MATCHING PREFERENCES AND ACCESS: SUSTAINABLE INVESTING IN 401(K) PLANS

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ABSTRACT

The vast majority of 401(k) plan participants want access to investments that match their personal values, yet a small fraction of plans offer those types of investments. The culprit for the existing misalignment has been unstable regulation, which has discouraged plan fiduciaries from including some categories of investments, such as sustainable investments, on 401(k) plan menus. In late 2022, the Department of Labor issued guidance that for the first time explicitly states that fiduciaries do not violate their duty of loyalty by considering participant preferences when making investment-related decisions. This Article makes two unique contributions. First, it evaluates the research on participant preferences for sustainable investments. Second, it provides a framework that fiduciaries can use to assess and consider those preferences while simultaneously fulfilling their duties of loyalty and prudence.

If fiduciaries adopt the framework developed in this Article, it could be a triple win. Data indicate, and experts believe, that employees will save more in their 401(k) plans if they have access to investments that support their personal values. An increase in retirement savings would help close the substantial pension gap that exists, particularly for young employees and women who are particularly vulnerable to under saving. Companies will benefit if employees place greater value on their 401(k) plans. And, the world would benefit from increased assets flowing to sustainable investments at a time when climate and social sustainability are close to or in crisis.

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INTRODUCTION

The vast majority of employees want to invest their 401(k)[1] assets in ways that fund or promote environmental, social, and governance (ESG) progress,[2] which this Article refers to as sustainable investing.[3] Yet, only between five and

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1. Issues similar to those discussed in this Article occur in other types of defined contribution plans, such as 403(b) plans, in which fiduciaries choose an investment menu from which participants may invest. For purposes of simplicity and clarity, this Article only addresses 401(k) plans.

2. SCHRODERS, 2022 US RETIREMENT SURVEY: ESG REPORT (2022), https://prod.schroders.com/en/sysglobalassets/digital/us/us-dc/2022_schroders_us_retirement_survey_esg_rpt_final.pdf [https://perma.cc/39SP-B8BF] ("almost 9 out of 10 (87%) DC plan participants surveyed report they want their investments to be aligned with their values").

3. *See* Susan N. Gary, *Best Interests in the Long Term: Fiduciary Duties and ESG Integration,* 90 U. COLO. L. REV. 733, 737 n.11 (2019) ("Sustainable investing may be more commonly used now as the generic term covering various strategies."); Morningstar, which provides investment research and ratings, now rates funds on their sustainability. CFI Team, CORP. FIN. INST., *Morningstar Sustainability Rating,* Oct. 13, 2022, https://corporatefinanceinstitute.com/resources/esg/morningstar-sustainability-rating/ [https://perma.cc/NSX4-V9J2]; The Morningstar ratings have become popular with scholars doing empirical work. *See, e.g.,* Rob Bauer, Jeroen Derwall & Colin Tissen, *Private Shareholder Engagements on Material ESG Issues,* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4171496 [https://perma.cc/S6DX-F9BZ] (2023); It often has been

eight percent of plans offer at least one sustainable investment option.[4] Stakeholders other than employees have tried to encourage employers to address this mismatch. Shareholders have asked companies to ensure their 401(k) plans offer sustainable investment options that align with corporate values.[5] In addition, proponents of sustainability initiatives recognize that the $8.9 trillion currently held in U.S. 401(k)-style plans could provide a source of funding for those initiatives.[6]

The obvious question is why such a mismatch exists between interest in sustainable investing and its availability in 401(k) plans. The answer is regulation. The Department of Labor has changed its guidance on the topic during every presidential administration from President Clinton to President Biden.[7] Plans point to the regulatory instability and the resulting potential for fiduciary liability as one of the reasons few 401(k) plans include those types of options on the plan's menu.[8]

The landscape changed on December 1, 2022, when the Department of Labor (DOL) issued a final regulation (2022 Final Regulation) that provides various

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observed that people and ratings vary in how they understand and weigh the components of ESG. Max M. Schanzenbach & Robert H. Sitkoff, *Reconciling Fiduciary Duty and Social Conscience: The Law and Economics of ESG Investing by a Trustee,* 72 STAN. L. REV. 381, 432-33 (2020) (using the oft-repeated example of Tesla); Professor Elizabeth Pollman investigated the development of the ESG terminology and concluded that some of the vagueness was intended. Elizabeth Pollman, *The Making and Meaning of ESG* (U. Penn. Inst. L. & Econ. Rsch. Paper No. 22-23, Eur. Corp. Governance Inst. Working Paper, Paper No. 659/2022, 2022), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4219857 [https://perma.cc/Y3EN-JUX8].

4. *See infra* Part II.D.

5. In 2022, shareholders forced Comcast and Amazon to include a proposal that the Board of Directors obtain a report on the extent to which their 401(k) investment options align with the company's stated values. Catherine Dunn, *Seeking More Sustainable Investments: Shareholder Group As You Sow is Pushing Comcast, Amazon to Offer Greener Choices in Employee's 401(k)s*, PHIL. INQ., May 2, 2022, at C1. Those proposals are discussed below. *See infra* Part V.B.

6. *Retirement Assets Total $32.3 Trillion in Third Quarter 2022*, INV. CO. INST., (Dec. 15, 2022), https://ici-stage.ici.org/statistical-report/ret_22_q3 [https://perma.cc/32CJ-JBBB] [hereinafter Investment Company Institute]; Considering just climate change, it will require between $3.5 and $5 trillion in annual investment to limit global warming to 1.5°C. SOPHIE BOEHM ET AL., STATE OF CLIMATE ACTION 2021, SYSTEMS TRANSFORMATIONS REQUIRED TO LIMIT GLOBAL WARMING TO 1.5°C, 18 (2021), https://files.wri.org/d8/s3fs-public/2021-10/state_climate_action_2021.pdf?VersionId=QBSICe3wSlKmOHc1rYyhdx3j3iSCqual [https://perma.cc/9YHC-F96T] (estimating $5 trillion annually by 2030); Heleen de Coninck, et al., *Strengthening and Implementing the Global Response*, *in* GLOBAL WARMING OF 1.5°C. AN IPCC SPECIAL REPORT ON THE IMPACTS OF GLOBAL WARMING OF 1.5°C ABOVE PRE-INDUSTRIAL LEVELS AND RELATED GLOBAL GREENHOUSE GAS EMISSION PATHWAYS, IN THE CONTEXT OF STRENGTHENING THE GLOBAL RESPONSE TO THE THREAT OF CLIMATE CHANGE, SUSTAINABLE DEVELOPMENT, AND EFFORTS TO ERADICATE POVERTY, 313, 321 (Valerie Masson-Demotte, et al. eds. 2018) (estimating $3.5 trillion).

7. *See infra* Part II.C.

8. *See infra* text accompanying notes 145-48.

sustainability-related fiduciary guidance for all types of private-sector retirement plans on the investment of plan assets and the exercise of shareholder rights.[9] Of special relevance for this Article, that regulation provides the first direction on consideration by fiduciaries of participant preferences when developing a plan menu.[10]

This is the first Article to evaluate the research on participant preferences for sustainable investments. This Article is also the first to provide a framework that fiduciaries can use to assess and consider preferences while simultaneously fulfilling their duties of loyalty and prudence. While this Article applies that framework in the context of participant preferences for sustainable investments, the framework is equally applicable to preferences for any type of investment.

Part I evaluates the research on whether participants want sustainable investment choices and will choose them when available. Overall, studies find that large majorities of participants respond that they want access to those types of investments in their 401(k) and similar plans. Some groups, who are at particular risk of not contributing to plans or having low account balances, namely young employees and women, have the strongest interest in sustainable investing. The data on the actual uptake of those investments when they are included on a plan menu, however, is more mixed. The Part ends with an investigation of why participants want access to sustainable investments, and whether they are willing to trade lower financial returns for those options.

Part II explains the regulatory landscape that governs 401(k) investment options, also referred to as 401(k) investment menus. It briefly outlines the instability of the regulation on fiduciary consideration of sustainability factors when making investment decisions.[11] The Part concludes by explaining the extent to which the instability and other factors have discouraged fiduciaries from including sustainable investments on 401(k) plan menus. Part III provides a framework for fiduciary compliance with the duty of loyalty when considering participant investment menu preferences. Part IV provides a framework for the duty of prudence. Part V closes by highlighting complementary actions that may increase the extent to which sustainability considerations are incorporated into 401(k) plan investments.

I. SUSTAINABLE INVESTING: PARTICIPANT PREFERENCES AND BEHAVIOR

Understanding participant preferences for sustainable investments is the first step in aligning 401(k) investment options with those preferences. This Part engages the research on whether participants want sustainable investments and will choose them when available. Studies consistently find that large majorities of participants—particularly young employees and women—want access to those

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9. Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights, 87 Fed. Reg. 73822 (Dec. 1, 2022), codified at 29 C.F.R. § 2550 [hereinafter 2022 Final Regulation].

10. *Id.* at 73822.

11. *See infra* Part II.C.

types of investments in their 401(k) and similar plans.[12] Whether participants will allocate assets to those investments when they are included on a plan menu has been less studied, however, some participants do allocate contributions to them. This Part discusses evidence indicating why participants may not appear as enthusiastic about sustainability in their plan allocations as they are when expressing preferences. This Part ends with an investigation of the evidence of why participants want access to sustainable investments, and whether they are willing to trade lower financial returns for those options.

A. Surveys of Participant Preferences

Surveys done by financial sector firms tend to find that plan participants have a strong interest in access to sustainable investments.[13] For example, a 2022 survey of U.S. investors by Schroders, a firm that focuses on sustainable investing, found that 87% of plan participants want to invest in ways that reflect their personal values.[14] In 2019, a survey by Natixis indicated 75% of participants wanted their investments to align with their personal values, whereas 56% of participants in a Cerulli Associates survey agreed they preferred to invest in sustainable companies.[15] Respondents in both the Schroders survey (74%)[16] and the Natixis survey (61%) said they would increase their contributions or be more likely to participate in a 401(k) plan if the plan gave them access to sustainable investments.[17] Millennials (aged 23-38) were most enthusiastic; 66% of them said they would begin saving or save more.[18] Including a sustainable option in its plan also may strengthen an employer's reputation among its employees.[19]

A survey done in 2022 by Sphere, a climate-focused fund provider, asked

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12. *See infra* Part I.A.

13. Studies of retail investors in general, not limited to retirement plan participants, find similarly strong interest in sustainable investing. *See, e.g.,* MORGAN STANLEY INST. for Sustainable INV., SUSTAINABLE SIGNALS: INDIVIDUAL INVESTORS AND THE COVID-19 PANDEMIC, https://www.morganstanley.com/assets/pdfs/2021-Sustainable_Signals_Individual_Investor.pdf [https://perma.cc/JJ8F-6SLU] (reporting 79% of all investors interested in sustainable investments and 99% interest among millennials).

14. SCHRODERS, *supra* note 2.

15. Rebecca Moore, *Cerulli Finds All Talk, No Action Regarding DC Plan ESG Investment Adoption,* PLAN SPONSOR (Mar. 13, 2019), https://www.plansponsor.com/cerulli-finds-talk-no-action-regarding-dc-plan-esg-investment-adoption/ [https://perma.cc/Z82Q-FWJE]; NATIXIS INVESTMENT MANAGERS, RETIREMENT REALITY CHECK: A GENERATIONAL LOOK AT DEFINED CONTRIBUTION PLAN PARTICIPATION 7 (2019), https://www.im.natixis.com/us/resources/2019-defined-contribution-plan-participant-survey [https://perma.cc/PE43-W8SJ] [hereinafter Retirement Reality Check].

16. SCHRODERS, *supra* note 2, at 2.

17. RETIREMENT REALITY CHECK, *supra* note 15, at 6.

18. *Id.*

19. *See id.*

questions targeted at each of the ESG factors and reported nuanced results.[20] About 65% of the respondents reported their employer offered a 401(k) plan.[21] The survey asked how important investing to improve the future of the climate was to respondents.[22] About 47% said it was either very important or extremely important to them.[23] The percentage increased to 76% if those who found it somewhat important were included.[24] The strongest interest attached to an ESG factor was for companies with good board oversight, which about 61% found very or extremely important.[25] Diverse and equitable company leadership had the lowest interest, with 45% of respondents stating that was very or extremely important to them.[26]

Surveys in the United Kingdom (U.K.) and European Union (E.U.) similarly find that participants want their retirement plan investments to support sustainability.[27] As in the U.S., women[28] and younger employees[29] tend to be the strongest supporters of sustainable investment of their retirement funds. In a small survey of 22 to 34-year-old U.K. citizens, nearly 80% reported they want their retirement savings invested "for good."[30] Almost 60% of those respondents said

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20. Sphere, *ESG in 401(k)s*, https://www.research.net/results/SM-R1hiLJSijdHcMo2rVExTow_3D_3D/ [https://perma.cc/UT4J-QC4J] (last visited July 20, 2023).

21. *Id.* at Q2.

22. *Id.* at Q5.

23. *Id.*

24. *Id.*

25. *Id.*

26. *Id.* The Schroders survey asked participants to identify any or all of five specific sustainability factors they thought would be important for investing. The data showed: (1) 51% "employee welfare/living wage," (2) 39% "climate change/global warming/carbon reduction," (3) 36% "human rights," (4) 30% "biodiversity (pollution, deforestation, clean water)," and (5) 22% "diversity and inclusion." SCHRODERS, *supra* note 2, at 2.

27. Sarah Pennells, *Over Half of Consumers Want their Pension Invested Responsibly to Help Tackle Climate Change,* ROYAL LONDON (July 5, 2021), https://www.royallondon.com/media/press-releases/press-releases-2021/july/over-half-of-consumers-want-their-pension-invested-responsibly-to-help-tackle-climate-change/ [https://perma.cc/FN82-GEZK] (almost 60% of respondents believed retirement funds should invest to counter climate change); Sophie Smith, *Member Support for ESG "Plateaus" as Pension Saver Awareness Issues Persist,* PENSIONS AGE (Sept. 9, 2021), https://www.pensionsage.com/pa/Support-for-ESG-plateaus-as-member-awarness-issues-persist.php [https://perma.cc/2TBN-4PLC] (77% of participants surveyed believed their pensions should be invested "to do some good as well as provide financial return).

28. UBS, WOMEN ON PURPOSE: VALUES, MONEY AND THE PURSUIT OF MORE INTENTIONAL LIVES 8 (2022), https://advisors.ubs.com/mediahandler/media/466635/Own%20Your%20Worth%204.0%20report.pdf [https://perma.cc/UX6E-Y25T] (79% of women believed it was important to align their investments with values and 67% ranked environmental and social factors as of higher importance than governance factors); *see also* Pennells, *supra* note 27.

