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Our Opinion: ESG is critical to maintaining ERISA's 'Unwavering Focus'

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On June 23, the Department of Labor (DOL) proposed new language for the Employee Retirement Income Security Act of 1974 (ERISA) requiring that pensions always put economic interests ahead of "non-pecuniary" goals. The agency specifically took aim at ESG with this language, with US Labor Secretary Eugene Scalia commenting, "Private employer-sponsored retirement plans are not vehicles for furthering social goals or policy objectives that are not in the financial interest of the plan. Rather, ERISA plans should be managed with unwavering focus on a single, very important social goal: providing for the retirement security of American workers."

We believe that the DOL-proposed language and the comments of Secretary Scalia himself present a false choice to pension funds, suggesting that they must choose between Environmental, Social, and Governance (ESG) integration and investment performance. The former is a requirement for the latter, making ESG a critical key to achieving retirement security for American workers. At the heart of investing are two extremely difficult challenges: predicting the future and forming a thesis as to how today's investment opportunities relate to that future. ESG themes like climate change, water stress, gender and racial diversity, and information privacy give us insight into the forces that will shape our economy and our society at large. ESG information as a complement to traditional financial statement analysis helps us evaluate how company management has prepared (or not!) for the changes that are upon us. A company's ability to anticipate and react to these forces of change will ultimately affect its earnings, its brand value, its valuation, its cost of capital. ESG integration in investments falls squarely under ERISA's "eye single" requirement in that it has, and should continue to, enhance retirement savings. While it is true, as Secretary Scalia points out in an opinion piece he wrote for the Wall Street Journal, that some thematic and otherwise narrow, exclusions-based investments have underperformed, the preponderance of research on ESG integration has shown it to be helpful in downside risk prediction and/or additive to returns—both in the COVID-related drawdown as well as in the extended bull market before it. The silver lining is that the proposed DOL language does acknowledge that ESG factors can be pecuniary, "but only if they present economic risks or opportunities that qualified investment professionals would treat as material economic considerations…", though this provision acts as an additional hurdle. Regardless, the proposed DOL ruling need not have a chilling effect on the use of ESG considerations in pension fund management for the simple reason that ESG meets the "materiality" standard. It is therefore an essential component of any investment management strategy that allows ERISA plans to maintain their "unwavering focus."

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