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What You Should Know About ESG Investing And The DOL's Proposal

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In June, the Department of Labor advanced a rule relating to socially responsible investing – also commonly known as environmental, social, and corporate governance (ESG) investing. The proposed regulation by the Labor Department reiterates that fiduciaries are prohibited from disregarding pecuniary considerations to instead pursue ESG-related considerations. The Employee Retirement Income Security Act (ERISA) is the ruleset that ensures that fiduciaries properly use plan assets, and a bedrock principle of the ERISA ruleset is that a provider cannot sacrifice the financial security of a retirement plan for any reason including advancing social causes. Funds that adhere to ESG investing are required to consider the environmental, social, and corporate governance scores of the securities they are screening, and from 2018 to 2019 the number of firms that subscribe to this method grew fourfold.

The current state of ESG investing is still a bit obscure. While it has garnered heavy interest from asset managers such as BlackRock and Vanguard, the grading of ESG securities is still only vaguely defined. A study from the MIT Sloan School of Management of six different rating agencies reveals that there is a rater bias amongst them and, consequently, significant variance in grading results by the six different firms. In addition, funds that make ESG considerations must do their due diligence to analyze the degree of social responsibility of securities and therefore often charge higher fees.

This is not to say that the socially conscious investor is necessarily forgoing profits. Sustainability is a major risk factor for large corporations, with most now going so far as appointing chief sustainability officers. With the abundance of sustainability and environmental risk that certain companies and industries assume, many investors look to socially responsible investment options – to reduce said risk. For example, if investing in an oil company, there is always the possibility that the company may incur an environmental crisis due to the relatively low tolerance for error. For example, BP's stock has still not recovered to its pre-2010 offshore oil spill levels, which resulted in a record $18.7 billion fine by the EPA in 2015. Though, this is not to lead anyone to believe that traditionally environmentally unfriendly industries cannot be included in ESG funds – tobacco and alcohol companies can still have highly graded environmental sustainability and workforce conditions even though they may not be thought of as socially uplifting industries.

So, should you involve ESG criteria when investing? The answer will vary from person-to-person depending on your goal. If your goal is completely centered on financial returns, then it may be best to check your fundamentals first and consider any high scoring ESG characteristics as an added bonus. If your goal is to invest in what you believe in and advance your social considerations, then there is a fund for nearly any set of socially responsible beliefs. From catholic funds that follow the guidelines of the

July 10, 2020

U.S. Conference of Catholic Bishops, to the Amana Mutual Funds Trust which seeks to match its guidelines with Islamic faith, there really is a fund for everyone. When considering an ESG investment, do not overlook poor financial characteristics just to support a cause. Remember to consult with a financial advisor to determine if a ESG investing aligns with your retirement goals.