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THE CONTINUING BATTLE OVER ECONOMICALLY TARGETED INVESTMENTS: AN ANALYSIS OF THE DEPARTMENT OF LABOR'S INTERPRETIVE BULLETIN 2015-01

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INTRODUCTION

In Interpretive Bulletin 2015-01 (IB 2015-01),[1] the U.S. Department of Labor (DOL) renewed the now two-decades old battle over "economically targeted investments" (ETIs). As a matter of statutory interpretation, IB 2015-01, like its predecessors, is unpersuasive. The Employee Retirement Income Security Act of 1974

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[1] 29 C.F.R. § 2509.2015-01 (2015).

(ERISA)[2] requires plan trustees to invest "solely" to provide participants' retirement benefits. A trustee who invests in ETIs violates this statutory obligation by pursuing collateral economic benefits for persons other than plan participants.

As a matter of policy, the social investing which ETIs exemplify is unsound. At best, such social investing in practice merely shuffles investment ownership without altering market-based allocations of capital.

I. STATUTORY BACKGROUND

Among its many innovations, ERISA codified the traditional fiduciary standards for the investment of the assets of federally regulated[3] employee benefit plans.[4]

Historically, the trustees of private trust funds have been required to invest such funds prudently,[5] diversely,[6] and loyally.[7] While the grantor of a private trust can modify these standards,[8] prudence, diversification, and loyalty are the default standards for fiduciaries investing private trust funds.[9] The standard of loyalty demands of the trustee a single-minded concern for the beneficiary. This standard of loyalty is typically expressed in terms of a sole or exclusive benefit, i.e., trustees are "to administer the trust solely in the interest of the

[2] ERISA was originally passed as P.L. 93-406. *See* Employee Retirement Income Security Act of 1974, Pub. L. No. 93-406, 88 Stat. 829 (1974). It has subsequently been amended many times. *See* 29 C.F.R. § 2509.2015-01. Parts of ERISA are codified in the Internal Revenue Code, which is Title 26 of the U.S. Code. *See* 26 U.S.C. §§ 401–409 (2012). Other parts of ERISA are codified in Title 29 of the U.S. Code. *See* 29 U.S.C. §§ 1001–1461 (2012).

[3] Some employee benefit plans are not covered by ERISA. For example, ERISA does not apply to state and local governments' plans for their employees. 29 U.S.C. § 1003(b)(1) (2012). However, many states, by statute or in their respective constitutions, impose the duties of prudence and loyalty upon the trustees of governmental pension plans. To take one case, California's constitution provides that "[t]he assets of a public pension or retirement system are trust funds and shall be held for the exclusive purposes of providing benefits to participants in the pension or retirement system and their beneficiaries and defraying reasonable expenses of administering the system." CAL. CONST. art. XVI, § 17.

[4] Under ERISA, employee benefit plans include both employer-provided retirement plans, such as defined benefit pensions and 401(k) arrangements and employer-sponsored fringe benefit plans, such as medical and death benefit arrangements. *See* 29 U.S.C. §§ 1002(1)–(2) (2012) (defining "welfare plan[s]" and "pension plan[s]); 29 U.S.C. § 1002(3) (2012) (defining "employee benefit plan[s]" as both welfare and pension plans).

[5] RESTATEMENT (THIRD) OF TR. § 90 (AM. LAW INST. 2003).

[6] *Id.* § 90(b).

[7] *Id.* at §§ 78, 90(c)(1).

[8] *Id.* §§ 78(1), 90(d), 91.

