, such as industry diversification, developed companies or growing companies, domestic versus international companies, investors' preferences for company types (small or large companies), and consideration of collateral benefits.[377] As a result, two subsections should be created in the bill: one for ESG factors used in a risk-return analysis and another for ESG factors used outside the risk-return analysis. The bill should incorporate section (b)(ii)(C) of the Department of Labor's proposed rule, which incorporates ESG factors into examining the projected return of a portfolio,[378] and section (b)(4), which allows consideration of any factor, including ESG factors, that is "material to the risk-return analysis."[379] In addition, methods using ESG factors as an "additional lens" to the traditional fund analysis should be incorporated into the bill.[380]

Second, the bill should add a new section requiring appropriate weight be given to ESG factors, stated in section (c)(2) of the Department of Labor's proposed rule, and prohibit fiduciaries from "accept[ing] expected reduced returns or greater risks to secure such additional benefits," stated in section (c)(3) of the proposal.[381] Therefore, the bill should be amended to state:

> (3)(A) Provided that a fiduciary discharges the fiduciary's duties with respect to a plan in a

377. *See id.* "Investment decision" can mean "*a decision* to purchase, transfer, hold or sell securities; *any participation in any decision* regarding the retention, purchase, sale, exchange, tender, or other transaction affecting the ownership of or rights in investments." *Investment Decision Definition*, LAW INSIDER, https://www.lawinsider.com/dictionary/investment-decision (last visited Nov. 4, 2022) (emphasis added); *see also* Schanzenbach & Sitkoff, *supra* note 1, at 388–89 (comparing the collateral benefit ESG investment strategy with the risk-return ESG investment strategy).

378. Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights, 86 Fed. Reg. 57272, 57302 (proposed Oct. 14, 2021) (to be codified at 29 C.F.R. § 2550.404a-1).

379. *Id.* at 57302–03.

380. *See* Hawley, *supra* note 84.

381. *See* Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights, 86 Fed. Reg. at 57278, 57303.

manner otherwise consistent with this subsection, a fiduciary may—

(i) consider environmental, social, governance, or similar factors, that the fiduciary prudently determines are material to evaluating an investment's:[382]

(a) projected and current risks and returns,[383] or,

(b) remaining factors, after applying a traditional risk-return analysis,[384] to carry out an investment decision, strategy, or objective, or other fiduciary act.[385]

(ii) consider collateral environmental, social, governance, or similar factors as tie-breakers when competing investments can reasonably be expected to serve the plan's economic interests equally well with respect to expected return and risk over the appropriate time horizon.[386]

(B) In a case described in clause (i) and (ii) of subparagraph (A), a fiduciary shall consider "[t]he weight given to any [environmental, social, governance, or similar] factor[s] . . . [to] appropriately reflect a prudent assessment of [such factors'] impact on risk-return"[387] and any other portion of an investment evaluation. A fiduciary shall not "accept expected reduced

382. *See id.* at 57302–03.

383. *See id.* at 57302.

384. *See* Hawley, *supra* note 84.

385. *See* Financial Factors in Selecting Retirement Plan Investments Act, S. 1762, 117th Cong. § 2 (as introduced on May 20, 2021).

386. *Id.*

387. *See* Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights, 86 Fed. Reg. at 57303.

> returns or greater risks to secure such additional [collateral] benefits."[388]

The other sections included in the bill, that is, sections (B) and (C) regarding documentation and default investments, respectively, should remain in the bill and accordingly become sections (C) and (D).[389]

In conclusion, the bill should be modified to include narrow language focusing on ESG factors in a financial assessment and alongside a traditional financial evaluation. In either analysis, the financial assessment should hold greater weight than the evaluation of ESG funds' collateral effects. More specific language would ensure that (1) ESG factors are used in the sole interest of plan participants, (2) a prudent fund assessment is completed by keeping up with financial industry standards, and (3) financial benefits are achieved for participants.

B. *A Matter of Public Policy: Evolution Requires Adaptation*

Congress should enact the Financial Factors in Selecting Retirement Plan Investments Act because ESG funds have an important impact on economic growth and development; and, therefore, justifies the need for exceptions for specific securities that still meet the majority of ERISA fiduciary requirements, just as Congress did for ESOPs.[390] Similar to *Fifth Third Bancorp*, in which the Supreme Court recognized the "bold and innovative method" of ESOPs to strengthen the private enterprise system and improve capital growth,[391] ESG factors strengthen fund risk-return analysis and fund evaluation and have a positive impact on the environment, society, and corporate governance.[392] The Supreme Court held that ESOP fiduciaries are held to ERISA's standard of prudence but have

388. *Id.* at 57278, 57303.
389. *See* S. 1762.
390. *See supra* pp. 131–33, 135–36, 153–54, 161–63.
391. Fifth Third Bancorp v. Dudenhoeffer, 573 U.S. 409, 416 (2014).
392. *Id.* at 422; *supra* Part IV; *supra* pp. 131–33, 153–54.