29. Pennells, *supra* note 27.

30. Defined Contribution Investment Forum, *Navigating ESG: A Practical Guide,* 18 (2018) https://dcif.co.uk/wp-content/uploads/2022/02/navigating-esg-final-lo-res.pdf.

they would probably increase their contributions to their retirement accounts if their money was held in sustainable investments.[31] In a 2019 survey done of participants over age 39 in a variety of Dutch pension plans, nearly 75% of the respondents strongly supported sustainable investing even if that would result in lower pensions.[32]

In sum, surveys show that a substantial majority of U.S. plan participants want access to investments that align with their personal values and that sustainability is a significant concern. Survey data indicate that pension savers in the U.K. and in the Netherlands hold levels of commitment to sustainable investing that are very similar to the interest of U.S. participants.

B. Investment Behavior of Plan Participants

Surveys differ on the extent to which participants in plans with a sustainable investment option use that option. There is evidence from multiple surveys that if participants know the menu contains a sustainable option, the vast majority will use it.[33] On the other hand, a study by David Blanchett and Zhikun Liu found that only about 9% of new participants who actively allocated their contributions apportioned some assets to a sustainable fund even when they had at least one sustainable option.[34] The Blanchett and Liu study supports demographic data indicating that younger employees are more interested than older employees in sustainable investing. The younger employees selected sustainable investments at a higher rate than older employees.[35] The authors did not code for gender, so the study does not show if the stronger interest women show in sustainable investments translates into them choosing those investments at higher rates.[36]

Blanchette and Liu offer two additional insights on the characteristics of participants who allocated funds to sustainable investments. First, participants who allocate contributions across a larger number of funds are more likely than their counterparts with fewer funds to invest in sustainable funds.[37] The authors suggest this is due to naïve diversification;[38] the participants simply think more

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31. *Id.* at 25.

32. Lei Delsen & Alex Lehr, *Value Matters or Values Matter? An Analysis of Heterogeneity in Preferences for Sustainable Investments,* 9 J. SUS. FIN. & INV. 240, 248, 252 (2019), https://doi.org/10.1080/20430795.2019.1608709 [https://perma.cc/PKY3-RVU8].

33. RETIREMENT REALITY CHECK, *supra* note 15, at 7 (finding that 87% of such participants invested in the sustainable option); *see also* SCHRODERS, *supra* note 2, at 1-2 (more than 90% of participants who knew about the sustainable option invested at least part of their assets in it).

34. David Blanchett & Zhikun Liu, *ESG Fund Allocations Among New, Do-it-Yourself Defined Contribution Plan Participants* 9 (2022), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4149885 [https://perma.cc/6GEM-DF8F].

35. *See id.* at 10 (investment negatively correlated with age).

36. *See id.* at 6 (listing the variables studied).

37. *Id.* at 10.

38. *Id.*

funds are better or have a weak preference for sustainable funds.[39] Second, when higher percentages of participants in a plan contribute to a sustainable fund, the average allocations to sustainable funds are higher.[40] This implies that if participation in sustainable funds continues to grow, the result may be compounded by higher rates of contributions to the funds. The authors do not offer an explanation for the relationship between overall engagement with sustainable funds and individual allocation amounts. Perhaps it results from the herd behavior that some behavioral economists have observed among employee benefit plan participants. Their work shows some people will follow the lead of fellow employees when making employee benefit plan decisions.[41]

One way to reconcile the low uptake in the Blanchett and Liu study with the surveys that show a much stronger uptake among participants who understand their plan offers sustainable options is the relative knowledge of the participants. Blanchett and Liu analyzed how many participants choose to allocate their contributions and selected a sustainable fund for at least a portion of their contributions. The study does not determine, however, whether all of those participants understood that a sustainable option was available. Many participants have little understanding of all the options available in their plan. For example, in one survey, fewer than one-third of participants knew whether their plan had at least one sustainable option.[42] It also is reasonable to question whether participants who report knowing their plan offers a sustainable option are far more likely to invest in one than the average participant who makes an active account allocation but does not necessarily examine or understand all the alternatives.

The notion that many participants do not understand the meaning of a sustainability fund has support in the Sphere study.[43] It found that a significant majority of participants do not have even a basic understanding of the words that make up the acronym ESG.[44] More than 75% of the participants failed to identify "Environmental, Social, and Governance" from among 5 choices when asked what ESG means.[45]

There is a dearth of academic work on the actual behavior of 401(k) plan participants who have access to sustainable investments. However, in 2018 researchers at Maastricht University surveyed participants in the Pensionenfonds

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39. *Id.* at 11.

40. *Id.*

41. Dana M. Muir, *How Behavioral Science Ultimately Fails Retirement Savers: A Noble Experiment,* 56 AM. BUS. L.J. 707, 721-22 (2019).

42. SCHRODERS, *supra* note 2, at 1-2. The Sphere survey was consistent, with nearly 70% of participants stating they did not know whether their 401(k) plan menu contained an ESG fund. Sphere, *supra* note 20, at Q3.

43. *See* Sphere, *supra* note 20.

44. *See id.*

45. Sphere *id.* at Q4; *see also* Pennells, *supra* note 27 (44% of the British participants surveyed were confused about how they could invest their retirement assets to counter climate change).

Detailhandel (PD) pension fund.[46] PD is a defined benefit (DB) plan. A vote by participants in the study determined whether PD would expand its engagement with investee companies to include a fourth United Nations Sustainability Development Goal (SDG).[47] As is generally true of DB plans in the Netherlands, if the financial performance of the fund's investments fails to meet projections, the fund must cut benefits and may increase participants' contributions.[48] Thus, the participants' interest in the outcome of the vote was more than theoretical and may serve as an indicator that they would have similar views if they participated in a 401(k)-style plan.[49]

Almost 68% of the survey respondents voted to increase PD's sustainability goals and another approximately 21% had no opinion.[50] The 11% who voted against adding an additional sustainability goal were a clear minority.[51] Interestingly, an even higher percentage of the respondents, approximately 74%, favored using the SDGs to screen investments.[52] Because participants so strongly supported portfolio screening, the PD Board responded by designing and using a customized Financial Times Stock Exchange (FTSE) benchmark and passively investing a portion of fund assets to track the benchmark.[53]

In June 2020, the researchers resurveyed PD participants primarily to determine whether their preferences on sustainable investing remained stable.[54] In spite of the global pandemic, which began in March 2020, and the subsequent declines in the financial markets, participants remained committed to sustainable investing.[55] After disclosure of how the PD implemented its increased engagement and began considering the SDGs in investment decisions, more than 56% of participants approved of the engagement.[56] That was a reduction from the 68% who in 2018 supported adding an additional SDG but remained a significant majority of participants. Perhaps surprisingly, 77% of participants, an even higher

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46. Rob Bauer et al., *Get Real! Individuals Prefer More Sustainable Investments,* 34 REV. FIN. STUDIES 3976, 3982 (2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3287430 [https://perma.cc/MK22-4STF]; Rob M.M.J. Bauer & Paul M.A. Smeets, *Eliciting Pension Beneficiaries' Sustainability Preferences: Why and How?, in* PENSION FUNDS & SUSTAINABLE INVESTMENT 173-98 (P. Brett Hammond, Raimond Maurer, & Olivia S. Mitchell eds., 2023) ,https://repository.upenn.edu/prc_papers/710/ [https://perma.cc/HG43-YKK7].

47. Bauer et al., *supra* note 46, at 3983-84. The U.N. has promulgated 17 SDGs. United Nations Department of Economic and Social Affairs, *The 17 Goals*, https://sdgs.un.org/goals [https://perma.cc/AC6N-S7EJ] (last visited July 6, 2022).

48. Bauer et al., *supra* note 46, at 3978.

49. *Id.*

50. *Id.* at 3979.

51. *Id.*

52. *Id.* This was a theoretical question because participants were informed that PD had not committed to screening its portfolio based on the outcome of the vote. *Id.*

53. *Id.* at 3980.

54. *Id.*

55. *Id.* at 4002.

56. *Id.* at 3980.

percentage than in the 2018 survey, supported investment screening.[57]

To summarize, some data indicate that U.S. participants who understand and have a strong interest in sustainable investments allocate at least some of their account assets to the investments when they have access to them.[58] Some participants, though, seem to be confused or lack knowledge about the term "ESG," which may explain some of the low uptake in sustainable investments.[59] The only academic study on actual participant behavior took place in the Netherlands, where pensions have a different structure.[60] It found that participants were overwhelmingly supportive of both engagement on and screening of investments on sustainability criteria.[61] Those preferences remained robust after a market downturn.[62] The strong parallels between stated interest in sustainable investing by U.S. and Dutch participants[63] may imply that U.S. participants would behave in similar ways to their Dutch counterparts. The differences in the pension systems or social values might, however, limit the inferences that can be drawn for U.S. participant behavior.

C. Value or Values—Which Drives Preferences and Actions in Sustainable Investments?

The available research has not answered the question of whether U.S. participant preferences for and adoption of sustainable investments is driven primarily by a belief they will earn superior financial returns or by their personal values. The surveys of U.S. plan participants have asked whether those participants expect sustainable investments to perform better than other alternatives.[64] When asked that question, the results have been consistent.[65] Seventy-four percent of the participants in the Natixis survey responded they saw a profit opportunity in sustainable investments.[66] Seventy-eight percent of participants in the Schroeders survey held that belief.[67]

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57. *Id.* In a survey done of participants in a variety of Dutch pension plans nearly 75% of the respondents strongly believed they would trade some level of investment returns and accept lower pensions in return for sustainable investing. Delsen & Lehr, *supra* note 32, at 252.

58. *See* Bauer et al., *supra* note 46.

59. *See id.*

60. *See id.*

61. *See id.*

62. *See id.*

63. *See supra* Part I.A.

64. *See, e.g.,* RETIREMENT REALITY CHECK, *supra* note 15, at 7; SCHRODERS, *supra* note 2, at 2.

65. *See, e.g., id.*

66. RETIREMENT REALITY CHECK, *supra* note 15, at 7.

67. SCHRODERS, *supra* note 2, at 2. One study of fund flows in mutual funds (not just funds within 401(k) plans) found a decline in investing during the pandemic-related marked downturn in sustainable mutual funds by retail investors, and that funds with a strong sustainability orientation were more likely than average funds to experience asset outflows. Robin Döttling & Sehoon Kim,

Participants could, however, believe they might earn superior returns from sustainable investing, but still be willing to trade financial returns in order to have their investments align with their personal values.[68] Surveys have not asked U.S. participants whether they would make that trade-off. Perhaps that is because, prior to the 2022 Final Regulation, most plan fiduciaries believed it would be a violation of fiduciary duty to consider participant preferences that had a goal other than financial maximization.[69]

In their study of plan participants in the Netherlands, Professor Rob Bauer and his colleagues assessed why participants were so strongly supportive of sustainable investing.[70] They concluded that people primarily were motivated by the personal value or positive emotions they associated with sustainable investing.[71] Fifty-eight percent of participants who said they expected lower financial returns still voted in favor of the sustainable proposals.[72] Nor were the choices of those who supported sustainability affected by modified default settings.[73] In addition, people with stronger social preferences were more likely to support sustainable investing.[74]

The lack of survey data on why U.S. plan participants state such strong preferences for sustainable investments makes it impossible to know whether their preferences are due to a belief that those investments will provide superior financial returns because they see the social value of those investments as so important that they are willing to accept lower returns or some combination of the two. Surveys tend to indicate that U.S. plan participants are as favorable to sustainable investing as participants in plans in the U.K. and the Netherlands.[75] That may be because participants in all three countries think about sustainable investing in the same ways and have the same rationales for wanting those investments.[76] Another possibility might be the weight participants in each country put on financial return as compared to alignment with personal values

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Sustainability Preferences Under Stress: Evidence from Mutual Fund Flows During COVID-19, J. FIN. & QUANTITATIVE ANALYSIS 1 (2022), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3656756 [https://perma.cc/8HYK-STU5]. Whether the behavior of all market participants would translate to 401(k) behavior is unknown.

68. Schroders, *supra* note 2, at 2.

69. Moore, *supra* note 15 (stating that one of the reasons plan sponsors give for not offering sustainable investments is a belief they have lower returns).

70. Bauer et al., *supra* note 46, at 3979.

71. *Id.* at 3997.

72. *Id.* However, participants who expect sustainable investing to significantly lower their pensions were less supportive of that investing. *Id.* at 4003.

73. *Id.* at 3979.

74. *Id.* The authors measured social preferences by using the standard question "How willing are you to give to good causes without expecting anything in return?" *Id.* at 3995; *see also* Delson & Lehr, *supra* note 32, at 253 (finding strong alignment between personal values and preferences for sustainable investments).

75. *See supra* Part I.A.

76. *See id.*

may be very different.[77]

II. THE REGULATORY LANDSCAPE

This Part first explains the Employee Retirement Income Security Act's (ERISA) statutory fiduciary provisions.[78] It then considers the nuances of fiduciary obligations in 401(k) plans. It next reviews the unstable history of the DOL's regulatory interpretations that apply the fiduciary obligations to sustainable investing decisions. Finally, it analyzes the extent to which regulatory and other concerns have discouraged fiduciaries from including sustainable investment options on 401(k) plan menus.

A. Fiduciary Obligations

ERISA imposes four general requirements on fiduciaries, all of which are framed within an overarching command that the "fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries."[79] The first is a duty to act "for the exclusive purposes of (i) providing benefits to participants and their beneficiaries and (ii) defraying reasonable expenses of administering the plan."[80] The second is a duty to act prudently.[81] The final two duties are a duty to diversify investments in most circumstances, which can be characterized as an implementing rule[82] for the duty of prudence, and a duty to administer the plan in accordance with the plan's instruments "insofar as such documents and instruments are consistent with the provisions of [ERISA]."[83] The primary duties clearly are based in the traditional fiduciary duties of loyalty and prudence.[84]

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77. *See, e.g.,* Delsen & Lehr, *supra* note 32, at 247 (noting that the "Netherlands is one of the most post-material societies in the world.").