[9] *Id.* § 76 cmt. b(1) ("[T]he normal standards of trustee conduct prescribed by trust fiduciary law may, at least to some extent, be modified by the terms of the trust. Briefly stated, much of trust law, especially trust fiduciary law, is default law—but some is not."); § 91 cmt. a ("[M]ost—but not all—trust fiduciary law is default law and therefore not applicable to the extent permissibly modified by trust terms.").

beneficiaries."[10]

ERISA incorporated these traditional fiduciary standards and applied them to the trustees holding the assets of employee benefit plans.[11] ERISA adopted the fiduciary duty of loyalty by decreeing that an employee benefit plan fiduciary must "discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and for the exclusive purpose of providing benefits to participants and their beneficiaries."[12]

ERISA similarly incorporated the standard of prudence by obligating employee benefit trustees to act "with the care, . . . prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims."[13]

A. *Background: Social Investing*

The cause of social investing travels under many banners including ethical investing, socially responsible investing, impact investing and socially conscious investing.[14] Regardless of the particular label, all of these approaches postulate that investments should be made, not simply on the basis of anticipated risk and return, but to pursue other criteria as well. The proponents of social investing contend that, even as investors seek collateral benefits beyond conventional financial returns, social investing does not diminish profitability or increase risk for the investor.[15]

Calvert Investments typifies this approach, which Calvert calls "responsible investing."[16] Responsible investing, Calvert asserts, achieves "competitive investment returns" for the assets invested in

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[10] *Id.* § 78(1).

[11] *See, e.g.*, Curtiss-Wright Corp. v. Schoonejongen, 514 U.S. 73, 85 (1995) ("ERISA . . . follows standard trust law principles . . . ."); Mass. Mut. Life Ins. Co. v. Russell, 473 U.S. 134, 151 (1985) (Brennan, J., concurring) ("The legislative history demonstrates that Congress intended by § 404(a) to incorporate the fiduciary standards of trust law into ERISA. . . .").

[12] 29 U.S.C. § 1104(a)(1)(A)(i) (2012). Before the enactment of ERISA, this standard appeared in § 401 of the Internal Revenue Code where it still appears today. Internal Revenue Code Section § 401 declares that qualified pension and profit sharing plans must be "for the exclusive benefit of" the employees of the sponsoring employer and such employees' beneficiaries. *See* I.R.C. § 401(a).

[13] 29 U.S.C. § 1104(a)(1)(B) (2012).

[14] Paul Sullivan, *Jon Bon Jovi, the Jersey Shore and the Impact Investing Strategy*, N.Y. TIMES, Oct. 31, 2015, at B4; AUGUSTIN LANDIER & VINAY B. NAIR, INVESTING FOR CHANGE: PROFIT FROM RESPONSIBLE INVESTMENT x (2009).

[15] *See, e.g.*, LANDIER & NAIR, *supra* note 14, at 68 (Social investing can be used to "construct a portfolio that expresses strong responsibility preferences without giving up returns or significantly raising risk.").

[16] CALVERT INVESTMENTS, www.calvert.com (last visited Sept. 24, 2016).

Calvert's funds.[17] In general terms, Calvert channels its clients' investments to companies which are environmentally sensitive, "respect human rights," and are governed accountably and transparently.[18] Among the specific rules implementing these principles, Calvert will not sponsor investments in companies involved with tobacco, alcohol, gambling, or firearms.[19]

TIAA (formerly TIAA-CREF) has also climbed onto the responsible investing bandwagon, maintaining both bond and equity funds designed to achieve "direct environmental and social benefits."[20] Such funds, TIAA assures its customers, "deliver[] competitive performance . . . . over the long term."[21]

In another variant, Timothy Plan funds promote "biblically responsible investing."[22] For example, Timothy Plan has identified "77 companies that have given corporate donations or sponsored events for Planned Parenthood within the past five years."[23] Timothy Plan's mutual funds avoid investments in these firms.

B. *Administrative Background*

The DOL issued Interpretive Bulletin 94-1 (IB 94-1) during the Clinton Administration. IB 94-1 encouraged employee benefit trusts to make social investments designated as ETIs. Per IB 94-1, ETIs are investments of employee benefit plan assets "selected for the economic benefits they create apart from their investment return to the employee benefit plan."[24] IB 94-1 opined that, if an ETI is prudent, ERISA's duty of loyalty permits an employee plan trustee to select such investment for its economic benefits to third parties.[25]

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[17] *Our Philosophy*, CALVERT INVESTMENTS, www.calvert.com/approach/overview/our-philosophy (last visited Sept. 24, 2016).

