

## DOL Regulation on Financial Factors in Selecting Plan Investments Comparison of Proposed and Final Regulation (11.2.2020)

Topic	Proposed Regulation (June 2020)	Final Regulation (October 2020)	Notes
<b>Individual Account Plans - QDIAs</b>	<p>Even a prudently selected, well managed, and properly diversified investment alternative could not be added as, or as a component of, a QDIA if the investment alternative included one or more ESG judgements in its mandate or included those parameters in the fund name</p> <p><b>(Section 2550.404a-1(c)(3)(iii))</b></p>	<p>Plans are prohibited from adding any investment fund, product, or model portfolio as a QDIA or as a component of such an investment alternative, if the fund, product, or model portfolio's investment objectives or goals or its principal investment strategies include, consider, or indicate the use of one or more non-pecuniary factors</p> <p><b>(Section 2550.404a-1(d)(2)(ii))</b></p>	<ul style="list-style-type: none"> <li>Stakeholders interpreted the proposed regulation as a ban on any investment alternative serving as a QDIA if the investment or any of its components was constructed using any ESG factors, even if the factors were pecuniary in nature</li> <li>In the preamble to the final regulation, DOL stated this was not the DOL's intention</li> </ul>
<b>Individual Account Plans - investments other than QDIAs</b>	<p>A fiduciary's addition of a prudently selected, well managed, and properly diversified investment alternative that includes one or more ESG factors in the investment process is permissible provided the fiduciary uses only objective risk-return criteria, such as benchmarks, expense ratios, fund size, long-term investment returns, volatility measures, investment manager investment philosophy and experience, and mix of asset types in selecting and monitoring all investment alternatives for the plan, including ESG oriented investments and documents compliance with this condition</p> <p><b>(Section 2550.404a-1(c)(3))</b></p>	<p>The same prudence and loyalty duties that apply generally to evaluating investments under ERISA also apply to a fiduciary's evaluation and selection of designated investment alternatives from which participants select where to direct their retirement assets. Thus, when assembling, choosing, or modifying an investment menu for participants' investment choices, a fiduciary must evaluate the designated investment alternatives on the menu based solely on pecuniary factors, not subordinate the interest of participants to unrelated objectives, and not sacrifice investment return or take on additional investment risk to promote non-pecuniary objectives or goals</p> <p><b>(Section 2550.404a-1(d))</b></p>	<ul style="list-style-type: none"> <li>Stakeholders were concerned the proposed regulation established more strict or different rules for individual account plans than for all other types of plans</li> <li>In the final regulation, DOL removed the objective-only criteria and removed the documentation requirement</li> <li>The rule is a legal requirement, not a safe harbor</li> <li>In the preamble to the final regulation, DOL stated it doubts the concept of a "tie" is relevant when adding designated investment alternatives to a platform of investments that allows participants to choose from a broad range of investment alternatives (see "Tie-breaker" or "all things being equal" below)</li> </ul>

<p><b>“Tie-breaker” or “all things being equal”</b></p>	<p>When alternative investments are determined to be “economically indistinguishable” and an investment is selected on the basis of a non-pecuniary factor or factors, the fiduciary should document specifically (a) why the investments were determined to be indistinguishable and (b) why the selected investment was chosen based on the purposes of the plan, diversification of investments, and the interests of the plan participants and beneficiaries in receiving benefits from the plan</p> <p><b>(Section 2550.404a-1(c)(2))</b></p>	<p>When choosing between or among investment alternatives that the fiduciary is unable to distinguish on the basis of pecuniary factors alone, the fiduciary may use non-pecuniary factors as the deciding factor in the investment decision provided the fiduciary documents (a) why pecuniary factors were not sufficient to select the investment, (b) how the selected Investment compares to the alternative investments, and (c) how the chosen non-pecuniary factor or factors are consistent with the interest of participants and beneficiaries</p> <p><b>(Section 2550.404a-1(c)(2))</b></p>	<ul style="list-style-type: none"> <li>• Stakeholders were concerned the prior standard, which was characterized as functional equivalence, was replaced with a new, more restrictive economically identical standard</li> <li>• In the final regulation, DOL wanted to make clear that it was not demanding investments be identical in each and every respect before the tie-breaker provision would be available</li> <li>• In the preamble to the final regulation, DOL stated it remains convinced that it is appropriate for the regulation to include a safeguard against the risk that fiduciaries will improperly find economic equivalence and make decisions based on non-pecuniary factors without a proper analysis and evaluation</li> </ul>
<p><b>Consider other available alternatives</b></p>	<p>Fiduciaries must give “appropriate consideration” to facts and circumstances relevant to the particular investment, including how the investment compares to “available alternative investments”</p> <p><b>(Section 2550.404a-1(b)(2)(ii)(D))</b></p>	<p>Fiduciaries must give “appropriate consideration” to facts and circumstances relevant to the particular investment, including how the investment compares to “reasonably available alternatives with similar risks”</p> <p><b>(Section 2550.404a-1(b)(2)(i))</b></p>	<ul style="list-style-type: none"> <li>• Stakeholders were concerned with the reference to “available alternative investments” in the proposed regulation because (a) there may be no true alternative to a particular investment because the opportunity is unique (b) the investment opportunity may lapse if a thorough undertaking of all alternatives is pursued, and (c) the number of potential alternatives might be so numerous that consideration of every alternative is impossible.</li> <li>• In the final regulation, DOL wanted to avoid suggesting that fiduciaries must scour the marketplace or look at an infinite number of possible alternatives as part of their evaluation</li> </ul>
<p><b>Specific references to “ESG” and similar terms</b></p>	<p>Text specifically refers to ESG and similar terms</p>	<p>Text does not refer to ESG or similar terms; rather, refers to pecuniary and non-pecuniary factors in defining the relevant fiduciary investment duties</p>	<ul style="list-style-type: none"> <li>• Stakeholders were concerned references to ESG and similar terms in the regulation itself would create a heightened level of scrutiny for ESG investments that does not apply to other types of investments</li> <li>• In the final regulation, DOL wanted to make clear that, from a fiduciary perspective, the relevant question is not whether a factor under consideration is ESG, but whether it is a pecuniary factor</li> </ul>