78. Employee Retirement Income Security Act §§ 1-4402, 29 U.S.C. §§ 1001-1461 [hereinafter ERISA].

79. ERISA § 404(a)(1), 29 U.S.C. § 1104(a)(1).

80. ERISA § 404(a)(1)(A), 29 U.S.C. § 1104(a)(1)(A).

81. ERISA § 404(a)(1)(B), 29 U.S.C. § 1104(a)(1)(B).

82. Implementing rules adapt flexible and broad fiduciary obligations to specific applications. *See* Robert H. Sitkoff, *The Economic Structure of Fiduciary Law*, 91 B.U. L. REV. 1039, 1044-45 (2011) (discussing implementing rules in fiduciary trust law). Fiduciary law's implementing rules are similar to the rules and regulations developed by agencies such as the Securities and Exchange Commission (SEC) to provide guidance on statutory provisions. Those rules and regulations also sometimes are referred to as implementing rules. *See, e.g.*, James J. Park, *Insider Trading and the Integrity of Mandatory Disclosure*, 2018 WIS. L. REV. 1133, 1134 n.1 (referring to a regulation promulgated by the SEC as an implementing rule).

83. ERISA § 404(a)(1)(C)-(D), 29 U.S.C. § 1104(a)(1)(C)-(D).

84. Dana M. Muir, *Decentralized Enforcement to Combat Financial Wrongdoing in Pensions: What Types of Watchdogs are Necessary to Keep the Foxes Out of the Henhouse?,* 53 AM. BUS. L.J. 33, 65 (2016).

B. Participant-Directed Plans

401(k) plans can, and usually do, delegate responsibility for making investment decisions regarding their account assets to participants.[85] Such plans are known as participant-directed plans.[86] Participants choose their investments from an investment menu created by plan fiduciaries.[87] ERISA shields employers and other plan-related actors from fiduciary responsibility for the specific investment decisions made by participants when participants "exercise[] control" over account assets.[88] Regulations provide a safe harbor for plans that include sufficient investment alternatives and access to information about those alternatives.[89]

The selection and monitoring of the investment alternatives included on a plan's menu is a fiduciary function.[90] In *Hughes v. Northwestern Univ.*, participants in Northwestern University's plan[91] alleged fiduciaries violated their obligation of prudence by permitting excessive record-keeping fees and investment choices that were more expensive than necessary.[92] Northwestern

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85. Dana Muir & Norman Stein, *Two Hats, One Head, No Heart: The Anatomy of the ERISA Settlor/Fiduciary Distinction*, 93 N.C. L. REV. 459, 498 (2015).

86. *Id*.

87. *Id*. Some plans add what is known as a "brokerage window" to the list of designated investment alternatives on the plan's investment menu. *Id.* Typically, an additional administrative fee is charged for participants who choose to use the brokerage window, which enables the participants to choose from a significantly larger set of investments. *Id.* It remains unclear whether fiduciaries have an obligation to monitor the investments available in the window or how the inclusion of a window in a plan affects the fiduciary monitoring obligations of the designated investment alternatives. Some scholars have argued that it would be bad policy to immunize fiduciaries of plans that include brokerage windows. Ian Ayers & Quinn Curtis, *Beyond Diversification: The Pervasive Problem of Excessive Fees and "Dominated Funds" in 401(k) Plans*, 124 YALE L.J. 1476, 1485, 1508 (2015). The DOL has struggled with the application of fiduciary principles to brokerage windows. *See* U.S. Dept. of Lab., *Fee Disclosure Guidance,* FAB No. 2012-02R, July 30, 2012, Q39 (stating brokerage windows are not designated investments on a plan menu and fiduciaries have obligations regarding the "nature and quality of services" associated with the window).

88. *See* ERISA § 404(c)(1)(A), 29 U.S.C. § 1104(c)(1)(A).

89. 29 C.F.R. § 2550.404c-1(b) (2010); *see also infra* Part III.C. (explaining the requirements in the context of adding a sustainability option).

90. Tibble v. Edison Int'l, 575 U.S. 523, 530 (2015); *see* Fifth Third Bancorp v. Dudenhoeffer, 573 U.S. 409, 421 (2014) (holding that decisions regarding employer stock in an Employee Stock Ownership Plan were fiduciary decisions); Peter J. Wiedenbeck, *Untrustworthy: ERISA's Eroded Fiduciary Law*, 59 WM. & MARY L. REV. 1007, 1068 (2018) (positing that the Supreme Court may view plan sponsor decisions on plan investments as an "inherent fiduciary function.").

91. The Northwestern plan was a 403(b) plan, which is governed by the same basic fiduciary rules as govern 401(k) plans. *See* Brief for Respondent, at 3-4, Hughes v. Northwestern Univ., 142 S. Ct. 737 (2022).

92. *Hughes*, 142 S. Ct at 739.

relied on a version of what had come to be known as the large menu defense—that there was no fiduciary breach because the plan offered at least one prudent option.[93] The Supreme Court rejected Northwestern's argument, noting that the Court had held in an earlier case that fiduciaries have an ongoing duty of prudence to monitor all of the plan investment options.[94] In *Hughes,* the unanimous Court held that the duty of monitoring and eliminating any imprudent options applied to each option on the plan's investment menu.[95]

In 401(k) plans with automatic enrollment, employees may affirmatively decline to participate (they may opt out of the plan), or they may specify the amount they want to contribute; but if they fail to do either, then the employer automatically withholds contributions to the plan.[96] Thus, an employee who does nothing becomes a participant in the plan.[97] Every 401(k) plan that uses automatic enrollment must set two additional defaults—the amount of a participant's contribution and the investment vehicle in which the contributions will be invested.[98] Employees who affirmatively exercise their right to designate their account investments may allocate some or all of their contributions to the default vehicle.[99]

To encourage employers to adopt automatic enrollment provisions, in 2007 the Department of Labor (DOL) issued final regulations that partially eliminated fiduciary liability for employers who select "qualified default investment alternatives" (QDIAs)[100] as the investment default for their plan.[101] In order to qualify as a QDIA, the default must be a diversified investment product.[102] The

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93. *Id.* at 740.

94. *Id.* at 741 (citing *Tibble,* 575 U.S. at 530).

95. *See Hughes*, 142 S. Ct. at 741.

96. Kathryn L. Moore, *An Overview of the U.S. Retirement Income Security System and the Principles and Values It Reflects*, 33 COMP. LAB. L. & POL'Y J. 5, 21 (2011).

97. *Id*.

98. *Id*.

99. *See* Steven D. Cohen, *Autoenrollment and Annuitization: Enabling the 401(k) "DB-ation,"* 5 N.Y.U. J. L. & BUS. 281, 310 (2009) (noting that a life-cycle fund may be both a default and an investment option).

100. 29 C.F.R. § 2550.404c-5(e)(4) (2019). Four types of investment products qualify as QDIAs. First, a short-term, capital preservation product, which may be used for the first 120 days of an employee's plan participation, is the only conservative product. *Id*. Second, three categories of long-term products meet the requirements to be QDIAs. *See id.* Third, two must be appropriate to the individual characteristics of the specific employee. *See id.* Specifically, "targeted-retirement-date" funds, more commonly known as target date funds ("TDFs"), may qualify. *See id.* Fourth, a QDIA may consist of a product that contains investments tailored to account for the characteristics of the plan participants as a group. *See id.*

101. 29 C.F.R. § 2550.404c404c-5; *see also* Debra A. Davis, *How Much is Enough? Giving Fiduciaries and Participants Adequate Information about Plan Expenses*, 41 J. MARSHALL L. REV. 1005, 1031-32 (2008) (discussing QDIA regulation).

102. *See* Dana Muir, *How Behavioral Science Ultimately Fails Retirement Savers: A Noble Experiment,* 56 AM. BUS. L.J. 707, 717 (2019).

DOL's requirement for QDIAs is consistent with the advice of experts who agree that typical individual investors should "hold a portfolio which is (1) well-diversified, (2) low-cost, and (3) exposes [them] to age-appropriate stock market risk."[103]

A Vanguard study of its defined contribution plan clients, who sponsor plans with approximately five million participants, determined that 88% of the plans designated a QDIA.[104] Nearly all QDIAs (93%) are target date or balanced funds.[105] Regardless of the investment vehicle selected as the QDIA, after three years, 80% of participants contributed only to the QDIA and nearly all (97%) allocated some portion of their contributions to the QDIA.[106]

New 401(k) plans adopted after 2024 must provide for automatic enrollment at a minimum of 3% of the salary.[107] Participants may opt-out.[108] Unless the participant elects otherwise, the contributions will be invested in the plan's QDIA.[109] As a result of this change, it is likely that over time an even greater portion of plan assets will be held in QDIAs.

C. The Unstable Regulatory Guidance for Sustainable Investing

In 1979, the DOL issued the first regulation providing general guidance to fiduciaries on the investment of pension assets.[110] That regulation based its

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103. Ian Ayres & Edward Fox, *Alpha Duties: The Search for Excess Returns and Appropriate Fiduciary Duties*, 97 TEX. L. REV. 445, 453 (2019).

104. Vanguard, *How America Saves,* 10, Fig. 1 (2022), https://institutional.vanguard.com/content/dam/inst/vanguard-has/insights-pdfs/22_TL_HAS_FullReport_2022.pdf [https://perma.cc/2UTT-DSAJ]. Vanguard manages more tax-exempt assets than any other institutional asset manager. Erin Arvedlund, *Vanguard Takes Institutional Lead over BlackRock,* PENSIONS & INVS., June 12, 2023, https://www.pionline.com/largest-money-managers/vanguard-pulls-ahead-blackrock-worldwide-institutional-assets [https://perma.cc/WR45-73MX].

105. Vanguard, s*upra* note 104. Professor Amy Monahan explained, "[t]arget date funds, which are designed to automatically shift the fund's asset allocation as the target retirement date nears, are attractive because they are designed around the participant's investment time horizon, and they offer one-stop shopping." Amy B. Monahan, *An Affordable Care Act for Retirement Plans?,* 20 Conn. Ins. L.J. 459, 475 (2014); *see also* STACY L. SCHAUS, DESIGNING SUCCESSFUL TARGET-DATE STRATEGIES FOR DEFINED CONTRIBUTION PLANS: PUTTING PARTICIPANTS ON THE OPTIMAL GLIDE PATH 14 (2010) (investment strategies targeted to a retirement date "rebalance on an ongoing basis and adjust allocations as a[n employee] ages.").

106. Vanguard, *Autoenrollment and the Importance of the Default* (Oct. 15, 2021), https://institutional.vanguard.com/VGApp/iip/site/institutional/researchcommentary/article/InvResAutoenrollmentAndTheImportanceOfTheDefault [https://perma.cc/LGR5-J2DJ].

107. Secure 2.0 Act of 2022, § 414A(b)(3)(A)(i), *enacted in* Consolidated Appropriations Act 2023 (Dec. 29, 2022).

108. *Id.*

109. *Id.* § 414A(b)(4).

110. Rules and Regulations for Fiduciary Responsibility; Investment of Plan Assets Under the "Prudence Rule," 44 Fed. Reg. 37221 (June 26, 1979), codified at 29 C.F.R. § 2550 (2023)

interpretation of prudence on modern portfolio theory, advising fiduciaries to evaluate each investment in light of the entire portfolio.[111] The DOL stated in the preamble that it would not be appropriate for a regulation to specify a list of acceptable or unacceptable investments.[112] Nor should any investment be treated, when considered alone, as per se prudent or imprudent.[113] The regulation did not address directly the duty of loyalty, instead stating that to fulfill its duty of prudence the fiduciary's investment approach must be "reasonably designed . . . to further the purposes of the plan."[114]

In 1994, during the administration of President William J. Clinton, the DOL issued an interpretative bulletin (IB), its first guidance other than in advisory opinions, on sustainable investing.[115] The IB clarified "that under ERISA a plan fiduciary may invest plan assets in [a sustainable investment] provided the fiduciary determines that such investment is appropriate for the plan in terms of the same factors that a prudent fiduciary would use in determining whether any other type of investment is appropriate for the plan."[116] The DOL intended to eliminate the "perception . . . within the investment community that investments in [sustainable investments] are incompatible with ERISA's fiduciary obligations."[117]

After the election of President George W. Bush, in 2008, the DOL issued an

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[hereinafter 1979 Final Regulation].

111. Max M. Schanzenbach & Robert H. Sitkoff, *Did Reform of Prudent Trust Investment Laws Change Trust Portfolio Allocation?,* 30 J. LAW & ECON. 681, 685-86 (2007). At the time, trust law still caused trustees to be extremely risk-averse in the investment of trust assets because each investment was subject to ex-post evaluation of its individual risk. *Id.* at 683-85; David H. Webber, *The Use and Abuse of Labor's Capital*, 89 N.Y.U.L. REV. 2106, 2152 (2014). The constraints acted as a default. Trust documents could direct other investment approaches. Schanzenbach & Sitkoff, *supra* note 111, at 683-85. Trust law did not begin to catch up to the ERISA standard until the mid-to-late 1980s. *Id*. at 685-86 n.45. Trust law in all states now follows the entire portfolio approach to prudence. *Id*. at 686.

112. 1979 Final Regulation, 44 Fed. Reg. at 37225.

113. *Id.*

114. *Id.*

115. DOL Interp. Bull. 94-91, Interpretative Bulletin Relating to the Employee Retirement Income Security Act of 1974, 59 Fed. Reg. 32606, 32606 (June 23, 1994) ("This document sets forth the view of the [DOL] . . . with respect to a plan fiduciary's decision to invest plan assets in 'economically targeted investments' (ETIs)) [hereinafter DOL IB 94-01]. The typical understanding of ETIs is that the investments were intended to provide collateral benefits, often to the communities where the investments were located. *Id*. In 2015, the DOL began to shift its references to ESG. *Id*. The Preamble of a 2015 IB referred to both ETIs and the consideration of Environmental, Social, and Governance (ESG) factors in investment decisions, but the IB explicitly referred only to ETIs. DOL Interp. Bull. 15-01, Interpretive Bulletin Relating to the Fiduciary Standard Under ERISA in Considering Economically Targeted Investments, 80 Fed. Reg. 65135 (Oct. 26, 2015) [hereinafter DOL IB 15-01]. To avoid confusion, this Article consistently uses the term ESG rather than ETI.

