INTERPRETIVE BULLETIN 08-1 AND ECONOMICALLY TARGETED INVESTING: A MISSED OPPORTUNITY

EDWARD A. ZELINSKY*

I. INTRODUCTION

In the waning days of the Bush administration, the Department of Labor ("DOL") issued Interpretive Bulletin 08-1 ("IB 08-1")[1] concerning the legal obligations of employee benefit plan[2] fiduciaries when they invest the plan assets they control. Specifically, IB 08-1 addresses plan fiduciaries' duties in the context of "economically targeted investing," the investment of plan assets in pursuit of benefits for third parties rather than for plan participants and their beneficiaries.[3] IB 08-1 revises prior regulations on economically targeted investing issued early in the Clinton administration.[4]

The assets held in trust by employee benefit plan fiduciaries represent compensation earned by plan participants. In accordance with the duty of loyalty codified by the Employee Retirement Income Security Act of 1974

* Morris and Annie Trachman Professor of Law at the Benjamin N. Cardozo School of Law of Yeshiva University. He is the author of THE ORIGINS OF THE OWNERSHIP SOCIETY: HOW THE DEFINED CONTRIBUTION PARADIGM CHANGED AMERICA (2007), published by Oxford University Press.

1. Interpretive Bulletin Relating to Investing in Economically Targeted Investments, 73 Fed. Reg. 61,734 (Oct. 17, 2008) (to be codified at 29 C.F.R. pt. 2509.08-1) [hereinafter IB 08-1].

2. For purposes of the Employee Retirement Income Security Act of 1974 ("ERISA"), the term "employee benefit plan" includes "pension plan[s]" as well as "welfare plan[s]" providing such fringe benefits as medical care and life insurance. Employee Retirement Income Security Act § 3(1)–(3), 29 U.S.C. § 1002(1)–(3) (2006). For these purposes, the term "pension plan" includes profit sharing plans, since profit sharing plans defer "income by employees for periods extending to the termination of covered employment or beyond." *Id.*

3. IB 08-1, 73 Fed. Reg. at 61,735.

4. Interpretive Bulletin Relating to the Fiduciary Standard Under ERISA in Considering Economically Targeted Investments, 29 C.F.R. § 2509.94-1 (2008), *repealed by* IB 08-1, 73 Fed. Reg. at 61,735.

("ERISA"), such assets must be invested with single-minded concern for the welfare of the participants and their beneficiaries.[5] Economically targeted investing contravenes ERISA's duty of loyalty by permitting, indeed encouraging, plan trustees to invest plan assets to generate ancillary benefits for persons other than the participants whose labor is embodied in those assets.

IB 08-1 was thus a missed opportunity. Economically targeted investing is neither a coherent concept nor a concept compatible with ERISA's duty of loyalty. Nevertheless, IB 08-1, rather than repudiating such investing, purports to limit it. Like most such half measures, IB 08-1 proves wanting.

II. BACKGROUND

A central feature of ERISA is the statute's codification and federalization of the legal duties of employee plan fiduciaries.[6] In the execution of their offices, traditional fiduciaries, such as trustees of family trusts, have historically been held to high standards of loyalty, prudence, and diversification.[7] Under the heading of loyalty, such fiduciaries have been required to discharge their responsibilities with exclusive concern for the welfare of their beneficiaries.[8] This broad, prophylactic standard precludes fiduciaries from considering any objective other than the beneficiaries' well-being.

When Congress adopted ERISA, it imposed on employee benefit plan fiduciaries these traditional duties of loyalty, prudence, and diversification.[9] As to the duty of loyalty, ERISA provides that a plan fiduciary must "discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and . . . for the exclusive purpose of . . . providing benefits to participants and their beneficiaries."[10] This statutory duty of loyalty has come to be known as ERISA's exclusive

5. Employee Retirement Investment Security Act of 1974 § 404(a)(1), 29 U.S.C. § 1104(a)(1).

6. *Id.* § 1001(b). *Metropolitan Life Insurance Co. v. Glenn*, 128 S. Ct. 2343 (2008), is the Supreme Court's most recent acknowledgment that the duties imposed on ERISA fiduciaries derive from the traditional fiduciary obligations of private trustees. In reviewing benefit denial by an ERISA plan administrator, it noted that a court "should analogize a plan administrator to the trustee of a common-law trust." *Id.* at 2347.

