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John Wilson

Head of Corporate Governance, Engagement & Research

Flash Commentary: ESG Investing

Department of Labor: ESG Compatible with Fiduciary Duty

The Department of Labor (DOL) has affirmed that incorporating environmental, social and governance (ESG) factors into investments is compatible with the fiduciary duty of plan sponsors covered under the Employee Retirement Income Securities Act (ERISA).

According to DOL Interpretive Bulletin 2015-01, ERISA does not preclude plan sponsors from incorporating Environmental, Social and Governance (ESG) considerations into investment decisions, as long as those decisions do not hamper portfolio returns or impose additional risk on the plan. Plan sponsors are bound by a fiduciary duty to act prudently and in the best economic interests of plan participants, particularly with respect to portfolio risk and return.

Cornerstone Capital Group has explored the range of ESG strategies available to fiduciaries in our *ESG Essentials – A Guide for Investors* report. Although many large institutions have used these strategies successfully for many years, some investors have continued to believe that ERISA guidelines preclude ESG incorporation. The Department of Labor found that previous guidance "unduly discouraged" plan sponsors from considering "Economically Targeted Investments," (ETIs), those that are selected at least in part for benefits other than investment returns. The new document explains how ESG is consistent with the responsibilities of investors:

> An important purpose of this Interpretive Bulletin is to clarify that plan fiduciaries should appropriately consider factors that potentially influence risk and return. Environmental, social, and governance issues may have a direct relationship to the economic value of the plan's investment. In these instances, such issues are… proper components of the fiduciary's primary analysis of the economic merits of competing investment choices….

> In addition, this Interpretive Bulletin also clarifies that plan fiduciaries may invest in ETIs based, in part, on their collateral benefits so long as the investment is economically equivalent, with respect to return and risk to beneficiaries in the appropriate time horizon, to investments without such collateral benefits. [1]

These "collateral benefits" include environmental protection, social equity and financial stability, which Cornerstone considers necessary outcomes for the mitigation of long-term macroeconomic investment risk.

The DOL's observations are consistent with Cornerstone's publication *Sustainable Investing: Addressing the Myth of Underperformance*, which identifies several studies that demonstrate that consideration of ESG factors may strengthen investment analysis, and in any case need not detract from risk or return expectations.

The bulletin also indicates that plan sponsors may develop policies concerning ESG issues, or to consider how external investment managers take these factors into account, as long as the managers' investment practices are consistent with ERISA rules and guidance.

The new guidance provides comfort to investors who are interested in ESG but have been concerned about the implications for fiduciary duty. Investors may consider how, executed prudently, integration of corporate governance and sustainability considerations can both enhance investment strategies and offer desirable "collateral benefits."

[1] Department Of Labor, Employee Benefits Security Administration
29 CFR Part 2509, RIN 1210-AB73, Interpretive Bulletin Relating to the Fiduciary Standard under ERISA in Considering Economically Targeted Investments, pg. 5-6

John K.S. Wilson is the Head of Corporate Governance, Engagement & Research at Cornerstone Capital Group. John has over 16 years of experience in socially responsible investing and corporate governance. Previously, he was Director of Corporate Governance for TIAA-CREF, where he oversaw the voting of proxies at CREF's 8,000 portfolio companies and engaged in dialogue with corporate boards and management to promote sustainability and good corporate governance. An Adjunct Assistant Professor at Columbia Business School, John is also a member of the Advisory Council to the Sustainability Accounting Standards Board. He writes and presents widely about the relevance of social responsibility to investment performance.

john.wilson@cornerstonecapinc.com

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