

# Defined Contribution Plan Legislative Update

While legislators have been focused on negotiating the next round of stimulus and dealing with the implications of the recent election cycle, the U.S. Department of Labor (DOL), as the primary regulator of the Employee Retirement Income Security Act (ERISA), has been fairly active with issuing proposed changes and final rules that may impact many of our defined contribution plan clients.

## Private Investments in Defined Contribution Plans

In June, the DOL issued an [information letter](#) to clarify its view on the use of private investments in defined contribution plans. As background, an “information letter” is essentially an authoritative interpretation by the DOL of how ERISA should be applied generally (as opposed to in a specific context) and is how the DOL has historically commented on innovative investment solutions. In accordance with the Information Letter, plan sponsors of defined contribution plans may, under certain circumstances, offer participants access to private investments through diversified investments options. Stay tuned for an upcoming write-up from our research team that further explores the implications of this Information Letter.

## Proxy Voting Guidance

In September, the DOL published a new [Proposed Rule](#) regarding proxy voting by plan sponsors. In addition to codifying existing DOL guidance for ERISA fiduciaries regarding plan assets that are shares of stock, the Proposed Rule provides additional guidance on how fiduciaries are to approach proxy voting. While proxies themselves have been deemed plan assets and therefore subject to the prudence and exclusive benefit standards of ERISA, the Proposed Rule provides additional standards that create a more strict cost-benefit analysis for fiduciaries to apply when evaluating whether and how to exercise shareholder rights. The focus of these new standards is on weighing the costs associated with proxy voting with the likely impact on investment performance of the plan. The DOL is strongly incentivized to finalizing the Proposed Rule before year-end, making it more difficult for the Biden administration to unwind. We will continue to provide updates and guidance regarding any final rule on this subject.

## ESG Considerations

On October 30<sup>th</sup>, 2020, the DOL issued a [Final Rule](#) regarding the use of environmental, social and governance (ESG) factors in selecting investments. The Final Rule states that ERISA requires plan fiduciaries to make investment decisions solely based on pecuniary factors (i.e., factors that a fiduciary prudently determines are expected to have a material effect on risk/return in light of the plan’s investment objectives and funding policy), except in the event of a “tie-breaker.” The “tie-breaker” term refers to the “all things being equal test” (established by prior DOL guidance) — when a fiduciary is unable to distinguish between reasonably available investment alternatives based on pecuniary factors alone, non-pecuniary factors may be considered. The DOL cautions that consideration of non-

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pecuniary factors should be rare and requires that such consideration be consistent with the duty of loyalty. The Final Rule also includes the following documentation requirements to be provided when non-pecuniary factors are considered: (1) why the consideration of only pecuniary factors was not sufficient to make the decision; (2) how the selective investment compares to the considered alternative(s); and (3) how the applicable non-pecuniary factor(s) is consistent with the interests of the participants and beneficiaries (including participant demand).

It is our interpretation that this framework still supports the use of ESG investment options in certain circumstances. One notable difference between the [Proposed Rule from June](#) on this issue and the Final Rule is the latter's removal of heavy reference to ESG; the Final Rule instead focuses on "pecuniary" and "non-pecuniary" factors. By taking such action, the DOL seems to acknowledge that ESG is a broad, complex term that is not necessarily synonymous with "non-pecuniary." In fact, the Final Rule acknowledges that ESG factors may be considered "pecuniary" under certain circumstances, providing the example that a fiduciary may prudently conclude that management diversity or a company's environmental record would have a material financial effect on the investment. This interpretation is accommodative of ESG Integration, a practice increasingly utilized by investment managers to assess risk while maintaining a returns-focused strategy. Additionally, a plan fiduciary could determine that a fund with an ESG focus cannot be distinguished from reasonably available investment alternatives and may therefore utilize non-pecuniary factors (including participant demand) in the evaluation. To the extent the fiduciary can then show that the ESG factor(s) do not create additional risk or sacrifice return, consistent with the ERISA duty of loyalty, such a fund can be offered to participants.

## 2021 Contribution Limits

The IRS has announced that for 2021, the limitation on the exclusion for elective deferral is \$19,500 and the catch-up limit is \$6,500, unchanged from 2020. ■

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