[18] *The Calvert Principles for Responsible Investment*, CALVERT INVESTMENTS, www.calvert.com/approach/how-we-invest/the-calvert-principles (last visited Sept. 24, 2016).

[19] *Id.*

[20] *The Road to Wealth Can Be Paved With Good Intentions*, TIAA GLOBAL ASSET MANAGEMENT, https://www.tiaa.org/public/assetmanagement/land/responsible-investing (last visited Sept. 24, 2016).

[21] *Id.*

[22] *Timothy Plan: Investing with Biblical Principles*, TIMOTHY PLAN, http://timothyplan.com/download/Brochure.pdf (last visited Sept. 30, 2016).

[23] *Companies Directly Supporting Planned Parenthood*, EVALUEATOR, http://evalueator.com/download/Companies_Funding_Planned_Parenthood-LD.pdf (last updated Dec. 9, 2015).

[24] 29 C.F.R § 2509.94-1 (2006) (superseded by 29 C.F.R. § 2509.08-1 (2012)).

[25] *See id.*; *see also* Edward A. Zelinsky, *Economically Targeted Investments: A Critical Analysis*, 6 KAN. J. L. & PUB. POL'Y 39, 39 (1997) (hereinafter *Kansas*); Edward A. Zelinsky, *ETI, Phone the Department of Labor: Economically Targeted Investments, IB 94-1 and the Reincarnation of Industrial Policy*, 16 BERKELEY J. EMP. & LAB. L. 333, 335 (1995) (hereinafter *Berkeley*).

Subsequently, in the waning days of the second Bush Administration, the DOL replaced IB 94-1 with Interpretive Bulletin 08-1 (IB 08-1).[26] While IB 94-1 was a robust endorsement of ETIs, IB 08-01 placed a damper on ETIs, declaring that employee plan fiduciaries may consider collateral economic benefits only "in very limited circumstances."[27] According to IB 08-01, employee benefit trustees may consider collateral economic benefits only to break ties when such trustees must choose among otherwise comparable investments.[28]

Just as IB 08-1 superseded IB 94-1, IB 2015-01 now replaces IB 08-01. The DOL's stated intent in promulgating IB 2015-01 is to reinstate the more robust support for ETIs previously embodied in IB 94-1.[29] IB 2015-01 characterizes the duty of loyalty "as prohibiting a fiduciary from subordinating the interests of participants and beneficiaries in their retirement income to unrelated objectives."[30] The standard of prudence, IB-2015-01 states, is not satisfied if an employee benefit plan trustee invests plan assets in an investment "with a lower expected rate of return than available alternative investments with commensurate degrees of risk or is riskier than alternative available investments with commensurate rates of return."[31] If these "requirements are met," IB 2015-01 concludes that "the selection of an ETI, or the engaging in an investment course of action intended to result in the selection of ETIs" complies with ERISA's standards of prudence and loyalty.[32]

II. EVALUATING IB 2015-01

A. *ETIs Violate the Statutory Standard of Prudence: "Solely" Means Solely*

At one level, the difference among IB 94-1, IB 08-01 and IB 2015-

[26] 29 C.F.R. § 2509.08-1 (2012) (superseded by 29 C.F.R. § 2509.2015-01 (2015)).

[27] *Id.*; Edward A. Zelinsky, *Interpretive Bulletin 08-1 and Economically Targeted Investing: A Missed Opportunity*, 82 S. CAL. L. REV. POSTSCRIPT 11, 14 (2009), *reprinted in* NEW YORK UNIVERSITY REVIEW OF EMPLOYEE BENEFITS AND EXECUTIVE COMPENSATION 1A-5 (Alvin D. Lurie ed., 2009).

