DOL Issues Final Rule on Financial Factors in Selecting Plan Investments

The Department of Labor (DOL) has issued final regulations on fiduciary standards for selecting and monitoring investments held by plans subject to the Employee Retirement Income Security Act of 1974 (ERISA), and addresses the scope of those fiduciary duties.

In response to public comments, the final regulation contains several important changes from the proposal. The fact that the loyalty principles of section 404(a)(1)(A) of ERISA are now coupled with the previous prudence regulation under section 404(a)(1)(B) confirms that, in making investment decisions of any kind, ERISA requires that both the principles of loyalty and of prudence must be considered. The final rule applies these principles not just to investments and investment courses of action, but also to the selection of available investment options for plan participants in individual account plans.

The final rule makes **five major amendments** to the investment duties regulation under Title I of ERISA at 29 CFR 2550.404a-1.

First, the rule confirms that ERISA fiduciaries must evaluate investments and investment courses of action based solely on pecuniary factors—financial considerations that have a material effect on the risk and/or return of an investment based on appropriate investment horizons consistent with the plan's investment objectives and funding policy. The term "investment course of action" is defined to mean "any series or program of investments or actions related to a fiduciary's performance of the fiduciary's investment duties, and includes the selection of an investment fund as a plan investment, or in the case of an individual account plan, a designated investment alternative under the plan."

Second, the rule includes an express regulatory provision stating that compliance with the exclusive purpose (loyalty) duty in ERISA section 404(a)(1)(A) prohibits fiduciaries from subordinating the interests of participants to unrelated objectives, and bars fiduciaries from sacrificing investment return or taking on additional investment risk to promote non-pecuniary goals.

Third, the rule includes a provision that requires fiduciaries to consider reasonably available alternatives to meet their prudence and loyalty duties under ERISA.

Fourth, the rule includes investment analysis and documentation requirements for those circumstances in which plan fiduciaries use non-pecuniary factors when choosing between or among investments that the fiduciary is unable to distinguish on the basis of pecuniary factors alone. The final rule includes a related documentation requirement for such decisions intended to prevent fiduciaries from improperly finding economic equivalence or making investment decisions based on non-pecuniary benefits without appropriately careful analysis and evaluation.

Fifth, the final rule states that the prudence and loyalty standards set forth in ERISA apply to a fiduciary's selection of designated investment alternatives to be offered to plan participants and beneficiaries in a participant-directed individual account plan. The final rule provides that, in the case of selecting investment alternatives for an individual account plan that allows plan participants and beneficiaries to choose from a broad range of investment alternatives, a fiduciary is not prohibited from considering or including an investment fund, product, or model portfolio merely because the fund, product, or model portfolio promotes, seeks, or supports one or more non-pecuniary goals, provided that the fiduciary satisfies the prudence and loyalty provisions in ERISA and the final rule, including the requirement to evaluate solely on pecuniary factors, in selecting any such investment fund, product, or model portfolio. However, the provision prohibits plans from adding any investment fund, product, or model portfolio as a qualified default investment alternative described in 29 CFR 2550.404c-5, or as a component of such an investment alternative, if the fund, product, or model portfolio's investment objectives or goals or its principal investment strategies include, consider, or indicate the use of one or more non-pecuniary factors.

Effective Date and Other Impacts

- The effective date will be 60 days following the date of publication in the Federal Register and will apply prospectively in its entirety to investments made and investment courses of action taken after that date.
- Plan fiduciaries will not be required to divest or cease any existing investment, investment course of action, or designated investment alternative, even if originally selected using non-pecuniary factors in a manner prohibited by the final rule; however, after the effective date, all decisions regarding these investments, investment courses of action, or designated investment alternatives, including decisions that are part of a fiduciary's ongoing monitoring requirements, must comply with the final rule.
- The DOL will not pursue enforcement, and does not believe any private action would be viable, pertaining to any action taken or decision made with respect to an investment or investment course of action by a plan fiduciary prior to the effective date of the final rule to the extent that any such enforcement action would necessarily rely on citation to this final rule.
- Nothing in the final rule precludes the DOL from taking enforcement action based on prior conduct that violated ERISA's provisions, including the statutory duties of prudence and loyalty, based on the statutory and regulatory standards in effect at the time of the violation.
- The final rule includes one extended compliance date -- plans have until April 30, 2022 to make any changes to Qualified Default Investment Alternatives (QDIAs). Certain designated investment alternatives are prohibited from being used as a QDIA where the investment objectives or goals or the principal investment strategies include, consider, or indicate the use of one or more non-pecuniary factors.

Contact the Pentegra Solutions Center at solutions@pentegra.com
or 855-549-6689 for expert guidance on how to make the most of the new rules.