7. *See, e.g.*, RESTATEMENT (THIRD) OF TRUSTS § 78 (2007) (discussing a trustee's duty of loyalty); *id.* § 90 (discussing a trustee's duty of prudence, including the duty of diversification).

8. *Id.* § 78.

9. 29 U.S.C. § 1104(a)(1).

10. *Id.* § 1104(a)(1)(A)(i).

benefit rule[11] and embodies the same policy as the traditional fiduciary duty of loyalty, which the exclusive benefit rule tracks: plan fiduciaries must give single-minded devotion to the interests of employee benefit plan participants and their beneficiaries. Other interests are extraneous and are to be ignored, lest they influence fiduciary decisionmaking to the detriment of plan participants and their beneficiaries. The assets held in trust by employee benefit plans represent compensation earned by the employees participating in such plans. Trust funds of this sort are susceptible to abuse and thus must be protected by strong prophylactic measures like ERISA's exclusive benefit rule—measures designed to keep at bay extraneous pressures and influences when employee benefit plan trustees invest the assets they control.

In Interpretive Bulletin 94-1 ("IB 94-1"), the DOL, under President Clinton, introduced the notion of "economically targeted investments" ("ETIs"), defined as investments of plan assets "selected for the economic benefits they create apart from their investment return to the employee benefit plan."[12] According to this now-superseded regulation, if an ETI is prudent, selecting such an investment for its economic benefits to third parties is consistent with ERISA's duty of loyalty as codified in the exclusive benefit rule. The evident purpose of creating and bestowing the ETI label is to encourage plan fiduciaries to make investments so labeled.

Economically targeted investing proved controversial.[13] As both a statutory matter and as a matter of logic, ERISA's command that plan

11. JOHN H. LANGBEIN, SUSAN J. STABILE & BRUCE A. WOLK, PENSION AND EMPLOYEE BENEFIT LAW 557 (4th ed. 2006). *See also* LAWRENCE A. FROLIK & KATHRYN L. MOORE, LAW OF EMPLOYEE PENSION AND WELFARE BENEFITS 273 (2d ed. 2008). Language foreshadowing ERISA's exclusive benefit rule can be found in the qualified plan provisions of the Internal Revenue Code, specifically in I.R.C. § 401(a) (2006) (defining an employer's qualified plan as "for the exclusive benefit of his employees or their beneficiaries").

12. Interpretive Bulletin Relating to the Fiduciary Standard Under ERISA in Considering Economically Targeted Investments, 29 C.F.R. § 2509.94-1 (2008), *repealed by* IB 08-1, 73 Fed. Reg. 61,734 (Oct. 17, 2008) (to be codified at 29 C.F.R. pt. 2509.08-1).

13. *See Targeted Pension Fund Investment for Economic Growth and Development: Hearing Before the J. Economic Comm.*, 103d Cong. 38 (1994) (statement of William Niskanen, Chairman of the Board, CATO Institute) ("[Interpretive Bulletin 94-1 is] either meaningless or mischievous. It's meaningless if it does not change the standard that ERISA investments must meet. It is potentially mischievous if it does change the standard."); *id.* at 4 (opening statement of Rep. Jim Saxton) ("While we're all social-minded and want our collective lot in life to improve, it is clear that the primary function of a retirement income security system is, and should be, to provide benefits to participants and to their beneficiaries."); Edward A. Zelinsky, *Economically Targeted Investments: A Critical Analysis*, KAN. J.L. & PUB. POL'Y, Winter 1997, at 39, 39 [hereinafter Zelinsky, *Critical Analysis*]; Edward A. Zelinsky, *ETI, Phone the Department of Labor: Economically Targeted Investments, IB 94-1 and the Reincarnation of Industrial Policy*, 16 BERKELEY J. EMP. & LAB. L. 333, 333 (1995) [hereinafter Zelinsky, *Phone the DOL*].

fiduciaries act exclusively for the benefit of plan participants precludes such fiduciaries from picking investments for the benefits such investments yield to nonparticipants. A fiduciary cannot serve the exclusive interests of plan participants while simultaneously pursuing benefits for third parties. By condoning extraneous considerations in a plan trustee's decisionmaking—that is, the search for collateral "economic benefits" for nonparticipants—economically targeted investing opens the door to concerns and pressures which the traditional duty of loyalty, codified by ERISA as the exclusive benefit rule, kept shut. An ERISA fiduciary cannot be concerned "exclusively" about plans and their participants while, at the same time, making an investment because of its advantages for third parties.