[28] *See* 29 C.F.R. § 2509.08-1.

[29] Interpretive Bulletin Relating to the Fiduciary Standard Under ERISA in Considering Economically Targeted Investments, 80 Fed. Reg. 65,135, 65,136 (Oct. 26, 2015) (to be codified at 29 C.F.R. § 2509.2015-01) ("IB 2008-01 has unduly discouraged fiduciaries from considering ETIs and ESG factors."). ESG refers to "environmental, social and governance" matters. *Id.* at 65,135.

[30] 29 C.F.R. § 2509.2015-01 (2015).

[31] *Id.*

[32] *Id.*

01 is rhetorical: IB 94-1 and IB-2015-01 encourage employee benefit plan trustees to make ETIs. IB 08-01 is more subdued, acknowledging that such investments can be made only "in very limited circumstances." Rhetoric matters, which is why the Bush DOL sought to dampen enthusiasm for ETIs through IB 08-01 and the Obama Administration now seeks to encourage ETIs through IB 2015-01.

All three interpretive bulletins are wrong to condone the pursuit of collateral economic benefits with employee benefit plan funds. The pursuit of ETIs contradicts ERISA's statutory text which commands that plan fiduciaries "solely"[33] and "exclusive[ly]"[34] concern themselves with the provision of participants' retirement and welfare benefits.

This uncompromising statutory terminology incorporates the traditional standard of fiduciary loyalty. That standard demands of trustees single-minded concern for the interests of the trust beneficiaries. When a trustee pursues collateral economic benefits for third parties through an ETI, the trustee violates the statute's unforgiving mandate as the trustee no longer acts "solely" or "exclusive[ly]" for the participants' welfare.

Thus, IB 2015-01, like its two predecessors, flouts ERISA's statutory text. IB 2015-01 replaces ERISA's strong statutory standard of loyalty ("solely" and "exclusive") with a weaker rule of nonsubordination. According to IB 2015-01, pension trustees may pursue third parties' interests as long as such collateral interests do not subordinate the pursuit of risk-adjusted returns earned for plan participants.

For good reason, the standard of loyalty, incorporated into ERISA, is not articulated in these or in similarly attenuated terms. Trustees, as the old saying goes, invest other people's money.[35] Beneficiaries often lack the ability to monitor trustees' actions on the beneficiaries' behalf.[36] To protect these beneficiaries, the legal standard of loyalty permits no considerations in trustees' decisionmaking other than the interests of the beneficiaries. In contrast, IB 2015-01, like its predecessors, opens trustees' decisionmaking to the interests of third parties and to the pursuit of collateral goals other than the financing of employees' retirement and welfare benefits.

In setting aside the single-minded statutory duty of loyalty, IB 2015-01 implicitly propounds a naive theory of decisionmaking. IB

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[33] 29 U.S.C. § 1104(a)(1)(A)(i) (2012).

[34] *Id.*

[35] This venerable phrase traces its origins back to Adam Smith and Louis D. Brandeis. *See* 3 ADAM SMITH, AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS 334 (Edinburgh, A. and C. Black; London, Longman, Brown, Green, & Longmans 1850); LOUIS BRANDEIS, OTHER PEOPLE'S MONEY AND HOW BANKERS USE IT (1914).

[36] *See* John H. Langbein, *The Contractarian Basis of the Law of Trusts*, 105 YALE L.J. 625, 657–58 (1995).

