Socially Responsible Investing: What Retirement Plan Sponsors Need to Know

Denise Burns, CFA; John Italiano, CFA; Ray McGrath
Cammack Retirement Group

Interest in environmental, social and governance (ESG) investing has soared since the launch of the Principles for Responsible Investments (PRI) in 2006 (www.unpri.org). PRI is an independent organization that encourages investors to use responsible investment to enhance returns and manage risk. As of March 2017, the signatories, representing $73 trillion in assets, have signed the principles and committed to integrating ESG considerations into investment decision making. Mutual funds have incorporated the principles, and low-carbon funds are the most recent innovation.

Climate change is one of the top environmental issues today. More companies are looking to reduce greenhouse gas emissions and lower their carbon footprint. Additionally, investors are looking to support and invest in companies that are good corporate citizens and conscious of their business's effect on the environment and community. As a result, asset managers have created socially responsible funds focused on environmental, social, and governance (ESG) factors. Several investment managers have developed ESG funds that look primarily at a company's current and future carbon emissions. These funds also assess climate change criteria, natural resource usage and waste management procedures. The result is a portfolio of attractively-valued stocks with a significantly lower carbon footprint than the benchmark. Part of the investment approach involves stewardship, engaging with management, and voting proxies in accordance with ESG principles.

ESG funds may also exclude the stock of tobacco, fossil fuel, firearm and defense companies, and of firms that are opposed to union organizing or that pay excessive executive compensation. ESG, or socially responsible funds, may actively pursue the shares of companies that have a commitment to gender equality, diversity, shareholder rights and community engagement.

RETIREMENT PLAN SPONSOR CONSIDERATIONS

While investing in companies that are socially and environmentally conscious is not a consideration for all active and passive investment strategies, for those retirement plan sponsors that try to match the moral and ethical expectations of their plan participants, the way in which they approach ESG-focused investment strategies can be a point of confusion. Earlier this year, the U.S. Department of Labor (DOL) issued some new guidance on the topic:

In IB 2015-01, the Department reiterated its longstanding view that, because every investment necessarily causes a plan to forego other investment opportunities, plan 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. IB 2015-01 also reiterated the view that when competing investments serve the plan's economic interests equally well, plan fiduciaries can use such collateral considerations as tie-breakers for an investment choice. The preamble of IB 2015-01 added: "if a fiduciary prudently determines that an investment is appropriate based solely on economic considerations, including those that may derive from environmental, social and governance [(ESG)] factors, the fiduciary may make the investment without regard to any collateral benefits the investment may also promote."

This bulletin updates the previous DOL Interpretive Bulletins (IB 2015-01 and 2016-01) regarding a fiduciary's consideration of ESG factors when evaluating investments for employee benefit plans, and when voting proxies and exercising other shareholder rights. It does not rescind any portion of the 2015 and 2016 guidance. The purpose of field assistance bulletins is generally to augment the language of interpretive bulletins.

The key issue for retirement plan sponsors is how the consideration of ESG factors fits with a fiduciary's obligation to act prudently, and solely in the interest of plan participants and beneficiaries, particularly when making investment decisions.

The bulletin states, "Fiduciaries must not too readily treat ESG factors as economically relevant to the particular investment choices at issue when making a decision." However, social impact can be used as a "tie-breaker" between two otherwise equally prudent investment choices.

The Field Assistance Bulletin does state that plan sponsors may designate a fund as the qualified default investment alternative (QDIA) that considers ESG factors, but only if this consideration is part of the economic analysis the fiduciaries undertake to ensure that the QDIA will further the interests of plan participants and beneficiaries in their retirement income. More explicitly themed religious, socially responsible, or impact funds, it says, will not be appropriate for the QDIA, even when they are permissible as part of the overall menu of options. For example, "The selection of an ESG-themed target date fund as a QDIA would not be prudent if the fund would provide a lower expected rate of return than available non-ESG alternative target date funds with commensurate degrees of risk, or if the fund would be riskier than non-ESG alternative available target date funds with commensurate rates of return."

The new guidance notes that DOL policy does not require fiduciaries to include ESG considerations in investment policies, develop ESG-specific policy statements or guidelines, or incorporate

ESG-related tools, metrics or analyses into risk/return analyses. While the bulletin does not prohibit these actions, it does warn that fiduciaries “must disregard” routine compliance with ESG-related investment policy statements if it would be imprudent, as it relates to participants’ retirement income interests, to comply.

When investing in an ESG fund, retirement plan sponsors should maintain records regarding the decision to do so. The bulletin can be found in its entirety here: https://www.dol.gov/agencies/ebsa/employers-and-advisers/guidance/field-assistance-bulletins/2018-01

ABOUT CAMMACK RETIREMENT GROUP

Cammack Retirement Group has been helping retirement plan sponsors meet their goals for half a century. Solely focused on serving retirement plan sponsors, we provide a tailored approach to investment advisory and consulting services. We work with some of the nation’s leading academic and research institutions, healthcare providers, corporations, non-profit organizations and public sector employers to help them manage fiduciary risk.

For more information on our services, please contact **Mike Volo,** Senior Partner, at **781.997.1426** or **mvolo@cammackretirement.com**.

Note: *This feature is to provide general information only, does not constitute legal advice, and cannot be used or substituted for legal or tax advice.*

Investment products available through Cammack LaRhette Brokerage, Inc. Investment advisory services available through Cammack LaRhette Advisors, LLC. 100 William Street, Suite 215, Wellesley, MA 02481 | p 781-237-2291