

ESG Investing Limitations for Fiduciaries Confirmed by New Court Ruling

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Surprise decision acknowledges that Biden and Trump rules are virtually identical.

In a surprise ruling, a very conservative federal district court in Texas, known for striking down Biden Administration policies, actually upheld a Biden Administration rule governing environmental, social, and governance (ESG) investing in ERISA retirement plans. Consistent with an amicus brief filed by the Covington & Burling law firm, the court concluded that the Biden ESG rule changed little of substance from the Trump ESG rule it replaced. The amicus brief explained and the court agreed that both rules were controlled by and faithfully followed the Supreme Court's *Dudenhoeffer* decision, which requires ERISA plan fiduciaries to make investment decisions *for the sole purpose of* maximizing risk-adjusted returns and not for any other purpose, no matter how laudatory.

A little background. Earlier this year, 24 red state Attorneys General and other plaintiffs sued the Department of Labor in Texas and Wisconsin federal courts to block the Biden ESG rule, claiming it violated the law by encouraging fiduciaries to select “woke” ESG investments for purposes other than maximizing risk-adjusted returns. In response to these suits, Covington & Burling **submitted amicus briefs** on behalf of Mark Iwry, a former Treasury official and probably the nation's leading expert on the policy and law of retirement plans – not to take sides – but to clarify that, despite a lot of partisan rhetoric across Republican and Democratic Administrations, the Biden and Trump ESG rules are virtually identical. And both sharply circumscribed the use of ESG investing.

The reason that the Biden and Trump rules are virtually identical is that both rules are tightly constrained by ERISA, as interpreted by the Supreme Court in 2014 (*Fifth Third Bancorp v. Dudenhoeffer*). The Court, in a unanimous decision, said very clearly that ERISA fiduciary investment decisions must be made for the exclusive purpose of maximizing risk-adjusted returns. Both the final Biden rule and the final Trump rule

make it very clear that a fiduciary cannot make investment decisions for any other reason. The Biden rule says ESG factors can be considered only to the extent that they are relevant to a risk-return analysis, not as collateral benefits. The Trump rule effectively reaches the same conclusion, but states it in the negative – ESG factors must *not* be considered to the extent they are *not* a “pecuniary factor.”

The waters get muddied because, in each Administration, the proposed rules that preceded the final rules staked out diametrically opposed views on the appropriateness of using ESG factors in investment decisions. The proposed Trump rule created the impression that the final rule would prohibit any consideration of ESG factors, which it did not do. Similarly, the proposed Biden rule created the impression that the final rule would require consideration of ESG factors, which it did not do. In the end, however, the constraints of the Supreme Court’s 2014 decision produced nearly identical products.

The bottom line is that the Texas decision, determining that the Supreme Court’s *Dudenhoeffer* decision controlled the issue, provides much needed clarity to the ESG controversy. Maximizing risk-adjusted returns is an ERISA fiduciary’s sole responsibility when it comes to making investment decisions. In pursuing that goal, a fiduciary can adopt a strategy that is “pro-ESG, anti-ESG, or entirely unrelated to ESG.” But the decision must be solely in terms of maximizing risk-adjusted returns, not collateral benefits.

One final note, while the Texas decision provides clarity for ERISA plans, substantial uncertainty still surrounds state and local plans where fiduciaries’ ability to maximize risk-adjusted returns may be limited by local laws and pending bills with regard to ESG investing – both pro and con.