2015-01 assumes that plan trustees' investment decisions involve a two-step process in which the two steps are hermetically sealed from each other. In the first step, trustees identify the universe of prudent investments "giv[ing] appropriate consideration" to "such factors as diversification, liquidity, and risk/return characteristics."[37] Then, in the second stage, trustees can select from among these equally prudent investments by choosing ETIs for the collateral economic benefits they generate for third parties.[38] Under this vision, the collateral benefits of ETIs serve as "tie-breakers when choosing between investment alternatives that are otherwise equal . . . ."[39]

The traditional formulation of the standard of loyalty is more psychologically compelling by insisting that a trustee concern herself "solely" with the beneficiaries' welfare throughout the fiduciary decisionmaking process. A trustee seeking to make an ETI will be tempted (perhaps unconsciously, perhaps deliberately) to classify that investment as part of the eligible universe identified in the first step of her decisionmaking. To counteract such temptations, the standard of loyalty, as traditionally articulated and as incorporated into ERISA, mandates single-minded concern for the beneficiary's welfare throughout the trustees' decisionmaking process: Trustees must pursue beneficiaries' interests "solely" and "exclusively." Anything less opens the door of the fiduciary decisionmaking process to influences which are potentially detrimental to the beneficiaries' welfare.

Much modern research under the rubric of behavioral economics reinforces the historic formulation of the standard of prudence as now incorporated in ERISA. Even professional decisionmakers can be influenced by the way in which issues are framed.[40] Choices can be "nudged" by the manner in which such choices are presented.[41] A trustee who knows that, in a second stage of decisionmaking, he may select an ETI for its collateral economic benefits may be more inclined in the first stage to classify the desired investment as part of the available universe. The standard of IB 2015-01—do not subordinate the pursuit of risk adjusted returns for collateral economic benefits—is notably weaker than the rule commanded by the stronger standard of loyalty—consider the participants' welfare exclusively.

Thus, collateral economic benefit is not an innocent tie-breaking

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[37] 29 C.F.R. § 2509.2015-01 (2015).

[38] *Id.*

[39] Interpretive Bulletin Relating to the Fiduciary Standard Under ERISA in Considering Economically Targeted Investments, 80 Fed. Reg. at 65,136.

[40] *See* Edward A. Zelinsky, *Do Tax Expenditures Create Framing Effects? Volunteer Firefighters, Property Tax Exemptions, and the Paradox of Tax Expenditure Analysis*, 24 VA. TAX REV. 797 (2005).

[41] *See* RICHARD H. THALER AND CASS R. SUNSTEIN, NUDGE: IMPROVING DECISIONS ABOUT HEALTH, WEALTH, AND HAPPINESS 1–4 (2008).

device. Rather, it introduces into the fiduciary decisionmaking process extraneous considerations best left aside.

What should the prudent trustee do when genuinely confronted with a choice from among economically identical investments? Better to flip a coin, since coin flipping (unlike the pursuit of collateral economic benefits or any other social investing goal) does not introduce into the decisionmaking process considerations which, unconsciously or deliberately, can skew that process. Consider, for example, a pension trustee whose personal religious views correspond to those of the Timothy Fund. When deploying his own money, that trustee is free to make only "biblically responsible investments." He is then investing his own funds.

However, the pension assets this trustee controls are other people's money, assets financing participants' benefits. Some of those participants may disagree with the values animating the Timothy Fund. Even if every participant in the plan embraces those values, if those values can be considered at the second stage of the investment process, those values may (unconsciously or deliberately) influence the choices made at the first stage of the process.

The import of the traditional rule of prudence is that, once some collateral considerations start to influence the investment of trust funds, regardless of how worthy those considerations might be, it is not easy to shut the door to other extraneous concerns. Not all of these considerations will be admirable or compatible with the beneficiary's welfare. Hence, ERISA (reflecting traditional fiduciary standards) requires that employee benefit trust funds be invested single-mindedly, solely, and exclusively to fund employees' retirement and welfare benefits.

In short, "solely" means solely.

Consider in this context an employee benefit plan with two trustees, one of whom is strongly pro-choice and, therefore, seeks the collateral benefit of supporting corporations which are equally firm in their support of the right of abortion. The other trustee is pro-life and consequently opposes investment in any corporation which manufactures products used in the abortion procedure. Which of these contrasting collateral benefits is this plan to pursue?