no duty to diversify;[393] accordingly, ESG fund fiduciaries should be held to ERISA's standard of prudence but the duty to diversity and the duty of loyalty (regarding investors' ESG goals) should not be violated when investors are provided information about an ESG fund's objectives.[394]

ESG funds have become a growing interest among investors, with millennials driving the demand.[395] As millennials move into prominent roles in today's workforce, there is a growing interest in climate change and wealth inequality.[396] Among the general public, investors, workers, customers, clients, and communities "are expecting a higher standard from companies in the way that they operate."[397] In 2020, the world experienced one of the warmest years on record, and in the United States, the Black Lives Matter protests spread across the country after the death of George Floyd.[398] These, and other events, have caused many investors and society at large to demand for public companies "to use their resources and influence for broad and meaningful social impact."[399] For example, companies have expanded diversification among their board of directors, donated to nonprofit organizations that combat hate crimes against Asian Americans and Pacific Islanders, and have created social media campaigns to denounce racism.[400] In addition, companies' climate change initiatives can impact seats held on their own board of directors.[401] Exxon Mobil's board

393. *See Fifth Third Bancorp*, 573 U.S. at 418–19.

394. *See id.* at 418–19; *see supra* pp. 173–75.

395. *See* MSCI ESG RSCH. LLC, *supra* note 10, at 2–3; MORGAN STANLEY INST. FOR SUSTAINABLE INVESTING, *supra* note 12, at 2, 4.

396. *See Money Invested in ESG Funds More Than Doubles*, *supra* note 174.

397. Emily Glazer, *Companies Brace Themselves for New ESG Regulations Under Biden*, WALL ST. J., https://www.wsj.com/articles/companies-brace-themselves-for-new-esg-regulations-under-biden-11610719200 (Jan. 18, 2021, 9:15 AM) (quoting Jon Hale, head of sustainability research at Morningstar).

398. *Money Invested in ESG Funds More Than Doubles*, *supra* note 166.

399. *See* Jonathan L. Kravetz, *Spotlight on ESG Investing: The Importance of Understanding Environmental, Social and Governance Factors and Their Impact on Investing*, MINTZ (Oct. 19, 2021), https://www.mintz.com/insights-center/viewpoints/2901/2021-10-18-spotlight-esg-investing-importance-understanding.

400. *Id.*

401. *See id.*

nominees lost two seats to a small hedge fund group, who were voted in by Exxon's top institutional investors, because of the group's aggressive plan to improve Exxon Mobil's inability to reduce its carbon footprint.[402] This growing demand for companies' participation in combating ESG issues "is helping companies move away from a short-term shareholder-centric approach to a longer-term perspective that focuses on creating value for all stakeholders, with better outcomes for society and the planet."[403]

CONCLUSION

While ESG funds "accounted for about a fourth of the money that flowed into all U.S. stock and bond mutual funds" in 2020,[404] of which approximately $6.9 trillion were 401(k) assets,[405] few 401(k) plans offer ESG funds as investment options.[406] With investors' growing interest in ESG funds,[407] ESG funds' strong performance history,[408] the material impact of ESG factors on funds' performance,[409] and society's heighted awareness of ESG issues,[410] ESG funds should be readily accessible in retirement plans. Throughout history, ESG matters have influenced investors' decisions during critical social and environmental events occurring around the world.[411] Although the Financial Factors in Selecting Retirement Plan Investments Act may have a long road ahead of it,[412] the bill should be

402. *See id.*; Michael J. de la Merced, *How Exxon Lost a Board Battle with a Small Hedge Fund*, N.Y. TIMES (May 28, 2021), https://www.nytimes.com/2021/05/28/business/energy environment/exxon-engine-board.html.

403. *See Sustainable Equity Funds Outperform Traditional Peers in 2020*, *supra* note 206.

404. *Money Invested in ESG Funds More Than Doubles*, *supra* note 174.

405. *Frequently Asked Questions About 401(k) Plan Research*, *supra* note 97 (stating amount of assets in 401(k) plans as of March 31, 2021).

406. *See Climate Funds Hold Less than 1% of 401(k) Money*, *supra* note 118; *see also* SUSTAINABLE FUNDS U.S. LANDSCAPE REPORT, *supra* note 118, at 28.

407. *See supra* pp. 124, 135–36.

408. *See supra* Part IV.

409. *See supra* pp. 150–54.

410. *See supra* notes 395–403 and accompanying text.

411. *See supra* pp. 123–24.

412. *See supra* Part II.

amended to pass through both houses of Congress and end the ongoing cycle of Department of Labor guidance, which is likely to continue without congressional action.[413] ESG matters are not going away and will continue to gain more prominence as society evolves.[414] Therefore, ERISA should be amended to create a fiduciary standard that will ensure financially successful retirement plans while also ensuring "a world worth retiring in."[415]

413. *See supra* Section VI.A; *supra* pp. 138–43, 151–52.
414. *See supra* Section VI.B.
415. Barney, *supra* note 157.