



Deja Vu: DOL Issues Final Rule on Use of ESG Factors and Shareholder Rights...Again

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On November 22, 2022, the Department of Labor (DOL) released a Final Rule, titled “Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights,” which generally becomes effective January 30, 2023. The Final Rule addresses how ERISA’s core fiduciary duties of prudence and loyalty apply to the use of environmental, social, and corporate governance (ESG) factors in connection with investment decision-making and the exercise of shareholder rights by ERISA plans.

The Final Rule endorses but moderates the approach the DOL expressed in the proposed rule issued on October 13, 2021 (“Proposed Rule”) regarding the role of ESG in investment decision-making, and largely tracks the view set forth in the Proposed Rule on the exercise of shareholder’s rights. Both the Proposed and Final Rule represent a significant departure from the DOL’s 2020 rules on the topics of ESG and proxy voting. See [prior alert](#) for more details regarding the Proposed Rule and the history of the DOL’s guidance on ESG and proxy voting.

Fiduciaries of ERISA plans may be relieved by the certainty of the Final Rule given the recent regulatory uncertainty on these topics, discussed further below.

Background

The DOL’s position on the role of ESG and the exercise of shareholder rights has shifted over the past decades as different political parties have held the White House. However, the DOL has consistently maintained that ERISA prohibits fiduciaries from subordinating the economic interests of plan participants and beneficiaries to unrelated objectives and would never justify the acceptance of reduced returns or greater risks to promote unrelated goals. The DOL has also consistently provided in the case of a tie-break, ESG could play a role in investment decision-making.

Additionally, the DOL has consistently recognized the fiduciary act of managing plan assets includes the management of those shareholder rights, including proxy voting rights, connected to shares of stock.

In 2020, the DOL adopted two final rules relating to ESG (“2020 Rules”). The first essentially prevented plan fiduciaries from considering any non-pecuniary factors in connection with the selection of investments except where investments were *indistinguishable* based upon pecuniary factors. Additionally, this rule prohibited defined contribution plan fiduciaries from having a qualified default investment alternative (QDIA) that included ESG as a part of its investment objectives. The second rule addressed the fiduciary exercise of shareholder rights, including proxy voting, in a manner that many viewed as discouraging the exercise of shareholder rights, particularly in relation to ESG factors.

The Proposed Rule – issued after the DOL announced a nonenforcement policy with respect to the 2020 Rules and President Joe Biden directed the DOL to publish a new rule – was intended to eliminate the “chilling effect” of the 2020 Rules.

Public comments in response to the Proposed Rule provided support while pointing out areas for clarification and suggestions for improvement; many of which were implemented in the Final Rule.

ESG

The Final Rule adopts many of the changes found in the Proposed Rule, such as the removal of “pecuniary/non-pecuniary” terminology, and the inclusion of ESG factors among factors that may be relevant to a risk and return analysis. However, the Final Rule reflects a more restrained view on the role ESG should play in investment decision-making and adds some helpful clarification on how investment decision-making is different in the context of a participant directed individual account plan.

The Proposed Rule provided that a prudent fiduciary should appropriately consider and make certain determinations regarding an investment or investment course of action (for simplicity, referred to as an “investment”) relative to the plan’s portfolio.

Commentors noted that this language doesn't really make sense for participant directed defined contribution plans. The Final Rule revised the language to clarify an investment may be considered as a part of a plan's menu in lieu of its portfolio. Additionally, the Final Rule provides that the fiduciary of a participant-directed individual account plan can consider participant preferences in connection with ESG.

The Proposed Rule included a provision that projected returns of a portfolio related to funding objectives of the plan "may often require" an evaluation of the economic effects of ESG factors on a particular investment. Many comments expressed concern that this provision created a de facto requirement to consider ESG factors. The DOL found these comments persuasive and removed the "may often require" language, so the Final Rule references and allows, but does not require, the consideration of ESG factors on the same basis as any other factor. For similar reasons, the DOL also removed specific ESG examples that were in the Proposed Rule. However, the Final Rule still references ESG factors that may be relevant depending on the facts and circumstances in a list that is not exhaustive.

The Final Rule also generally endorses the Proposed Rule's approach to the "tiebreaker test," which allows a fiduciary to make decisions on the collateral benefits of the investments if the fiduciary concludes that the investments equally serve the financial interests of the plan over the appropriate time horizon. However, the Final Rule eliminated a special disclosure requirement in the Proposed Rule that applied if the fiduciary of a participant-directed individual account plan utilized the tie-break rule and selected an investment option based upon collateral benefits.

Additionally, the Final Rule implements the Proposed Rule's elimination of restrictions for QDIAs found in the 2020 Rules. As a result, fiduciaries may consider QDIAs with ESG strategies, and QDIAs are subject to the same legal standards as all other investments.

Shareholder Rights and Proxy Voting

The Final Rule generally tracks the approach of the Proposed Rule related to shareholder rights and proxy voting, and eliminates provisions set forth in the 2020 Rules which the DOL viewed as creating a bias against the exercise of shareholder rights, e.g., special documentation and special monitoring requirements. The DOL has delayed the effective date for certain parts of the proxy voting provisions until December 1, 2023.

If you have any questions related to the effect of the Final Rule, please contact any attorney with Frost Brown Todd's [Employee Benefits & ERISA](#) practice group.

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