The traditional rule of loyalty as incorporated into ERISA wisely protects plan assets from becoming political battlegrounds in these and other similar settings. These two trustees may invest their personal assets however they choose. However, in their capacities as the trustees of ERISA-regulated employee benefit plans, these trustees must put their personal concerns aside and must act "solely" for the participants' welfare. By attenuating this high fiduciary standard, IB 2015-01 ignores the statutory text of ERISA and improperly opens trustees' decisionmaking to collateral interests and influences.

Instructive in this context is the U.S. Supreme Court's decision in *Fifth Third Bancorp v. Dudenhoeffer*.[42] Writing for a unanimous court, Justice Breyer expounded on ERISA's statutory standard that plan trustees must act exclusively in the interests of plan participants and their beneficiaries.[43] That steadfast standard of loyalty, Justice Breyer wrote, mandates that plan trustees focus upon "*financial* benefits (such as retirement income)"[44] for participants rather than pursue "nonpecuniary benefits like those supposed to arise from employee ownership of employer stock."[45] If ERISA's statutory duty of loyalty precludes a plan trustee from searching for "nonpecuniary benefits" for plan participants, a fortiori that statutory duty prohibits a plan trustee from seeking collateral benefits for third parties—which is precisely what economically targeted investing entails.

B. *Social Investing is Musical Chairs*

As a matter of policy, the kind of social investing which ETIs exemplify is unsound. At best, such social investing in practice merely shuffles investment ownership without altering market-based allocations of capital.

The advocates of social investing uniformly claim that those investing in this fashion achieve the risk adjusted rates of return which prevail in the marketplace.[46] If so, these social investors are not changing economic outcomes. If a social investor eschews a particular investment yielding a market-rate return, another investor will make that investment. This is what it means for an investment to yield a market-rate return, i.e., someone in the market will undertake that investment.

If a Calvert fund sells the stock of a corporation which yields market-rate returns but fails Calvert's environmental criteria, or if a Timothy Plan fund sells the stock of a corporation which generates market-rate returns but manufactures products used in abortions, someone without their respective qualms will buy the stock from them. The net result is a game of musical chairs which simply shuffles share ownership with no net economic impact.

Similarly, if, responding to IB 2015-01, a pension trustee makes a market-rate investment to pursue collateral economic benefits, the

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42 134 S. Ct. 2459 (2014).
43 *Id.* at 2467–70.
44 *Id.* at 2468.
45 *Id.*
46 LANDIER & NAIR, *supra* note 14, at 66–69.

market's allocation of capital is not thereby affected. If this investment truly yields a market-rate return, someone else (unconcerned about ETIs) will make this investment. In a reasonably well-functioning market, the market will allocate capital to investments generating a risk-adjusted market-rate return.

And this assumes that in practice social investing indeed achieves market-rate returns rather than sacrifices financial returns to pursue other goals.

Social investing is acceptable when one is investing one's own funds. An individual can deploy her own money at below market rates rather than hold investments which contravene her beliefs. But there should be no illusion about the economic results of investing at market rates. If markets are functioning reasonably well, the social investor is merely switching places with an investor without her qualms.

CONCLUSION

Both as a matter of statutory law and as a matter of policy, the ETIs encouraged by IB 2015-01 are unsound. Statutorily, a trustee of an employee benefit plan who invests to generate economic benefits for third parties violates his ERISA obligation to invest solely and exclusively for the welfare of the plan's beneficiaries. At best, the kind of social investing exemplified by ETIs in practice merely shuffles investment ownership without altering market-based allocations of capital.

Congress acted wisely when, in ERISA, it applied the traditional duty of loyalty to trustees' investments of employee benefit plan assets. Such assets should, as ERISA provides, be invested solely and exclusively to promote employees' financial interests. IB 2015-01, like its administrative predecessors, improperly dilutes this high fiduciary standard.