116. DOL IB 94-01, *supra* note 115, at 32606.

117. *Id.*

IB modifying and superseding the Clinton-era IB.[118] The 2008 IB appeared to threaten compliance actions against fiduciaries that too readily considered sustainability factors in investment decisions.[119] It stated: "The guidance provided in [this IB] clarifies, through explanation and examples, that fiduciary consideration of non-economic factors should be rare, and when considered, should be documented in a manner that demonstrates compliance with ERISA's rigorous fiduciary standards."[120]

During the Democratic administration of President Barack H. Obama, in 2015, the DOL issued its third IB on sustainable investing.[121] It echoed the concerns of the Clinton-era guidance when it stated that "[t]he [DOL] believes that [the 2008 guidance] has unduly discouraged fiduciaries from considering . . . [sustainability] factors."[122] The 2015 IB was the first explicitly to recognize that "[sustainability] 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."[123]

The pendulum swung once again during the Republican administration of President Donald J. Trump when the DOL issued a Field Assistance Bulletin (FAB) and a regulation, both of which were intended to discourage fiduciaries from sustainable investing.[124] The 2018 FAB advised that: "Fiduciaries must not too readily treat [sustainability] factors as economically relevant to the particular investment choices at issue when making a decision."[125] The administration upped the stakes for fiduciaries with a final regulation, which was promulgated in November 2020 (2020 Final Regulation), near the end of the Trump administration.[126]

Although the language of the 2020 Final Regulation did not explicitly address sustainability factors, the preamble made clear that the regulation intended to discourage fiduciaries from considering those factors when making investment decisions.[127] It did so by imposing burdens and restrictions on the use of

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118. DOL Interp. Bull. 08-1, Interpretive Bulletin Relating to Investing in Economically Targeted Investments, 73 Fed. Reg. 61734, 61734 (Oct. 17, 2008) [hereinafter DOL IB 08-1].

119. *Id*.

120. *Id*.

121. DOL IB 15-01, *supra* note 115, at 65135.

122. *Id*. at 65136.

123. *Id*.

124. U.S. Dep't. of Labor, Field Assistance Bulletin No. 2018-01, 2 (Apr. 23, 2018), https://www.dol.gov/agencies/ebsa/employers-and-advisers/guidance/field-assistance-bulletins/2018-01 [https://perma.cc/ES8U-ME8P] [hereinafter FAB 2018-01]; Financial Factors in Selecting Plan Investments, 85 Fed. Reg. 72846 (Nov. 13, 2020), codified at 29 C.F.R. §§ 2509 and 2550 [hereinafter 2020 Final Regulation].

125. FAB 2018-01 ("ERISA fiduciaries must always put first the economic interests of the plan in providing retirement benefits.").

126. 2020 Final Regulation, 85 Fed. Reg. at 72846.

127. *Id*.

sustainability factors.[128] It explained that the regulation's requirements reflected the DOL's "continued concern about the growing emphasis on sustainable investing that seeks to achieve non-pecuniary objectives or goals that are unrelated to the interests of the plan's participants in their retirement income or financial benefits under the plan."[129]

The DOL did not wait long after President Biden took office in January 2021 to advise fiduciaries that it was reversing its position on the 2020 Final Regulation. On March 10, 2021, the DOL announced that it would "not enforce [the 2020 Final Regulation] or otherwise pursue enforcement actions against any plan fiduciary based on a failure to comply with those final rules with respect to an investment."[130] The DOL followed in October 2021 with a proposed regulation (2021 Proposed Regulation) to revise and republish the 2020 Final Regulation.[131] The preamble explained the need for revisions, stating that the 2020 Final Regulation had "already had a chilling effect on appropriate integration of climate change and other [sustainability] factors in investment decisions, . . . including in circumstances that . . . regulation may in fact allow."[132]

On December 1, 2022, the DOL issued the 2022 Final Regulation, which addresses the duties of loyalty and prudence for investment-related decisions and the exercise of shareholder rights.[133] That regulation reversed and modified provisions in the 2020 Final Regulation in ways that support consideration of sustainability factors when making investment decisions in DB and DC plans.[134] The DOL, however, deleted language that had appeared in the 2021 Proposed Regulation and that, based on comments, appeared to be particularly contentious.[135] For example, the final regulation eliminated language stating that fiduciary obligation "may often require an evaluation of the economics effects of climate change and other environmental, social or governance factors."[136]

The DOL may have taken the "more neutral" approach[137] in the 2022 Final

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128. *Id*.

129. *Id.* at 72858.

130. U.S. Dep't. of Labor, *U.S. Department of Labor Statement Regarding Enforcement of its Final Rules on ESG Investments and Proxy Voting by Employee Benefit Plans,* Mar. 10, 2021, https://www.dol.gov/sites/dolgov/files/ebsa/laws-and-regulations/laws/erisa/statement-on-enforcement-of-final-rules-on-esg-investments-and-proxy-voting.pdf.

131. Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights, 86 Fed. Reg. 57272, 57275 (Oct. 14, 2021) (to be codified at 29 C.F.R. § 2550) (the 2020 Final Regulation has "been interpreted as putting a thumb on the scale against the consideration of ESG factors") [hereinafter 2021 Proposed Regulation].

132. *Id.* at 57275.

133. *See generally* 2022 Final Regulation, 87 Fed. Reg. 73822 (Dec. 1, 2022), codified at 29 C.F.R. § 2550.

134. *See id.*

135. *See id*. at 73830.

136. *See, e.g., id.* at 73830.

137. Brian Croce, *DOL Takes More Neutral Stance with ESG Rule,* PEN. & INV. (Dec. 12, 2022), https://www.pionline.com/esg/long-awaited-dol-rule-esg-takes-more-neutral-approach

Regulation in the hopes it could bring regulatory stability to an area much in need of that stability. The prior volatility in the DOL's guidance had often been referred to as "pingpong,"[138] although it would be more descriptive to characterize it as a nasty political tug-of-war in which plan fiduciaries were caught in the middle. Indeed, attempts to negate the rule began even before its effective date.[139]

Parts III and IV set out a framework for 401(k) plan fiduciaries to follow when considering participant preferences in order that the fiduciaries can fulfill their duties of loyalty and prudence. First, however, the next subsection explains the effect of the instability in fiduciary guidance on the availability of sustainable investment options in 401(k) plans.

D. Availability of Sustainable Investment Options in 401(k) Plans

Due to a lack of required reporting and transparency, no solid data is available on how many 401(k) plans include sustainable investment options on their plan menus. One of the largest organizations representing plan sponsors estimated in 2021 that about five percent of 401(k) or similar plans included a sustainable investment option on their plan menus.[140] Similarly, an investment consulting firm estimated based on 2021 data that the investment menus of only six percent of plans include a sustainable investment option.[141]

While the data is limited and may suffer from a variety of defects,[142] the data has been relatively consistent over recent years. A 2018 report by the Government

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[https://perma.cc/3HTK-EGMQ].

138. *Id*. ("regulatory pingpong"); *see also* Elizabeth S. Goldburg et al., *Regulatory Ping Pong: DOL Releases Proposed Rule on Considering ESG Factors in ERISA Plan Investing,* MORGAN LEWIS (Oct. 2021), https://www.morganlewis.com/pubs/2021/10/regulatory-ping-pong-dol-releases-proposed-rule-on-considering-esg-factors-in-erisa-plan-investing-practical-guidance [https://perma.cc/752G-HHKX].

139. A group of states and plan sponsors have filed litigation challenging the DOL's authority to issue the 2022 Final Regulation and alleging the regulation is arbitrary and capricious. Complaint at 2, Utah v. Walsh, No. 2:23-CV-016-Z (D. Ct. N.D. Tex. Jan. 26, 2023); *see also* Brian Croce, *Republican Senator Floats Resolution to Overturn Labor Department's ESG Rule,* PEN. & INV. (Dec. 02, 2022), https://www.pionline.com/washington/republican-senator-floats-resolution-overturn-labor-departments-esg-rule [https://perma.cc/64AQ-WNHF] (discussing Senator Tom Cotton's (R-Ark) resolution to nullify the regulation).

140. 2021 Final Regulation, 87 Fed. Reg. 73822, 73856-57 (Dec. 1, 2022), codified at 29 C.F.R. § 2550.

141. NEPC, *NEPC 2021 Defined Contribution Plan Trends and Fee Survey Results,* 8 (2022), https://www.nepc.com/institutional/wp-content/uploads/sites/4/2022/02/2021-NEPC-DC-Plan-Trends-and-Fee-Survey-Full-Results-final.pdf [https://perma.cc/RNC3-UAWZ] (including 137 defined contribution plans with 1.6 million participants).

142. *See* 2021 Final Regulation, 87 Fed. Reg. at 73857 (discussing potential data issues including lack of knowledge by surveyed fiduciaries); *see also* Ron Lieber, *How to Get Socially Conscious Funds into Your 401(k)*, N.Y. TIMES, Jan. 10, 2020 (reporting on a survey of plan sponsors finding about 3% of 401(k) plans offer a sustainability fund).

Accountability Office (GAO) gathered data on DC plans from a number of surveys.[143] Two large surveys that the GAO reviewed covered 600 and 1900 DC plans and estimated respectively that about 2% and 8% offered a sustainable investment option that in some way may prioritize non-financial goals.[144]

Asset managers told the GAO that the instability of regulatory guidance played a role in why relatively few fiduciaries factored sustainability into investment decisions.[145] Some of the asset managers believed the changes in guidance across Presidential administrations were substantive enough to raise concerns about the scope of fiduciary duties and the future reliability of the guidance.[146] It is understandable, given the frequency of litigation in private-sector retirement plans,[147] that plan fiduciaries might be reluctant to venture into uncertain investment territory, particularly as first or early movers. Even after the publication of the 2022 Final Regulation, one law firm stated that "Given the political controversy, any expansion of [sustainable] investing into 401(k) plans . . . can be expected to be controversial."[148]

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143. U.S. Gen. Acct. Off., Retirement Plan Investing: Clearer Information on Consideration of Environmental, Social, and Governance Factors Would be Helpful, GAO-188-398, at 2 (May 2018) [hereinafter GAO ESG Report].

144. *Id.* at 13. One sign of the low levels of engagement by private-sector plans in sustainability is that the Bloomberg LP Retirement Plans are the only plans sponsored by for-profit employers that have signed the United Nations Principles for Responsible Investments. To identify signatories that were pension plans sponsored by private-sector companies, in January 2022 the author reviewed all of the signatories listed on https://www.unpri.org/signatories/signatory-resources/signatory-directory. Michael Bloomberg, the founder of Bloomberg LP, has been active on environmental issues in many ways including as Chair of the Task Force on Climate-related Financial Disclosures. *See*, *e.g.*, *Benefits of Better Disclosure*, TASK FORCE CLIMATE-RELATED FIN. DISCLOSURE, https://www.fsb-tcfd.org/ [https://perma.cc/8D35-PTSY] (last visited Jan. 29, 2022) (video statement by TCFD Chair, Michael Bloomberg).

145. GAO ESG Report, *supra* note 143, at 19.

146. *Id.*

147. Brian Anderson, *The Dramatic Rise in Excessive 401k Fee Litigation – And Who's Fighting It,* 401(K) SPECIALIST (May 7, 2022), https://401kspecialistmag.com/the-dramatic-rise-in-excessive-401k-fee-litigationand-whos-fighting-it/ [https://perma.cc/2LL2-XGWS] ("More than 170 lawsuits challenging retirement plan fees have been filed in federal courts since 2020.").

148. R. Sterling Perkinson & Peter Daines, *DOL Opens ESG Door: What Does it Mean for Plan Fiduciaries?,* KILPATRICK TOWNSEND (Dec. 5, 2022), https://kilpatricktownsend.com/en/insights/alert/2022/12 [https://perma.cc/6L6D-PCLK]. The political controversy also can be seen in the division between states in their views on whether their state pension and other assets should be invested sustainably. *See, e.g.,* Matthew Goldstein & Maureen Farrell, *BlackRock's Pitch for Socially Conscious Investing Antagonizes All Sides,* N.Y. TIMES (Dec. 23, 2022) https://www.nytimes.com/2022/12/23/business/blackrock-esg-investing.html [https://perma.cc/NR6M-DQ66] (noting that officials in some states have withdrawn assets from BlackRock because of its pro-sustainability messaging and officials in other states have asked whether BlackRock's actions reflect a strong enough sustainability commitment). ERISA does not govern the actions of states in making investment decisions on pension or other state assets and the state law fiduciary implications are

III. Harmonizing Participant Preferences And the Duty of Loyalty

Although the nuances of how the duty of loyalty applies to sustainable investing has varied, at its core, the DOL's interpretation of that duty has been stable throughout all of the guidance it has issued.[149] The guidance always has prohibited fiduciaries from prioritizing other objectives over the pursuit of retirement income or other financial benefits.[150] Nor has it permitted them to "sacrifice investment return or take on . . . goals unrelated to the plan and its participants. . . ."[151]

The core duties, however, do not explicitly address whether fiduciaries of 401(k) plans may consider participant preferences when building and monitoring investment menus. Consistent with the DOL's approval of that consideration, this Part builds a framework for fiduciaries to follow in doing so. It also addresses how consideration of preferences may affect decisions in two areas that have been especially controversial.

A. Consideration of Participant Preferences

The language of the 2022 Final Regulation assures fiduciaries that "[t]he plan fiduciary of a [401(k)] plan does not violate the duty of loyalty . . . solely because the fiduciary takes into account participants' preferences in a manner consistent with [the regulation's guidance on the duty of prudence]."[152] This approach is entirely consistent with fiduciaries' obligation to prioritize the accumulation of retirement wealth. The preamble to the 2022 Final Regulation recognizes that asset managers and custodians believe that if employees have access to investments that align with their beliefs and preferences, some may be more likely to participate in 401(k) plans, may save at higher rates, and may be more engaged with the plan and their savings.[153] While the clarity of the regulatory statement will provide comfort to fiduciaries, the view that fiduciaries may consider participant preferences is not inconsistent with prior interpretations of the duty of loyalty.[154]

The industry and academic research reviewed in Part I above supports the argument that providing investment vehicles that accord with participant preferences could enhance the building of retirement wealth. Most participants

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beyond the scope of this Article.

149. *See infra* text accompanying notes 150-51.

150. 2021 Final Regulation, 87 Fed. Reg. 73822, 73835 (Dec. 1, 2022), codified at 29 C.F.R. § 2550. While economists may argue that if the pursuit of social or other non-financial goals may maximize participant utility, such an approach is not consistent with the Supreme Court's interpretation of ERISA's duty of loyalty.

151. *Id.* at 73835.

152. *Id.* at 73885.

153. *See id.* at 73828, 73841.

154. *See, e.g., id.* at 73842 (noting the preamble to the 2021 Final Regulation approved consideration of participant demand for investments).

appear to want sustainable investment options and many report they would increase their plan participation or contributions.[155] Opponents of considering participant preferences may object that some preferences may not be entirely focused on maximizing financial return at a given level of risk. Those opponents may argue fiduciaries would violate their duty of loyalty to maximize "financial benefits" as required by the Supreme Court.[156] The Court's full statement, though, was that fiduciaries must maximize "financial benefits (such as retirement income)."[157] For purposes of the framework advocated here, if fiduciaries reasonably determine that consideration of participant preferences is likely to empower and motivate participants to build greater retirement wealth, then the fiduciaries may consider those preferences.

