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Three Barriers to ESG Adoption for U.S. DC Plans: Insights from Consultants

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Introduction

DCIIA's Retirement Research Center (RRC) interviewed 12 defined contribution (DC) practice leaders at leading U.S. consulting firms on barriers to incorporating environmental, social and governance (ESG) considerations and investments in U.S. DC plans. According to these consultants, while interest in and demand for ESG continues to grow, implementation remains challenging. In this supplement to the RRC's report, we describe three barriers to implementation identified by U.S. consultants. For those seeking to move beyond these obstacles, we suggest potential ways to continue the dialogue in a manner consistent with fiduciary principles.

Barrier 1

Lack of consistent values across plan participants leads to difficulty in making appropriate fund selections. Some in the investment community continue to associate ESG investing with "values-based investing"–aligning investments with moral stances–making it difficult to identify investment options that align with the majority of DC plan participants.

Moving Forward

Consultants could share with DC plan committees that ESG investing has evolved away from funds with narrow issue preferences to an expanded range of sustainability factors. Moving the conversation from "values" to "value" can help identify options that are guided by risk / return considerations, and specifically non-financial goals that are expected to have a positive impact on investment performance over time. See a discussion of the ESG investment case in DCIIA's 2019 paper, "Sustainable Investing in DC Plans."

Barrier 2

Insufficient employee demand leads to delaying consideration. Most plan sponsors view their DC plan as a tool to attract and retain employees and attempt to customize the plan to address employee demographics and demands as much as possible. A sizable percentage of DC plan participants are not engaged with their DC plans and even fewer make requests to add ESG-specific funds to the plan lineup.

Moving Forward

Consultants could encourage plan sponsors to explore appropriate ESG options for their competitive returns and attractive risk profiles and incorporate risk and return information in participant fund communications when such funds become part of the plan. As with any new investment option added to a plan that is not the plan's qualified default investment option, sponsors should expect it to take time to attract asset flows due to employee inertia.

Barrier 3

Shifting political and regulatory environment has led to uncertainty. The U.S. Department of Labor's (DOL's) approach and tone around ESG investing has evolved over the past several decades and various Presidential administrations.

Moving Forward

Plan sponsors now have administrative guidance from both the prior and current DOL administrations (although a final rule from the current administration is still pending) to support integrating ESG investing strategies into DC plan design–namely, to rely on a well-documented, prudent process that emphasizes risk and return, diversification, and materiality in evaluating the duty of care, while relying on "prudent experts" as needed. See a discussion of legal and fiduciary considerations in DCIIA's 2020 paper, "Incorporating ESG in DC Plans: A Resource for Plan Sponsors."

In October 2021, the DOL proposed regulatory updates that are even more supportive of incorporating ESG into DC plans. The proposal clarifies that plan fiduciaries can consider climate change and other ESG factors in investment decision making. This approach is consistent with the growing acknowledgement that material ESG considerations are becoming established factors in the investment arena and across industries, both globally and domestically.

Learn more about the proposed rule and access DCIIA's related comment letter and other resources **in this News story on DCIIA's website**.

ABOUT DCIIA

The Defined Contribution Institutional Investment Association (DCIIA) is a nonprofit association dedicated to enhancing the retirement security of America's workers. To do this, DCIIA fosters a dialogue among the leaders of the defined contribution community who are passionate about improving defined contribution outcomes. DCIIA's diverse group of members include investment managers, consultants and advisors, law firms, recordkeepers, insurance companies, plan sponsors and other thought leaders who are collectively committed to the best interests of plan participants. For more information, visit: www.dciia.org.

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