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An ESG Setback? DOL Sounds Cautionary Tone on ESG-Related Proxy Voting, Shareholder Engagement and Economically Targeted Investments

With shareholder proposals regarding ESG and sustainability matters becoming the most common kind of proposal, proxy advisory firm ISS marketing a new “Environmental & Social QualityScore” product for rating public companies, asset managers developing ESG-related guidelines and voting policies, and significant activist and investor fundraising efforts underway with ESG-linked themes, the U.S. Department of Labor (the “DOL”) has issued new guidance that may influence the going-forward behavior of some market participants.

On April 23, 2018, the DOL issued [Field Assistance Bulletin No. 2018-01](#), clarifying previous DOL guidance for ERISA-covered private-sector employee benefit plans regarding proxy voting, shareholder engagement, and economically targeted investments in the context of environmental, social, and corporate governance (ESG) initiatives. The bulletin addresses the role of ESG in several areas, including:

Shareholder campaigns and engagement activities: The DOL emphasized that its prior guidance was not intended to encourage individual plan investors to incur significant expenses on shareholder campaigns and engagement (including on “direct negotiations” with boards and management teams of publicly traded companies) where the plan is just one of many investors. In addition, the bulletin unequivocally states that prior guidance “was not meant to imply that plan fiduciaries, including appointed investment managers, should routinely incur significant plan expenses to, for example, fund advocacy, press, or mailing campaigns on shareholder resolutions, call special shareholder meetings, or initiate or actively sponsor proxy fights on environmental or social issues relating to such companies.” The guidance also reminds fiduciaries that ERISA may require a documented cost-benefits analysis before undertaking routine or substantial expenditures of plan assets on environmental or social factors.

Investment decision-making: While reaffirming that where “otherwise collateral” ESG issues “present material business risk or opportunities,” such that companies should be managing them as part of business planning and qualified investment professionals would treat the issues as “economic considerations under generally accepted investment theories,” the DOL cautioned that fiduciaries of ERISA-covered plans must avoid too readily treating ESG issues as being economically relevant to any particular investment choice and calls on ERISA fiduciaries to focus on economic factors that have a material effect on risk and return.

Investment policies: 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. The bulletin does not per se prohibit such actions, but warns that ERISA fiduciaries “must disregard” rote compliance with ESG-related investment policy statements if it would be imprudent to comply in a particular instance.

While DOL’s latest interpretive guidance continues to support the view that ESG issues can give rise to important economic considerations, the cautionary language and tone of the bulletin may cause plan fiduciaries, asset managers and other interested stakeholders to pause before pursuing more aggressive tactics for escalating ESG issues at companies and take a fresh look at ensuring that ESG-oriented investment initiatives are clearly linked to financial and economic impacts on the targeted public company over relevant time horizons, rather than, as the bulletin describes it, “promoting collateral social policy goals” or “myriad public policy preferences” that lack such linkage. In addition, plan fiduciaries, private and union pension plans subject to ERISA and state and local pension systems that follow ERISA rules may need to re-assess whether they have appropriately analyzed, and documented, “the cost of the shareholder activity compared to the expected economic benefit (gain) over an appropriate investment horizon.”

It remains to be seen whether the guidance will result in a shift in future proxy seasons away from costly campaigns and Rule 14a-8 shareholder proposals towards less resource intensive (but perhaps more collaborative and effective) engagement on relevant ESG issues or promote increased diligence by fiduciaries who invest retirement assets into the amount and effectiveness of resources devoted by activist and other funds to ESG activities.

While plan fiduciaries and covered asset managers will focus carefully on the new DOL guidance and may seek to improve their economic cases for ESG initiatives, we expect most companies will continue integrating business relevant sustainability, corporate social responsibility and ESG matters into strategic and operational planning, stakeholder and shareholder engagement and external communication initiatives.

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