The demographic differences in support for sustainable investing offer an opportunity for fiduciaries to address the under-saving observed by two groups—young employees and women. As discussed in Part I, both of those groups have higher than average interest in sustainable investing.[158] Nothing in the regulation or case law prohibits considering the preferences of subgroups of employees, particularly where it may be especially effective in encouraging increased savings.[159]

To begin with young workers, the power of tax-free compound returns on pre-tax savings over a career means that young workers who save early in their career can build substantial retirement wealth.[160] Yet, younger workers are one of the groups least likely to enroll and participate in a 401(k) plan.[161] They often are not yet earning high wages and have relatively low tax rates so they realize only limited benefits from the tax benefits of saving in a deferred income plan such as a 401(k).[162] Low salaries also translate into lower levels of discretionary income available for savings, particularly for younger employees who may have educational loans or be facing new rent, transportation, and other expenses.[163]

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155. *See supra* Part I.A.

156. *See* Fifth Third Bancorp v. Dudenhoeffer, 573 U.S. 409, 421 (2014) (referring to financial benefits").

157. *Id.*

158. *Supra* Part I.

159. *See generally,* 2022 Final Regulation, 87 Fed. Reg. 73822 (Dec. 1, 2022), codified at 29 C.F.R. § 2550.

160. Colleen E. Medill, *Targeted Pension Reform,* 27 J. LEGIS. 1, 67 (2001).

161. Patricia Dilley, *Hope We Die Before We Get Old: The Attack on Retirement,* 12 ELDER L.J. 245, 270 (2004).

162. *See* Lorraine Schmall, *Defined Contribution Plans after Enron,* 41 BRANDEIS L.J. 891, 902 (2003) ("[T]he federal government's tax incentive for making contributions to a 401(k) is significantly more valuable for higher income workers because they are in a higher marginal income tax bracket.").

163. *See* Colleen E. Medill, *Challenging the Four "Truths" of Personal Social Security Accounts: Evidence from the World of 401(k) Plans,* 81 N.C. L. REV. 901, 936 (2003) ("Participants in traditional 401(k) plans are a self-selected group who earn wages and salaries at levels sufficient to provide a measure of discretionary income.").

Behavioral economics provides another explanation for low participation rates by younger employees. They may overly discount the benefit of having retirement assets many years in the future and favor current consumption.[164]

Women are at particular risk of retirement income inadequacy because the average women who retires at age 65 will live 3 years longer than her male counterpart who retires at age 65.[165] Yet, eligible women participate in 401(k) plans at lower rates than eligible men do.[166] Women also have lower average account balances ($70,000) than men ($108,000).[167] Because on average women earn less than men,[168] some of the reasons for their lower participation rates may be similar to the reasons given above for younger workers—limited benefits from the tax incentives for saving in a 401(k) plan and less discretionary income to save. Lower account balances also may directly be linked to lower salaries. A woman who contributes at the plan's default rate of, for example, three percent would save less on average than a man contributing at that rate. Women's greater adverseness to investment risk also may be a factor in lower account balances.[169]

Fiduciaries might question whether, consistent with their duty of loyalty, they may consider the interests of subgroups of participants. The weight fiduciaries should put on the preferences of subgroups of participants, such as women and younger employees, may depend on a variety of factors. The DOL explicitly chose not to mandate any particular or uniform approach for consideration of participant preferences.[170] Instead, it stated that fiduciaries should "consider[ ] the facts and circumstances of their plan and participant population."[171]

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164. *See* Colleen E. Medill, *Transforming the Role of the Social Security Administration,* 92 CORNELL L. REV. 323, 357 (2007) (discussing this psychological bias in the context of cash outs on job change).

165. *Id.*

166. Robert L. Clark, Jennifer A. Maki, & Melinda Sandler Morrill, *Can Simple Information Nudges Increase Employee Participation in a 401(k) Plan?*, 80 S. ECON. J. 677, 680 (2014); *see also* LORNA SABBIA, 2022 FINANCIAL LIFE BENEFITS IMPACT REPORT 1, BANK OF AMERICA (2022), https://business.bofa.com/content/dam/flagship/workplace-benefits/id20_0903/documents/Financial-Life-Benefits-Impact-Report.pdf, [https://perma.cc/GR4B-XPFJ] (reporting 55% of eligible women and 62% of eligible men participate in plans for which Bank of America serves as recordkeeper).

167. SABBIA, *supra* note 166, at 2.

168. Government Accountability Office, *Women in the Workforce: The Gender Pay Gap is Greater for Certain Racial and Ethnic Groups and Varies by Educational Level,* GAO-23-106041 (2022) https://www.gao.gov/products/gao-23-106041 [https://perma.cc/6GSC-ARHG] ("women . . . earn an estimated 82 cents for every dollar earned by men").

169. U.S. Dept. of Labor, *Women and Retirement Savings*, 2 (Sept. 2017), https://www.dol.gov/sites/dolgov/files/legacy-files/ebsa/about-ebsa/our-activities/resource-center/publications/women-and-retirement-savings.pdf [https://perma.cc/3YU9-2L9K].

170. 2022 Final Regulation, 87 Fed. Reg. 73822, 73842 (Dec. 1, 2022) ("The final rule . . . declines to mandate a uniform methodology for determining [participant] preferences."), codified at 29 C.F.R. § 2550.

171. *Id*.

Application of fiduciary duty under ERISA has long struggled with how fiduciaries should consider the complexities of large participant populations with varying interests.[172] In the context of a 401(k) plan menu, however, the standard advocated above provides that if fiduciaries reasonably determine that consideration of participant preferences is likely to empower and motivate participants to build greater retirement wealth, then the fiduciaries may consider those preferences. That should apply equally to subgroups of participants, especially if it counters lower participation and savings rates by those subgroups.

B. Tie-Breakers in 401(k) Plans

The most contentious issue with the duty of loyalty as applied to sustainability considerations may be what has come to be known as tie-breakers—situations in which fiduciaries must choose between two "equal" investments.[173] It is easiest to conceptualize the problem of tie-breakers in a DB plan, which has a fixed amount of assets to be invested. If fiduciaries are considering two "equivalent" investments, they must make a decision on whether to invest in one or both of those investments. In a 401(k) plan, fiduciaries may confront a similar situation in deciding, for example, between two different sustainable investments. Or, different groups of participants may want access to very different types of investments such as sin stocks and sustainable investments. If the preferences are equivalent or the best investments in each category are equivalent, the fiduciaries might need to choose among them.

Commenters are divided on the likelihood that tie-breakers actually exist. Some of the debate on whether and how frequently tie-breaker situations occur depends on the definition being used.[174] Professors Max Schanzenbach and Robert Sitkoff considered the question based on whether investments can be economically equivalent in their risk and return profile.[175] They concluded such a situation would be as rare as a "unicorn."[176] They worried that by recognizing the possibility of tie-breakers, the DOL would provide fiduciaries with too much opportunity to use the plasticity inherent in active investing to create supposed tie-breaker situations.[177]

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172. Daniel Fischel & John H. Langbein, *ERISA's Fundamental Contradiction: The Exclusive Benefit Rule,* 55 U. CHI. L. REV. 1105 (1988).

173. *See e.g.* 2022 Final Regulation, 87 Fed. Reg. at 73822 (table of contents listing section titled "Cost Associated With Changes to the 'Tiebreaker' Rule"); Schanzenbach & Sitkoff, *supra* note 111, at 408 (subsection titled "Collateral benefits as a tiebreaker?").

174. *See, e.g.,* 2022 Final Regulation, 87 Fed. Reg. at 73842, 73826-27, 73835 (discussing various definitions of the tie-breaker standard).

175. Schanzenbach & Sitkoff, *supra* note 111, at 410.

176. *Id.*

177. *Id.*; *see also* Joakim Sandberg, *Socially Responsible Investment and Fiduciary Duty: Putting the Freshfields Report Into Perspective,* 101 J. BUS. ETHICS 143, 149 (2011) ("[I]t actually seems rather unlikely that investors with adequate skills in modern financial analysis will find themselves in [tie-breaker] situations.").

Other experts are more sanguine about the probability of tie-breakers. In 2005, at the request of a United Nations group that preceded the Principles of Responsible Investment (PRI), the law firm of Freshfields Bruckhaus Deringer produced one of the most influential analyses supporting sustainable investing (the Freshfields Report).[178] The report concluded that tie-breaker situations could be legitimate and might occur more frequently than anticipated by Schanzenbach and Sitkoff.[179]

The DOL's position shifted between the 2020 Final Regulation, where it stated that tie-breakers "occur very rarely in practice, if at all,"[180] and the 2022 Final Regulation which takes a more expansive view.[181] It defines a tie-breaker as existing where multiple "investment courses of action . . . equally serve the financial interests of the plan over the appropriate time horizon."[182] This definition avoids the situation created by the narrower test in the 2020 Final Regulation, which some commenters believed "set out an unrealistically difficult and prohibitively stringent standard."[183] It does raise questions, however, on how fiduciaries should determine whether investments "equally serve" a 401(k) plan's financial interests.[184] The DOL declined to further define "equally serve," stating that it is a factual question that may depend on a variety of attributes of the investments in question and the plan.[185]

Consideration of participant preferences may result in situations where multiple types of investments could equally serve a plan's financial interests. As, discussed in the last subsection, it is consistent with fiduciaries' duty of loyalty to take into account whether a given investment alternative would be likely to empower and motivate participants to build greater retirement wealth. And, those determinations may be based on the interests of subgroups of participants.

In addition to the question of whether and how frequently tie-breaking situations occur, the next divisive issue has been how fiduciaries should proceed when faced with two 'tied' investments. Professor Edward Zelinsky, as well as Schanzenbach and Sitkoff, have argued that ERISA's fiduciary obligation to act solely in the interest of participants means fiduciaries never may take into account

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178. FRESHFIELDS BRUCKHAUS DERINGER, A LEGAL FRAMEWORK FOR THE INTEGRATION OF ENVIRONMENTAL, SOCIAL AND GOVERNANCE ISSUES INTO INSTITUTIONAL INVESTMENT (2005), https://www.unepfi.org/fileadmin/documents/freshfields_legal_resp_20051123.pdf [hereinafter 2005 Freshfields Report]; *see, e.g.*, Adam Sulkowski & Sandra Waddock, *Beyond Sustainability Reporting: Integrated Reporting is Practiced, Required, and More would be Better,* 10 U. ST. THOMAS L.J. 1060, 1079-80 (2003) (discussing the 2005 Freshfields Report).

179. 2005 Freshfields Report, *supra* note 178, at 12.

180. 2020 Final Regulation, 85 Fed. Reg. 72846, 72878 (Nov. 13, 2020), codified at 29 C.F.R. §§ 2509 and 2550.

181. 2022 Final Regulation, 87 Fed. Reg. 73822, 73885 (Dec. 1, 2022), codified at 29 C.F.R. § 2550.

182. *Id.*

183. *Id.* at 73835.

184. *Id.*

185. *Id.* at 73837.

factors other than the financial interests of the plan.[186] In a tie-breaker situation, the fiduciaries' first obligation would be to split the investment between the two equivalents.[187] If that is not possible because of minimum investment requirements, transaction costs, or some other financial reason, then the fiduciary must make the selection by some random action such as a coin flip.[188] As a normative matter, this approach arguably addresses their concern that fiduciaries might create tie-breakers in order to consider sustainability factors.[189]

The opposing line of argument is that once plan fiduciaries have met their duties of loyalty by narrowing investments to those that meet the solely in the financial interest standard, then they may make their choice among the remaining alternatives based on other factors.[190] This analysis is consistent with the theory of fiduciary loyalty. In both trust law and employee benefits law, the duty of loyalty's primary purpose is to discourage fiduciaries from engaging in opportunistic behavior vis-à-vis the trust's beneficiaries or plan's participants.[191] It is an unwarranted leap in tie-breaker situations to conclude that the duty of loyalty necessarily always precludes fiduciaries from considering any interests other than maximization of financial returns. By definition, the fiduciary culled opportunities based on that standard to reach the tie-breaker situation.[192] Arguably, ERISA's "solely in the interest of" language even requires a decision be made on factors that benefit the plan or participants, rather than a random action such as a coin flip.[193] It is hard to imagine how deciding to flip a coin is a decision in the interest of participants.

In the 2022 Final Regulation, the DOL clarified that in a tie-breaker situation a fiduciary may choose an investment "based on collateral benefits other than

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186. Schanzenbach & Sitkoff, *supra* note 111, at 405; Edward A. Zelinsky, *The Continuing Battle Over Economically Targeted Investments: An Analysis of the Department of Labor's Interpretive Bulletin 2015-01,* 2016 CARDOZO L. REV. DE NOVO 161, 167 (2016) [hereinafter Zelinsky I]. Schanzenbach and Sitkoff also make much of the difference between ERISA's sole interest standard and the best interest standard used in other contexts such as charities formed as corporations. Schanzenbach & Sitkoff, *supra* note 111, at 400-03, 422.

187. Schanzenbach & Sitkoff, *supra* note 111, at 409.

188. *Id.* at 410; Zelinsky I, *supra* note 186, at 168.

189. Schanzenbach & Sitkoff, *supra* note 111, at 410. Some commenters are skeptical that it is possible for two investments to have exactly the same risk and reward profile. *Id.* ("In allowing for the possibility of the unicorn that is a pair of identical investments . . .").

190. 2021 Proposed Regulation, 86 Fed. Reg. 57272, 57278-79, 57303 (Oct. 14, 2021) (to be codified at 29 C.F.R. § 2550).

191. The obligation is adapted in benefit plans because unlike in trusts, ERISA fiduciaries are permitted to act in their own interest as plan settlors as well as plan fiduciaries. *See generally* Muir & Stein, *supra* note 85 (critiquing the relevant doctrine).

192. Dana M. Muir, Comment Letter on Proposed Rule on Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights, 5 (Dec. 10, 2021), https://www.dol.gov/sites/dolgov/files/EBSA/laws-and-regulations/rules-and-regulations/public-comments/1210-AC03/00322.pdf [hereinafter Muir 2021 Comments].