There is, moreover, a paradox in declaring that investments are prudent but require the extra boost of ETI status: a prudent investment is one to which reasonably well-functioning capital markets will allocate capital. If an investment truly is prudent, the plan trustee who makes that competitive investment because it is an ETI thereby plays a game of musical chairs with other investors. If he doesn't make that competitive investment, some other participant in the market will. By making that investment, the trustee seeking collateral economic benefit merely displaces this other investor into another competitive investment. If, however, an ETI is not attracting the interest of other purchasers, that disinterest indicates that the investment is not competitive and is thus imprudent. The notion of the external economic benefit yielded to nonparticipants by an ETI is often elusive.[14]

Despite the best efforts of ETI defenders,[15] these concerns have never been convincingly addressed.

III. INTERPRETIVE BULLETIN 08-1: ETI AS TIE BREAKER

IB 08-1 does not address these concerns either. Rather than confront the incompatibility between ERISA's exclusive benefit rule and economically targeted investing, IB 08-1 instead attempts to place limits on such investing. IB 08-1 is thus a missed opportunity to correct the

14. For further discussion of these issues, see Zelinsky, *Critical Analysis*, *supra* note 13, at 39–45; Zelinsky, *Phone the DOL*, *supra* note 13, at 336–48; Edward A. Zelinsky, *Good Intention Gone Bad in State Pension Financing of Rebuilding WTC Area*, PENSIONS & INVS., Oct. 29, 2001, at 12; Edward A. Zelinsky, *Personal Dilemma on Swiss and Holocaust*, PENSIONS & INVS., Apr. 28, 1997, at 12; Edward A. Zelinsky, Op-Ed, *Reality of Social Investing*, NAT'L L.J. (New York), Oct. 1, 2007, at 22.

15. *E.g.*, Jayne Elizabeth Zanglein, *Protecting Retirees While Encouraging Economically Targeted Investments*, KAN. J.L. & PUB. POL'Y, Winter 1996, at 47, 54.

underlying problem: when a plan trustee seeks economic benefits for third parties under the ETI rubric, that trustee does not act exclusively for the interests of plan participants and their beneficiaries. Rather, the ETI-seeking trustee seeks to assist those third parties by deploying for their benefit trust assets which constitute the compensation of the plan participants.

To limit the breadth of the ETI category, IB 08-1 declares that employee plan fiduciaries may consider collateral economic benefits only "in very limited circumstances."[16] Before enumerating those circumstances, IB 08-1 acknowledges that, as a statutory matter, no such circumstances exist: "ERISA's plain text does not permit fiduciaries to make investment decisions on the basis of any factor other than the economic interest of the plan."[17]

Nevertheless, IB 08-1 instructs, third-party benefits may be used as a tie-breaking factor when the plan's "alternative [investment] options are truly equal."[18] IB 08-1 then provides five examples illustrating the consideration of economic benefits to nonparticipants to break ties when fiduciaries choose from among otherwise equal investments.[19]

No doubt, the drafters of IB 08-1 intended to leave for their successors a circumscribed delineation of the conditions under which plan fiduciaries may make ETIs. However, for three reasons, this effort fails.

First, as the drafters of IB 08-1 acknowledge, there is no statutory authority for economically targeted investing as "ERISA's plain text does not permit fiduciaries" to consider any factor other than the exclusive benefit of plan participants.[20] A plan fiduciary searching for an ETI engages in precisely the behavior the exclusive benefit rule proscribes, namely, deploying plan assets with the intent to generate collateral benefits for nonparticipants.

Second, investors in reasonably well-functioning markets continuously confront choices from among equal investments. Thus, the purported limit of IB 08-1—restricting economically targeted investing to tie situations—is no limit at all, since plan fiduciaries routinely select from among equal investment opportunities in competitive markets.

Third, IB 08-1 legitimizes economically targeted investing and

16. IB 08-1, 73 Fed. Reg. at 61,735.
17. *Id.*
18. *Id.*
19. *Id*. at 61,736.
20. *Id*. at 61,735.

thereby encourages the proponents of particular ETIs to pressure plan fiduciaries to declare ties to confer the particular economic benefits such proponents seek. While the strong terminology of ERISA's duty of loyalty ("exclusively") precludes the introduction of extraneous concerns into trustees' decisionmaking, IB 08-1, like IB 94-1, invites third-party pressures on plan trustees under the rubric of breaking ties from among comparable investments.

The likely retort of those defending IB 08-1 and economically targeted investing is that it "only" involves tie breaking. However, neither the logic nor the terminology of the exclusive benefit rule suggests that that rule should be jettisoned when plans confront equal investment opportunities.

