INFRASTRUCTURE INVESTING AND FIDUCIARY OBLIGATIONS

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(2009-2017)

OVERVIEW OF PRESENTATION

- Understanding the Legal Structure for Investment Decisionmaking: What ERISA Fiduciary Rules Require
- Deja Vu All Over Again: A Brief History of the Controversy Regarding Infrastructure Investing
- Practical Approaches to Infrastructure Investing for Trustees and Investment Professionals

ERISA'S FIDUCIARY DUTIES

- Same basic duties apply to ERISA fiduciaries regardless of type of plan or type of investment being considered, although whether a breach occurs is a facts and circumstances test
- ERISA Section 404 (a) sets the standard:
  - A fiduciary must
    - Act "solely in the interest" of the participants and beneficiaries of the plan and for the "exclusive purpose" of
      - Providing benefits to participants and their beneficiaries;
      - Defraying the reasonable expenses of administering the plan;
      - With 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 a like enterprise of a like character and with like aims;
    - Diversify the investments of the plan so as to minimize the risk of large losses, unless under the circumstances, it is clearly not prudent to do so;
    - Act in accordance with the documents and instruments governing the plan insofar as they are consistent with Titles I and IV of ERISA.

INFRASTRUCTURE INVESTING AND ERISA'S FIDUCIARY DUTIES

- In summary:
- The four basic fiduciary duties under ERISA Section 404(a) that an ERISA fiduciary are:
  - Duty of Loyalty (Exclusive Purpose/Solely in the Interest Rule)
  - Duty of Prudence
  - Duty to Diversify
  - Duty to Follow Plan Documents to the Extent Consistent with ERISA
- In discussing infrastructure investing, each of these are important, but historically, the first two have been the most discussed

DEJA VU ALL OVER AGAIN

- Infrastructure investing is not a new concept
- For more than 3 decades, ERISA experts have debated the so-called “collateral benefit” idea
  - Whether, in making their investment decisions, trustees can consider collateral or non-economic benefits that might flow to third parties (typically parties-in-interest)
  - Is this consistent with the exclusive benefit/solely in the interest statutory requirement?
- Terminology has changed and is evolving but legal questions are the same
    - ETI s (economically targeted investments)
    - Social Investing
    - SRI (socially responsible investing)
    - Sustainable and responsible investing
    - ESG (environmental, social and corporate governance focused-investing)
    - Impact investing
    - Infrastructure investing
- These terms do not have uniform meanings or even much consensus around their meanings

DOL'S VIEW OF THE COLLATERAL BENEFIT ARGUMENT

- DOL typically uses the term "economically targeted investment" or "ETI" in its written guidance to refer to any of the broad range of investments (including an infrastructure investment) that:
  - " … is selected, in part, for its collateral benefits, apart from the investment return to the employee benefit plan investor." IB 2015-1

- Since 1994, the DOL has published three broadly applicable written guidelines for trustees on whether ETIs are compatible with ERISA's fiduciary duties.
  - Guidance has generally been consistent through both Republican and Democratic administrations:
    - A fiduciary may consider collateral or non-economic factors in making an investment decision but only if the investment is the economic/financial equivalent of the other available alternative investments with similar rates of return and risk characteristics ("all things being equal" or "tiebreaker" rule)
    - Fiduciaries must place traditional financial and risk-based factors first and cannot sacrifice or subordinate those factors to collateral or non-economic benefits or considerations
  - But the emphasis and tone of each of these published guidelines has not been the same, leading to confusion and some reluctance by trustees to consider these investments

DOL'S INTERPRETATIVE BULLETINS (IB)

- IB-94-1 (Clinton Administration)
  - Codification of previous individual guidance but considered controversial at the time
  - Focus on plan's financial returns and risk to participants and beneficiaries is paramount; imprudent to do otherwise
  - ETI's are not necessarily incompatible with ERISA Sections 403 and 404
  - Plan fiduciaries may consider collateral goals as tie-breakers when choosing between investment alternatives that are otherwise equal with respect to return and risk over the appropriate time horizon