193. *Id.*

investment returns."[194] Some commenters were concerned that the phrase "collateral benefits" is too ambiguous to provide direction to fiduciaries and could be subject to changing sub-regulatory guidance.[195] As the DOL observed, however, its fiduciary guidance has long permitted fiduciaries to consider collateral benefits in appropriate circumstances and no major problems have resulted.[196]

Perhaps more importantly, the DOL recognized the differences between tie-breaker situations in DB plans as compared to individual account plans such as 401(k) plans. It stated that "adding additional investment options [to a 401(k) plan menu] is not necessarily a zero-sum game. . . ."[197] There are plan menu situations, however, where more is not better. Behavioral economics research shows that in many contexts, including 401(k) plan menus, too much choice can result in participants making less than optimal choices or no choice at all.[198] For example, participants may spread their contributions equally across multiple investment options even if that is inconsistent with their risk tolerance.[199] Research also shows that in plans without automatic enrollment, participation is lower in plans that have high numbers of menu options compared to few options.[200] Thus, although increasing a 401(k) plan's investment options is not a zero-sum game, it is not in the best interest of participants to offer an overly extensive plan menu. The relationship between menu size and the duty of prudence is explored below.[201]

C. QDIAs

A related issue for plan fiduciaries is the extent to which the plan's QDIA may or should incorporate sustainability considerations. The 2020 Final Regulation prohibited an investment "from being selected as a QDIA if it, or any of its components, has investment objectives or goals or principal investment strategies that include, consider, or indicate the use of one or more non-pecuniary factors."[202] After the 2020 Final Regulation, "[m]any stakeholders expressed concern that funds could be excluded from treatment as QDIAs solely because they expressly considered climate change or other [sustainability] factors, even though the funds were prudent based on a consideration of their financial

194. 2022 Final Regulation, 87 Fed. Reg. 73822, 73885 (Dec. 1, 2022), codified at 29 C.F.R. § 2550.

195. *Id.* at 73837.

196. *Id.*

197. *Id.* at 73841.

198. *See infra* text at notes 199-200.

199. *See* Dana M. Muir, *Choice Architecture and the Locus of Fiduciary Obligation in Defined Contribution Plans,* 99 IOWA L. REV. 1, 16-17 (2013).

200. *Id.* at 17-18.

201. *See infra* Part IV.A.3.

202. 2020 Final Regulation, 85 Fed. Reg. 72846, 72865 (Nov. 13, 2020), codified at 29 C.F.R. §§ 2509 and 2550.

attributes alone."[203] As Professor Bernard Sharfman noted, this meant that QDIAs could not include even passive funds that track widely used indexes if those indexes screen on any sustainability criteria.[204]

Commentary on the 2021 Proposed Regulation strongly supported rescission of the restrictions on investments included in QDIAs.[205] First, the increasing use of sustainability factors by investment managers as a part of their standard practice and the expansion of regulation, particularly in the European Union (EU) and United Kingdom (UK), requiring retirement funds and other financial market participants means that it could become difficult for plans to exclude such investments from QDIAs.[206] Perhaps more importantly, commenters believed that the application of "prudence and loyalty to fiduciary decisions on QDIAs" should be consistent with the way those obligations apply to all other investment-related plan decisions.[207]

The 2022 Final Regulation rescinded the provisions unique to QDIAs.[208] The result is that the duty of loyalty as discussed in this Part applies to the selection and monitoring of QDIAs.[209] On one hand, plans choose QDIAs as default investments to receive contributions when participants do not choose their own investments. That would imply that fiduciaries should use traditional risk and return principles to choose a QDIA that will maximize financial returns. On the other hand, employees who report they would be more likely to participate in a plan where they have access to sustainable investments might be especially likely to participate if they are assured their contributions automatically go to that type of investment. The standard advocated above can provide some guidance to fiduciaries confronted with these contrasting arguments. If they reasonably determine that consideration of participant preferences is likely to empower and motivate participants to build greater retirement wealth, then the fiduciaries may consider those preferences. In the case of QDIAs, though, fiduciaries must think carefully about the extent to which participant preferences diverge affect the accumulation of retirement wealth in the plan.

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203. 2021 Proposed Regulation, 86 Fed. Reg. 57272, 57279 (Oct. 14, 2021) (to be codified at pt. 29 C.F.R. § 2550).

204. Bernard F. Sharfman, *ESG Investing Under ERISA,* 38 YALE J. ON REGUL. BULL. 112, 115 (2020) (using the example of the S&P 500 index, which screens out new issues of dual-class shares).

205. 2022 Final Regulation, 87 Fed. Reg. 73822, 73842 (Dec. 1, 2022), codified at 29 C.F.R. § 2550.

206. *See, e.g.,* Dan Esty & Todd Cort, *Toward Enhanced Corporate Sustainability Disclosure: Making ESG Reporting Serve Investor Needs,* 16 VA. L. & BUS. REV. 423, 440 (2022) (summarizing the European Union's Sustainable Finance Disclosure Regulation); 2022 Final Regulation, 87 Fed. Reg. at 7384 (noting concerns with compliance difficulties).

207. Muir 2021 Comments, *supra* note 192, at 4.

208. 2022 Final Regulation, 87 Fed. Reg. at 73843.

209. *Id.* at 73827 ("[T]he final rule amends the current regulation to remove the stricter rules for QDIAs, such that, under the final rule, the same standards apply to QDIAs as to investments generally.").

IV. HARMONIZING PARTICIPANT PREFERENCES AND THE DUTY OF PRUDENCE

Of course, even if fiduciaries' investment-related decisions meet their duties of loyalty, those decisions also must comply with their duty of prudence. The general standard for prudence requires fiduciaries to give "appropriate consideration" to facts and circumstances relevant to the investments being evaluated.[210] The 2022 Final Regulation provides additional guidance on what constitutes "appropriate consideration" in the design or review of a menu for a 401(k) plan.[211]

Although it did not include the formula in the regulatory language, the DOL stated in the preamble that it agreed with a commenter's proposed two-part analysis for prudence in the construction of a 401(k) plan menu.[212] First, the fiduciary must consider how "a given fund fit[s] within the menu of funds to enable plan participants to construct an overall portfolio suitable to their circumstances[.]"[213] Second, the fiduciary must compare a fund under consideration "to a reasonable number of alternative funds to fill the given fund's role in the overall menu[.]"[214] This Part uses that analysis to build a framework for fiduciary consideration of plan participant preferences.

A. Construction of the Plan Menu

The 2022 Final Regulation states that the duty of prudence requires fiduciaries to give "appropriate consideration" when designing a plan's investment menu to whether the menu is "reasonably designed . . . to further the purposes of the plan."[215] The provision should be read in conjunction with the preamble's explanation that bearing in mind participant preferences may further plan purposes by leading to increased retirement savings. Attention to participant preferences also is consistent with the first prong of the prudence analysis for menu construction. It enables a fiduciary to construct a menu that enables plan participants to choose a set of investments "suitable to their circumstances."

Little direct guidance exists in regulation or case law, though, on how fiduciaries should comply with their obligation of prudence when determining and considering participant preferences. This subpart analyzes whether the determination of participant preferences itself is subject to the duty of prudence. It then considers which preferences matter and, finally, turns to how prudence intersects with menu size.

1. Determination of Participant Preferences.—The first question a fiduciary should consider when thinking about assessing participant preferences is whether the assessment process itself is subject to the duty of prudence. ERISA's settlor/fiduciary doctrine provides the answer to that question. Under that

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210. *Id.* at 73885.
211. *Id.*
212. *Id.* at 73830.
213. *Id.*
214. *Id.*
215. *Id.* at 73885.

doctrine, plan sponsors do not act as fiduciaries when they establish plans, determine or amend plan terms, or terminate plans.[216] For example, a plan sponsor makes a decision on a plan term when it decides what the default percentage of compensation should be in an automatic enrollment plan.[217] The plan sponsor acts as a settlor and is not subject to fiduciary duty.[218] Decisions on how to determine the participants' investment preferences arguably are similar to the types of decisions plan sponsors make when establishing plan terms and, thus, be outside the reach of ERISA's fiduciary provisions.

The better analysis, however, would distinguish a plan sponsor's role in setting discretionary plan terms from its role when determining participant investment preferences with the plan sponsor wearing its fiduciary hat in the latter situation. In two unanimous decisions, the Supreme Court held that decisions involving the selection and monitoring of plan investment menus are fiduciary decisions.[219] Assessing participant preferences to be used in the process of choosing and monitoring a menu is an integral part of that process. It becomes similar to the assessment of fund performance, fees, diversification, and other decision-making criteria, which are subject to the duty of prudence.[220]

Application of the duty of prudence to the determination of participant preferences should not impose a substantial burden on fiduciaries or result in undue risk. The jurisprudence is clear—process is the key to establishing prudence in 401(k) menu selection.[221] Courts have dismissed complaints that fund menus were imprudent because some funds had high comparatively high fees where plaintiffs failed to sufficiently allege that fiduciaries used a flawed process.[222]

The statutory language defines prudence as requiring "the care, skill, 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. . . ."[223] The reference to "an enterprise of a like character and with like aims" means the duty of prudence functions in the context of the 401(k) plan in question and enterprises similar to it. This standard does not require the preciseness of an academic survey being done according to professorial publication standards or according to human

216. *See generally,* Muir & Stein, *supra* note 85 (explaining and criticizing the settlor/fiduciary doctrine).

217. *See* Edward A. Zelinsky, *Retirement in the Land of Lincoln: The Illinois Secure Choice Savings Program Act.* 2016 U. ILL. L. REV. 173, 185 (discussing ERISA's settlor doctrine).

218. *Id.*

219. Hughes v. Nw. Univ., 142 S. Ct. 737, 741 (2022); Tibble v. Edison Int'l, 575 U.S. 523, 529-30 (2015).

220. *See Hughes,* 142 S. Ct. at 741.

221. Kate Bally et al., *Recent Developments in Employment and Labor Law,* 56 TORT & INS. L.J. 321 (2021).

222. *E.g.,* Martin v. CareerBuilder, No. 19-CV-6463, 2020 U.S. Dist. LEXIS 115002, at *16-17 (N.D. Ill. July 1, 2020).

223. ERISA § 404(a)(1)(B), 29 U.S.C. § 1104(a)(1)(B).

subject research limitations.

Because 401(k) plans have not typically surveyed participant investment preferences, the initial process expectations should be relatively low. As fiduciaries and their service providers develop expertise with participant surveys, the expectations of what constitutes a sufficient process should increase, but always in the context of the size and other characteristics of the plan. Expertise is developing due to requirements in other jurisdictions. In September 2022, the E.U. issued its final report on a requirement for investment managers and portfolio managers to add client preferences on ESG issues to their standard suitability determinations.[224] The requirement applies to sales and recommendations for pension products.[225]

2. Which Preferences Matter?—A second issue for plan fiduciaries once they prudently determine participant preferences is to decide which preferences should matter when establishing or amending a plan's investment menu. The most challenging situation would be if every participant's preference needed to be treated with equal weight. In one of the most academically influential ERISA articles, Professors John Langbein and Daniel Fischel suggested that ERISA's fiduciary obligation of loyalty should be interpreted to include a duty of impartiality.[226] The implementation of this idea, however, has been problematic for a variety of reasons, including the duty of fiduciaries to concentrate on the provision of plan benefits.[227]

Applying the concept of impartiality to the preferences of each participant would be inconsistent with the duty of prudence. One might imagine, as an example, the participant who wants to have the option to invest account assets in the worst performing, highest fee mutual fund in its category because a relative works there. It simply does not make sense to equate that preference with the desire of a group of participants for access to a sustainable investment fund that the plan fiduciary selects through a prudent process.

Fiduciaries that intend to consider participant preferences should build into the plan's investment policy statement (IPS) a framework for the analysis and relevance of preferences. Consistent with the preamble to the 2022 Final Regulation, the IPS should specify the facts and circumstances to be considered when taking participant preferences into account for plan menu decisions.[228] The

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224. EUR. SECS. AND MKTS. AUTH. FINAL REPORT: GUIDELINES ON CERTAIN ASPECTS OF THE MIFID II SUITABILITY REQUIREMENTS, 42-43 (2022), https://www.esma.europa.eu/sites/default/files/library/esma35-43-3172_final_report_on_mifid_ii_guidelines_on_suitability.pdf [https://perma.cc/A64V-CJG2].

225. Peter Konwitschka & Daniel Höhnl, *Insurance and ESG,* SCHONHERR (Feb. 1, 2023), https://www.schoenherr.eu/content/insurance-and-esg/ [https://perma.cc/NCQ9-JK2W].

226. Daniel Fischel & John H. Langbein, *ERISA's Fundamental Contradiction: The Exclusive Benefit* Rule, 55 U. CHI. L. REV. 1105, 1159-60 (1988).

227. Peter J. Weidenbeck, *Untrustworthy: ERISA's Eroded Fiduciary Law,* 59 WM. & MARY L. REV. 1007, 1022-23 (2018).

228. 2022 Final Regulation, 87 Fed. Reg. 73822, 73842 (Dec. 1, 2022), codified at 29 C.F.R. § 2550.

IPS should be clear that the fiduciaries' objective in considering preferences is to further the purposes of the plan.[229] For example, relevant factors might be the current participation and contribution rates of subgroups of participants who may be encouraged to save more if they have access to investments that accord with their preferences.

3. Prudent Limits on the Number of Menu Options.—At least one commenter has asserted that it is imprudent for a 401(k) plan to have too large of a menu of investment options.[230] The theory is that, as discussed above, when participants confront too many choices they are less likely to participate in the plan or they may apply heuristics or other reasoning that leads to suboptimal investment choices.[231] No court decision seems to exist, however, holding fiduciaries liable because a plan menu has too many options.

Until the Supreme Court's 2022 decision *Hughes v. Northwestern University*,[232] the incentives for fiduciaries were exactly the opposite. Under the large menu defense, fiduciaries successfully argued in some jurisdictions that if the plan menu included even one prudent option then they had met their fiduciary duty as to the entire menu. The Supreme Court rejected that defense, holding that each of the plan's investment options must be prudent when evaluated on an ongoing basis.[233] That decision flipped the incentive for plan fiduciaries on menu size. It should be substantially easier and more efficient for fiduciaries to monitor the options on a smaller rather than a larger plan menu.

Tension exists between, on one hand, a fiduciary's interest in providing investments that align with participant preferences, and on the other hand the research showing smaller menus encourage participation and better investment choice as well as the fiduciary's self-interest in having a menu size that is manageable to monitor. The DOL's "facts and circumstances" guidance provides fiduciaries with the latitude to balance these interests in favor of the plan for which the fiduciaries are responsible. The recommendation above that fiduciaries should address issues related to participant preferences in the plan's IPS should serve to help ensure fiduciary decisions follow an appropriate process and thus meet the duty of prudence.

B. Fund Selection

A fiduciary that has determined that it is appropriate, given participant preferences, to include a sustainable fund option on a 401(k) menu must then meet its duty of prudence[234] when choosing a specific fund. The first subsection

229. *Id.* at 73885.

230. William A. Birdthistle, *Federalism of Personal Finance: State & Federal Retirement Plans,* 41 SEATTLE U. L. REV. 367, 372 (2018).

231. *Id.*; *supra* text accompanying notes 171-72.

232. Hughes v. Nw. Univ., 142 S. Ct. 737 (2022).

233. *Id.* at 741-42.

234. The fiduciary also, of course, must meet its duty of loyalty. It will do so, however, so long as its choice meets the criteria of being in the best interest of the plan participants. *See supra* Part III

below discusses the application of procedural prudence to fund selection. The next subsection considers whether prudence, in this context, has an objective component and if so how that governs a fiduciary's actions. The subpart closes with a discussion of diversification.

1. Procedural Prudence.—To meet their duty of prudence, plan fiduciaries must use a prudent process when making investment decisions.[235] Applying that obligation to the selection of a sustainable fund is straightforward. The fiduciaries should use the same process for investment selection and monitoring as they do with other investments on the plan menu. Two questions are important. First, how should a fiduciary determine whether it would be prudent to include the type of fund participants want? And, second, if the type of fund is prudent, how should fiduciaries choose a specific fund within that category?

The statutory language provides the key to answering the first question. As a reminder, the statute defines prudence as requiring "the care, skill, 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. . . ."[236] The enterprise being referenced in this context is a 401(k) plan.

Professor Edward Zelinsky has argued that the only enterprise that should be used as a like enterprise for the determination of prudent investment options is a DB plan.[237] He then concludes that because DB plans have not invested heavily in sustainable investments, those investments are not a prudent category for 401(k) menus.[238]

Professor Zelinsky's assertion that an investment class must be widely adopted by DB plans before the class could be a prudent choice for a 401(k) menu is not supported by case law or DOL regulations. Furthermore, his logic that DB plans and 401(k) plans are similar enterprises because they both are accumulation vehicles for retirement assets is flawed.[239] He observes that investment decisions in DB plans typically are made by professional trustees investing large sums of money over a long time period.[240] From those facts he concludes that, because of the general lack of investment expertise by 401(k) plan participants, widespread use in DB plans is a necessary, but insufficient criterion for inclusion on a 401(k) plan menu.[241]

First, Professor Zelinsky fails to acknowledge that one reason private sector

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(discussing that obligation). For example, the fiduciary would violate its duty of loyalty if it selected a fund because it would earn fees from participant investments in that fund.

235. *See supra* text accompanying notes 192-93; *see also* Edward A. Zelinsky, *Is Bitcoin Prudent? Is Art Diversified? Offering Alternative Investments to 401(k) Participants,* 54 CONN. L. REV. 509, at 524-25 (2022) [hereinafter Zelinsky II].

236. ERISA § 404(a)(1)(B), 29 U.S.C. § 1104(a)(1)(B).

237. Zelinsky II, *supra* note 235, at 524-25.

238. *Id.* at 536.

239. *Id.* at 524.

240. *Id.* at 525.

241. *Id.*

DB plans have not been enthusiastic about sustainable investments may be due to the ongoing instability of the DOL regulatory guidance, much of which has been aimed at DB plans.[242] Some investment managers of DB plan assets reported that frequent changes in the guidance made it difficult for them to incorporate sustainability factors in their investing decisions.[243] If DB plans have been unduly discouraged by regulatory concerns, their decisions provide little insight into the facts and circumstances that should be important to 401(k) fiduciaries. The idiosyncratic regulation of DB plans does not affect whether sustainable investments have become generally acceptable by professional investors, are broadly enough traded to be subject to market discipline or constitute an asset class that is widely tracked by and rated by analysts.

Plan fiduciaries should, consistent with their prudence obligation, be able to consider whether to include a particular class of investment on a plan menu by looking at the adoption of that class far more broadly than just by private-sector DB plans. Those plans hold only 3.0 trillion of the more than $32 trillion in U.S. retirement assets.[244] Internationally, retirement assets exceeded $56 trillion at the end of 2020.[245] Total assets under professional management approximated $103 trillion.[246] The rapid growth in sustainable investing across the globe provides one example of the lack of perspective that would result from looking only to U.S. private sector DB plans as the one truth for prudent investments.[247]

Second, the paternalistic aspect of participant-directed accounts ends at development of the plan menu. Perhaps that is poor policy, given what is known about the investment decision making of plan participants,[248] but it is the current law and policy. As briefly noted above, fiduciaries of participant-directed plans have statutory protections from liability for decisions made by participants on plan investments if plans meet minimum criteria.[249] The safe harbor protection requires a plan menu to offer at least three investment alternatives.[250] Each of those three "core" alternatives must be diversified and have "materially different

242. *See supra* Part II.C. (describing the regulatory instability).

243. GAO ESG Report, *supra* note 143, at 19.

244. Investment Company Institute, *supra* note 6.

245. *Global Pension Statistics,* OECD, https://www.oecd.org/finance/private-pensions/globalpensionstatistics.htm [https://perma.cc/DR6W-RR9K] (last visited Feb. 2, 2022).

246. Lubasha Heredia et al., *The $100 Trillion Machine,* BOSTON CONSULTING GROUP (July 8, 2021), https://www.bcg.com/publications/2021/global-asset-management-industry-report [https://perma.cc/75VD-DV6Z].

247. *See, e.g.,* Chris Stokel-Walker, *How Sustainable Investing Will Become the Norm,* WORLD ECONOMIC FORUM (Feb. 2, 2022) https://www.weforum.org/agenda/2022/02/sustainable-investing-esg-finance-future-norm/ [https://perma.cc/E6NU-6G5P] (reporting an increase in global sustainable investing to $35.3 trillion in 2020).

248. Paul M. Secunda, *The Behavioral Economic Case for Paternalistic Workplace Retirement Plans,* 91 IND. L.J. 505, 517-24 (2016) (discussing the evidence for poor participant investment decision-making).

249. *See supra* text accompanying note 85.

250. 29 C.F.R. § 2550-404(c)-1(b)(3)(B).

risk and return characteristics."[251] Together the three alternatives must enable participants to establish a portfolio that reflects their personal risk tolerance.[252]

Although plans menus must comprise at least three diversified investment alternatives to qualify for the safe harbor fiduciary protection, the average plan menu includes twenty-eight investments.[253] Domestic U.S. equity and bond funds are the most popular frequently offered types of investment choices.[254] Menus also include international equity and bond funds, target date funds, money market funds, guaranteed investment contracts, and others.[255]

A prudent process also does not require, as Professor Zelinsky asserts, that 401(k) plan fiduciaries apply trust law's principle that only "cautious and conservative" investments are prudent.[256] Again, nothing in the case law or DOL regulation supports the import of that standard from trust law to the 401(k) menu context. Indeed, the Supreme Court has recognized that while trust law principles can inform the interpretation of ERISA's fiduciary provisions, those principles must be adapted to reflect the goals of pension plans.[257]

The regulatory requirement of three diversified investment alternatives with different risk and reward characteristics almost necessarily implies that at least one of those alternatives will be more risky than the "cautious and conservative standard." When the DOL explained that this requirement does not require either a "very conservative or a very risky investment alternative," it did not state that plans were per se precluded from offering menu options at either end of the risk spectrum.[258] From a choice standpoint, participants may want to invest in and even overweight their allocations to investments that are neither cautious nor conservative. They may be young and believe that over the term of their careers higher risk will provide more retirement security. Or, they may be confused and making a choice for imprudent reasons. If there is concern, though, about poor participant decision making it should be addressed by revisiting the nature and regulation of participant-directed accounts, not by imposing artificial constraints

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251. *Id.* at (B)(1) & (2).

252. *Id.* at (B)(3).

253. BrightScope and Investment Company Institute, *The BrightScope/ICI Defined Contribution Plan Profile: A Close Look at 401(k) Plans, 2019,* Sept. 18, 2022 (2019 data for plans averaging between $1 million and more than 1 billion in assets), https://www.ici.org/research/retirement/dc-plan-profile [https://perma.cc/G9VE-DX3G].

254. *Id.* at 31.

255. *Id.*

256. Zelinsky II, *supra* note 235, at 521.

257. Mass. Mut. Life Ins. Co. v. Russell, 473 U.S. 134, 139 n.6 (1985); *see also* 1979 Final Regulation, 44 Fed. Reg. 37221, 37222 (June 26, 1979), codified at 29 C.F.R. § 2550 (2023) ("The legislative history of [ERISA] indicates that the common law of trusts, which forms the basis for . . . [ERISA's fiduciary provisions] should, nevertheless not be mechanically applied to employee benefit plans.").

258. Final Regulation Regarding Participant Directed Individual Account Plans (ERISA Section 404(c) Plans, 57 Fed. Reg. 46906, 46920 (Oct. 13, 1992), codified at 29 C.F.R. part § 2550 [hereinafter 1992 Final Regulation].

on menu construction.

2. Objective Prudence.— Professor Edward Zelinsky argues there is an objective component to the analysis of whether fiduciaries meet their duty of prudence when choosing or monitoring investments on a plan menu.[259] This argument is misguided. Courts have sometimes stated that an investment option must be "objectively prudent."[260] A careful review of the case law, however, indicates that the objective standard typically is used to determine whether the fiduciaries' process was sufficient as opposed to being used to determine whether the investment itself was objectively prudent. For example one court explained that it was applying the "objective prudent person standard" to determine "'whether a fiduciary employed the appropriate methods to investigate and determine the merits of a particular [decision].'"[261] When courts do examine whether an investment is objectively prudent, they do so in order to determine whether a fiduciary should not be liable in spite of engaging in an insufficient process.[262] If a prudent fiduciary would have made the same decision in spite of the deficient process, then the fiduciary in question will not be liable.[263]

Correctly understood, the possible application of an objective component to the prudence analysis does not add anything to the ex-ante obligation of a fiduciary. It simply serves as an ex post check to ensure that a fiduciary does not face liability for a decision that was reached through an insufficient process but that an appropriate process would have supported.

Any discussion of sustainable investing invariably leads to the question of whether research shows sustainable investments outperform other investment options. That is an objective question. In spite of a vast finance literature, which now includes multiple meta studies,[264] finance scholars and market experts remain divided in their answer on that issue.[265] Sufficient evidence from those studies, however, exists to indicate it may be rational for an investor to allocate assets to a sustainable investment. And, even if that is not true, the legal standard for prudence permits (k) plan menus to include investment options that academic finance research views as inefficient.[266] For example, actively managed funds

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259. Zelinsky II, *supra* note 235, at 520.

260. Brotherston v. Putnam Invs., 907 F.3d 17, 39 (1st Cir. 2018).

261. Carrigan v. Xerox Corp., No. 3:21-CV-1085 (SVN), 2022 U.S. Dist. LEXIS 70428, at *12 (D. Conn. Apr. 18, 2022) (citations omitted); *see also* Smith v. Commonspirit Health, No. 20-95-DLB-oEBA, 2021 U.S. Dist. LEXIS 169922, at *17 (E.D. Ken. Sept. 8, 2021) (ERISA "establishes 'an objective standard' that focuses on 'the process by which' decisions are made, 'rather than the results of those decisions.'") (citations omitted).

262. Renfro v. Unisys Corp., 671 F.3d 314, 322 (3d Cir. 2011).

263. *Id.*

264. *See, e.g.* Gary, *supra* note 3, at 750-54 (summarizing two meta-studies finding that the majority of studies find positive investment performance).

265. 2022 Final Regulation, 87 Fed. Reg. 73822, 73861 (Dec. 1, 2022), codified at 29 C.F.R. § 2550 (citing many studies with divergent outcomes on the costs or benefits of ESG integration, screening, fees, and risk).

266. *See* Schanzenbach & Sitkoff, *supra* note 111, at 441-43 (discussing the pitfalls of active

tend to have higher fees than passive funds, but courts have held that it is not inherently imprudent for a fiduciary to include actively managed funds on a plan's menu.[267]

Fiduciary prudence should be determined according to the same standards for a participant-preferred type of investment, such as a sustainability investment, as for the other categories of funds on the plan's menu. Just as a fiduciary should not add a specific bond fund at a participant's request without comparing it on appropriate characteristics to other available bond funds, fiduciaries would not act prudently in selecting a specific sustainability fund simply because a participant asked for that fund. On the other hand, a fiduciary that follows the same process it uses to evaluate another category of fund, particularly another category of actively-managed fund, should be treated as having met the duty of prudence when selecting or monitoring a sustainable fund for a plan menu.

3. Diversification.—A final question on selection of a specific investment option for a 401(k) plan menu is whether every alternative on the menu must be diversified. Consistent with his view that 401(k) investments must be suitable for financially unsophisticated participants, Professor Zelinsky argues that each menu alternative must be diversified.[268] He accurately cites a Fourth Circuit decision that stated "each available fund on a menu must be prudently diversified."[269] If interpreted literally, however, that statement is inconsistent with DOL guidance, the weight of court authority, and the position of the United States in a brief as amicus curiae to the Supreme Court. The preamble to the regulation governing the safe harbor for participant-directed plans noted that the DOL had changed the language in the final regulation to be clear that each of the three "core" alternatives intended to satisfy the varied risk and return requirement must be diversified.[270] Nothing even implicitly indicated that every investment option must be diversified. In its brief recommending denial of certiorari, the DOL Solicitor stated that if the Fourth Circuit had, as the quoted language above implies, "actually interpreted ERISA to categorically prohibit single-stock or non-diverse funds from being included in a defined-contribution plan, then that would have been error, because such a per se rule would 'conflict with the fact-specific focus of the duty of prudence.'"[271]

Indeed, fiduciaries should be cautious in deciding to include undiversified funds on a 401(k) plan menu.[272] The clear weight of authority, however, shows

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investing).

267. *See, e.g.,* Smith v. CommonSpirit Health, 37 F.4th 1160 (6th Cir. 2022).

268. Zelinsky II, *supra* note 235, at 522.

269. Stegemann v. Gannett Co., 970 F.3d 465, 476 (4th Cir. 2020).

270. 1992 Final Regulation, 57 Fed. Reg. 46906, 46914 (Oct. 13, 1992), codified at 29 C.F.R. part § 2550.

271. Brief for the United States as Amicus Curiae at 14, Gannett Co. v. Quatrone, 142 S. Ct. 707 (No. 20-609), 2021 WL 5235848, at *14; *see also,* Fifth Third Bancorp v. Dudenhoeffer, 573 U.S. 409, 425 (2014) (stating that a fiduciary's obligation of prudence is context specific).