- IB- 2008-1 (Bush Administration)
  - Reiterated that plan fiduciaries may never subordinate the economic interests of the plan participants and beneficiaries to "unrelated objectives"
  - Although no real change in legal standard, the language and structure of the IB seemed to suggest that a different and much more rigorous analysis is necessary for ETIs than other type of investments
    - Fiduciary consideration of collateral or non-economic factors should be "rare" and "documented in a fashion that demonstrates compliance with ERISA"

DOL'S INTERPRETATIVE BULLETINS (IB)

- IB-2005-1 (Obama Administration)
  - Generally reinstates the language of IB 94-1
  - Reiterates the requirement that plan fiduciaries may not sacrifice the economic interests plan participants and beneficiaries in receiving their promised benefits to promote collateral or non-economic goals
  - Acknowledges that IB-2008-1 "unduly discouraged fiduciaries from considering ETIs and ESG factors" in making investment decisions
  - Recognizes the market developments that have occurred internationally and domestically that have provided fiduciaries and investment managers with new metrics and tools to evaluate and measure the economic benefits of ETI investments and identify economically superior investments
  - Two key takeaways:
    - "If a fiduciary prudently determines that an investment is appropriate based solely on economic considerations, including those that may derive from environmental, social and governance factors, the fiduciary may make the investment without regard to any collateral benefit the investment may promote"
    - The "all things being equal" or "tiebreaker" rule is still available to consider collateral or non-economic benefits

IMPLICATIONS FOR MULTIEMPLOYER PLAN TRUSTEES CONSIDERING INFRASTRUCTURE INVESTMENTS

- Still true:
  - Trustees/Fiduciaries may (but are not required to) consider infrastructure or other ETI investments or ESG factors in evaluating investment options
  - Trustees/Fiduciaries should consider whether they want to address this issue explicitly in their written investment policies
  - Like any other investment decision, a prudent procedure must be followed to identify and analyze appropriate infrastructure investments and monitor them carefully if selected

IMPLICATIONS FOR MULTIEMPLOYER PLAN TRUSTEES CONSIDERING INFRASTRUCTURE INVESTMENTS

- For instance, such procedures should include:
  - Review of plan's investment policy and delegation authority for selection of experts to assist plan fiduciaries in this process
    - What are experts required and allowed to do?
  - Developing and implementing criteria for selecting investment managers or consultants, evaluating performance and removal or other sanctions if necessary
    - RFP process
    - Evaluation criteria for experts
  - Rules addressing conflicts of interest with respect to investment committee members, Trustees/Fiduciaries and service providers (existing procedures may need to be reviewed and/or revised)
  - Developing a process for evaluating individual investments (existing process may need to be reviewed and/or revised)
  - Keeping written minutes of each meeting held to discuss or analyze issues around iinfrastructure investing, including the selection and monitoring of experts and the selection and monitoring of each individual investment

  - DOCUMENT, DOCUMENT, DOCUMENT

IMPLICATIONS FOR MULTIEMPLOYER PLAN TRUSTEES REGARDING INFRASTRUCTURE INVESTMENTS

- Specific considerations:
  - Infrastructure investing v. real estate expertise
  - Identifying benchmarks, metrics, other tools to evaluate economic effect of infrastructure investing generally and with respect to particular investments
  - Two tier analysis:
    - Is there a quantifiable and demonstrable effect of ESG factors on economic viability of proposed investment?
    - If not, can tie-breaker analysis be used?
  - **Caution**: DOL view: generation of new union jobs and broadening of plan's contribution base is not generally sufficient by itself to demonstrate an economic benefit to the plan
    - The exclusive benefit/solely in interest rule focuses on providing benefits to participants and beneficiaries in the plan , not new ones
    - If fiduciary wants to use those arguments to justify investments, make sure both costs and benefits are fully identified and analyzed

MOVING FORWARD

- The most important question for Trustees/Fiduciaries may not be:
  - Should you pursue infrastructure investing
  - But how to do it in a careful, prudent and procedurally defensible way.

- To do that, Trustees/Fiduciaries must understand:
  - How value to the plan is created
  - How to measure economic value and other financial factors in connection with an individual investment proposal
  - How to determine and measure success
    - What was successful and why
    - What didn't work as we expected and why
  - Identify lessons learned and take them seriously

  - None of these tasks are unique to infrastructure investing!

- DOCUMENT, DOCUMENT, DOCUMENT