272. *See, e.g.,* Schweitzer v. Inv. Comm. of the Phillips 66 Sav. Plan, 960 F.3d 190, 198 (5th Cir. 2020) (citing cases highlighting the risks of undiversified investments).

that not every fund needs to be diversified.[273] More generally, different types of investments have various levels of diversification.[274] For example, a U.S. equities index fund will be diversified across the firms included in the index, but have limited international diversification and no diversification into bonds.[275] A real estate investment trust, which is invested only in real estate, arguably is less diversified than the equities index fund just discussed but still can be somewhat diversified.[276] Fiduciaries choosing which sustainable investment fund to include on a plan menu should consider diversification as a factor, but the fund need not be diversified across all asset classes or geographies to be prudent.

To summarize, to meet their duty of prudence fiduciaries should use a two-part analysis when choosing and monitoring investments for a 401(k) plan menu.[277] First, the fiduciary should consider how "a given fund fit[s] within the menu of funds to enable plan participants to construct an overall portfolio suitable to their circumstances."[278] Second, the fiduciary should compare a fund under consideration "to a reasonable number of alternative funds to fill the given fund's role in the overall menu."[279] This Part has provided a framework for use by fiduciaries who wish to assess and consider participant preferences while at the same time meeting their obligation of prudence.

V. COMPLEMENTARY ACTIONS

The 2022 Final Regulation's validation of participant preferences as a legitimate consideration for plan fiduciaries to take into account when developing a plan's investment menu may encourage the availability of sustainable investments. Overall, the existing studies indicate that substantial numbers of U.S. participants tend to have strong preferences that their 401(k) plans at least offer one sustainable option.[280] On the other hand, careful fiduciaries legitimately worry about the litigation and regulatory risks associated with including those options on a plan menu. This Part evaluates the extent to which factors other than participant preference may create more alignment between participant interest in sustainable investments and the availability of those investments on 401(k) plan menus.

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273. *See supra* text accompanying notes 271-74.

274. *See* FINRA, *Asset Allocation and Diversification,* https://www.finra.org/investors/investing/investing-basics/asset-allocation-diversification [https://perma.cc/L53T-UFPD].

275. Funds that hold only U.S. real estate assets do not hold any, or very low levels of international assets and bonds. *See* Adam Hayes, *REIT vs. Real Estate Fund: What's the Difference?,* INVESTOPEDIA (July 16, 2023), https://www.investopedia.com/ask/answers/012015/what-difference-between-reit-and-real-estate-fund.asp [https://perma.cc/Z8AN-KMXT].

276. Zelinsky II, *supra* note 235, at 529.

277. 2022 Final Regulation, 87 Fed. Reg. 73822, 73830 (Dec. 1, 2022), codified at 29 C.F.R. § 2550.

278. *Id.*

279. *Id.*

280. *See supra* Part I.A.

A. Legislation

A bill introduced in 2021 by Senators Smith, Murray, and Blumenthal proposes changes to encourage use of sustainable investing in retirement plans.[281] That bill would enable fiduciaries to consider factors, including stainability factors, so long as the fiduciaries' decisions meet the existing ERISA fiduciary standards (loyalty, prudence, diversification, and compliance with plan terms).[282] It also provides that fiduciaries may designate ESG investments as the plan's default investment or as a component of the default investment.[283] The proposal explicitly nullifies the 2020 Final Regulation discussed above.[284] The bill's prospects for passage, however, are dim.[285]

Representative Andy Levin and others introduced legislation in the House that would require retirement plans to adopt a sustainable investment policy or give notice that they would not do so.[286] The bill expresses the belief that "[r]etirement plans and participants in individual account retirement plans should have the opportunity to make and hold sustainable investments, provided ERISA's fiduciary requirements are otherwise met."[287] The bill also proposes amendments to ERISA's fiduciary provisions to permit fiduciaries to select sustainable investments for a plan's menu so long as the investments have a risk and return profile comparable to similar types of investments.[288] "The hostility of Republican House members to sustainable investing makes it unlikely any pro-sustainability plan legislation will be successful."[289]

B. Adoption of Menu Options Consistent with Firm Values

Participants are not alone in asking that their 401(k) plans include sustainable choices on plan investment menus. During the 2022 annual meeting season,

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281. Financial Factors in Selecting Retirement Plan Investments Act, S. 1762, 117th Cong. (2021).

282. *Id.* § 2(a)(3)(A)(i).

283. *Id.* § 2(a)(3)(C).

284. *Id.* § 2(b). The 2020 Final Regulations are discussed *supra* at text accompanying notes 110-11.

285. *See* Pete Michaels & Alyssa Scruggs, *Call it a Comeback: The Likely Return of ESG Investing in ERISA Accounts,* JD SUPRA (June 7, 2021), https://www.jdsupra.com/legalnews/call-it-a-comeback-the-likely-return-of-1635185/ [https://perma.cc/JG8Z-VVDM] ("Republican senators, many of whom were supportive of the Trump-era DOL rule, are likely to oppose the bill and make its road to enactment extremely rocky.").

286. Retirees Sustainable Investment Opportunities Act of 2021, H.R. 3604, 117th Cong. § 4(b)(5) (2021).

287. *Id.* § 2(5).

288. *Id.* § 4(d).

289. Dana M. Muir, *Sustainable Investment Options in Defined Contribution Plans: The Disconnect Between Supply and Demand,* 2022 N.Y.U. REV. OF EMP. BEN. & EXEC. COMP. §7-1, §7.04[2].

shareholders at two large public companies, Amazon and Comcast, were able to have a 401(k) sustainable investments proposal included on the ballot at the companies' annual meetings.[290] The proposals asked that the companies' Boards of Directors produce a report evaluating the extent to which the investment options in the 401(k) plan reflected the companies stated climate goals.[291] The proposals also suggested the report could address opportunities for increasing sustainable plan options or explain why the Board did not encourage the addition of those options.[292]

Both companies unsuccessfully asked the SEC for a determination that they could omit the proposals from their proxies.[293] The proposals received little shareholder support — 9% at Amazon and 6% at Comcast.[294] The levels of support, however, were sufficient to meet the threshold required for the proposals to be resubmitted in 2023.[295]

As You Sow, the non-profit organization that filed the proposals at Amazon and Comcast on behalf of shareholders, states that its mission is "to promote environmental and social corporate responsibility through shareholder advocacy, coalition building, and innovative legal strategies."[296] The organization has evaluated the 401(k) plans of sixteen companies, including Amazon and Comcast, along seven environmental and social sustainability issues.[297] None of the plans score well so it is not inconceivable that As You Sow will file additional shareholder proposals in the future.[298] Certainly, the ratings are intended to encourage employees to request more sustainable investment options.[299]

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290. Lawrence K. Cagney et al., *Shareholder Climate Activism Comes for 401(k) Plans: Lessons Learned from Amazon and Comcast,* DEBEVOISE & PLIMPTON 1 (June 9, 2022), https://www.debevoise.com/-/media/files/insights/publications/2022/06/09_shareholder-climate-activism-comes-for-401k.pdf [https://perma.cc/L57W-2XR5].

291. *Id.*

292. *Id.*

293. *Id.*

294. *Id.*

295. *Comcast Shareholders Vote on Climate Safe Retirement Plans*, AS YOU SOW (June 8, 2022), https://www.asyousow.org/press-releases/2022/6/8/comcast-shareholders-vote-on-climate-safe-retirement-plans [https://perma.cc/73LJ-XJXN]; *Amazon Shareholders Vote on Climate-Safe Retirement Plans*, AS YOU SOW (May 25, 2022), https://www.asyousow.org/press-releases/2022/5/25/amazon-shareholders-vote-on-climate-safe-retirement-plans [https://perma.cc/C7ZV-E776].

296. *About Us*, AS YOU SOW https://www.asyousow.org/about-us [https://perma.cc/Q8Y5-R3H6] (last visited July 1, 2022).

297. *Your Retirement Plan May be Fueling the Climate Crisis. But it Doesn't Have To*, AS YOU SOW, https://investyourvalues.org/ [https://perma.cc/4BQH-YPS9] (last visited July 1, 2022).

298. *Id.*

299. *See* Talib Visram, *Is Your 401(k) Plan Using Your Retirement Money to Fund Fossil Fuel Companies?,* FAST COMPANY (July 27, 2021), https://www.fastcompany.com/90658947/is-your-401k-plan-using-your-retirement-money-to-fund-fossil-fuel-companies [https://perma.cc/W7WC-KBMG] (noting that the rankings are intended "to make it easier for employees with complicated

Attorneys argued that shareholder proposals such as the ones filed by As You Sow at Amazon and Comcast request actions that conflict with ERISA.[300] The attorneys point out that ERISA makes the choice of a plan menu a fiduciary function that must be executed in the sole interest of the plan participants.[301] Under the traditional analysis, it would be a violation of fiduciary duty to promote investments because they furthered an employer's policy values.[302]

Perhaps, though, the 2022 Final Regulations provide shareholders with a stronger case for their arguments. As shown in Part I above, surveys tend to show that significant numbers of people want access to sustainable investments. The DOL recognized commenters' beliefs that offering investments that align with those interests may boost retirement savings. It is in both companies' and employees' best interest for employees to value their benefit plans as an important component of their compensation and to maximize their retirement wealth.

C. Full Integration of Sustainability Considerations into Investment Evaluation

In the U.K. and E.U. regulatory requirements, particularly on disclosure of pension plans' policies on sustainable investing and the extent of sustainability-related portfolio risks, have increased the attention fund fiduciaries must pay to sustainability considerations.[303] If the trend continues and becomes entrenched, that should silence the critics who argue sustainable investing is a fad similar to tulips in the 17th century.[304] Across the globe, institutional asset owners have begun to commit to achieving net zero portfolios[305] and to consider climate change risk as part of their responsible investing practices.[306] One expert stated:

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retirement plans to learn about how their funds work and to ensure the money they're earning and investing is going to causes they care about.").

300. Cagney et al., *supra* note 290, at 3-4.

301. *Id.* at 4; *see also, supra* text accompanying notes 85-95 (discussing fiduciary responsibility in the selection of a plan's investment menu).

302. Cagney et al., *supra* note 290, at 4.

303. *See, e.g.* Stuart E. Fross & Sophie Lignier, *An Introduction to the EU Sustainable Financial Disclosure Regime and the Draft EU Corporate Sustainability Due Diligence Directive,* FOLEY & LARDNER LLP (Dec. 12, 2022) https://www.foley.com/en/insights/publications/2022/12/eu-sustainable-financial-disclosure-regime [https://perma.cc/7XMV-XHHS] (discussing the status of E.U. regulation).

304. Zelinsky II, *supra* note 235, at 548.

305. *See UN-Convened Net-Zero Asset Owner Alliance*, U.N. ENV'T. PROGRAM, https://www.unepfi.org/net-zero-alliance/ [https://perma.cc/K43X-M4BQ] (last visited Jan. 24, 2022) (presenting net-zero commitments by sixty-nine institutional investors).

306. *See Signatory Directory*, PRINCIPLES FOR RESPONSIBLE INV, https://www.unpri.org/signatories/signatory-resources/signatory-directory [https://perma.cc/65YP-534G] (last visited Jan. 25, 2022) (listing asset owners, investment managers, service providers, and others that have signed the Principles of Responsible Investment (PRI)). References to PRI can be confusing for two reasons.

"[W]e expect . . . [sustainability] integration to increasingly become a mainstream, if not standard, element of long-term, value driven investing."[307]

Professor Susan Gary cites, with apparent approval, two reports issued in alignment with United Nations supported entities.[308] Both reports conclude that fiduciaries should consider sustainability factors when making investment decisions.[309] Similarly, Professor James Hawley and co-authors argued that when making investment decisions, fiduciaries face systemic risks associated with sustainability factors.[310] They believed that fiduciaries should look to evolving sustainability norms and consider the interests of future as well as current participants. In addition to decreasing systemic risks and taking a longer-term view of investment interests, their approach would benefit society by decreasing the negative externalities created by plan investments.[311]

CONCLUSION

In the U.S. a significant disconnect appears to exist between strong interest by 401(k) plan participants' in access to sustainable investment options and the almost universal lack of availability of those options in plans. Plan fiduciaries have worried they might violate their fiduciary obligations by including sustainable investment options. Over the past almost 30 years, that fiduciary concern has been reinforced by unstable DOL guidance, significant levels of 401(k) litigation, practitioner advice, and the position of some scholars.

This Article explains that the 2022 Final Regulation and existing ERISA law provides fiduciaries a way forward to align participant desires for sustainable investments in their 401(k) plans with offerings on plan menus. The regulation only explicitly provides that fiduciaries do not violate their duty of loyalty when they consider participant preferences when evaluating investment options. This Article provides a framework for fiduciaries to follow when assessing and making menu decisions based on participant preferences. The framework addresses potential concerns with both the duty of loyalty and the duty of prudence.

First, PRI is the name of the organization as well as the name of the principles developed to guide sustainable investing. Second, the organization often is referred to as the UNPRI because it was initiated and is supported by the United Nations.

307. Melissa Kahn, *The New DOL Proposal May Change the ESG Game,* HARV. L.S. FORUM ON CORP. GOV. 2 (Dec. 8, 2021), https://corpgov.law.harvard.edu/2021/12/08/the-new-dol-proposal-may-change-the-esg-game/ [https://perma.cc/NT3M-BHCM]; *see also* Gary, *supra* note 3, at 796 ("New investment strategies incorporate material ESG factors, and financial analysts increasingly consider ESG factors in analyzing corporate strengths and weaknesses." (citations omitted)).

308. Gary, *supra* note 3, at 797-98 (citing the Freshfields Report and the report from the Fiduciary Duty in the 21st Century project.)

309. *Id.*

310. James P. Hawley, Keith Johnson & Ed Waitzer, *Reclaiming Pension Fund Fiduciary Duty Fundamentals, in* THE ROUTLEDGE HANDBOOK OF RESPONSIBLE INVESTMENT 632, 641 (Tessa Hebb et al. eds., 2015).

311. *Id.*

If fiduciaries adopt the framework developed in this Article it could be a triple win. Data indicate and experts believe that employees will save more in their 401(k) plans if they have access to investments that support their personal values. An increase in retirement savings would help close the substantial pension gap that exists, particularly for young employees and women who are particularly vulnerable to under saving. Companies will benefit if employees place a greater value on their 401(k) plans. And, the world would benefit from increased assets flowing to sustainable investments at a time when climate and social sustainability are close to or in crisis.