A key insight animating the traditional duty of loyalty is that trust funds are susceptible to abuse. Consequently, trustees must be held to single-minded concern for their beneficiaries' welfare. There is no warrant for suspending this broad, prophylactic standard when fiduciaries select from among comparable investments. Once the door is opened to concerns other than the welfare of the fiduciary's wards, the door cannot be easily shut.

Ties can be broken without abrogating the exclusive benefit rule. Plans can develop simple, efficient default rules when selecting from among equal investments. Alternatively, plans can utilize default procedures to choose from among comparable investments. If they are really stumped between equal investments, employee benefit plan fiduciaries better serve participants' interests by flipping coins to choose than by yielding to the pressures and concerns of groups favoring their own particular ETIs. It was to immunize fiduciary decisionmaking from such pressures and concerns that the courts developed the duty of loyalty and Congress incorporated that single-minded duty into ERISA to protect the employee compensation held in trust by employee benefit plan fiduciaries.

IV. THE SIGNIFICANCE OF IB 08-1

The original efforts of the Clinton administration to encourage ETIs were stillborn. Shortly after the DOL promulgated IB 94-1, Republicans took control of Congress and effectively suspended the administration's efforts to encourage economically targeted investing.[21] While the Bush

21. H.R. REP. NO. 104-238, at 3 (1995) (Rep. Jim Saxton, a Republican Congressman, introduced a bill that would prohibit the DOL from promoting economically targeted investments); Robert Pear, *The 1994 Elections: The Republicans; New Majority's Agenda: Substantial Changes May Be Ahead*,

administration left IB 94-1 on the books until its recent adoption of IB 08-1, the Bush administration made no effort to promote ETIs.

We are currently entering a different environment. Indeed, the anticipation of this environment likely encouraged the Bush DOL to publish IB 08-1 as a parting shot. However, labor unions confronting for the first time in a decade and a half both a Democratic White House and Congress will find IB 08-1, at best, a minor nuisance if they encourage plans to pursue economically targeted investing.

Others will also be tempted to dilute ERISA's exclusive benefit rule under the banner of economically targeted investing. The trillions of dollars held by pension plans are attractive targets for off-balance-sheet activism. As state and municipal budget constraints tighten in the current economic environment, those funds will likely entice governors, mayors, and state and municipal legislators. Elected officials, like union leadership, will often act with the best of intentions. They nevertheless will seek to attenuate the protections of the exclusive benefit rule to pursue other objectives with employee benefit funds.

Ironically, IB 08-1 and the ETI category may impact most dramatically state and municipal pension plans. These government plans are not subject to ERISA's regulation of fiduciary obligations[22] and are thus not bound by the DOL's interpretation of the duty of loyalty. Nevertheless, the interpretation embodied in IB 08-1 encourages states to weaken their respective versions of the exclusive benefit rule for public pension plans.[23] IB 08-1 provides a road map for pension trustees to invest in the projects elected officials favor, notwithstanding the legal constraints of the duty of loyalty: declare a tie and then elect those favored projects for the third-party economic benefits they are alleged to generate. Past experience indicates the costly results when political pressures displace financial considerations in the investment of employees' retirement funds.[24]

N.Y. TIMES, Nov. 11, 1994, at A26 (announcing that the Republicans will take over the Senate and House in Congress for the upcoming term).

22. Employee Retirement Income Security Act of 1974 § 4(b)(1), 29 U.S.C. § 1003(b)(1) (2006).

23. *See, e.g.*, CAL. CONST. art. XVI, § 17(a) ("The assets of a public pension or retirement system are trust funds and shall be held for the exclusive purposes of providing benefits to participants in the pension or retirement system and their beneficiaries . . . ."); MINN. STAT. § 356A.05(a)(1) (2004) ("The activities of a fiduciary of a covered pension plan must be carried out solely . . . to provide authorized benefits to plan participants and beneficiaries . . . .").

24. *See, e.g.*, Zelinsky, *Phone the DOL*, *supra* note 13, at 350–51 (discussing the losses sustained by the Connecticut state pension plans attempting to save Colt's Manufacturing Company).

In the current environment, it is particularly likely that the ETI label will be used to secure pension funds for questionable infrastructure projects. Infrastructure investments, when they yield competitive, risk-adjusted returns, will be prudent for pension plans to undertake and, as such, will not need the extra boost of ETI status. When infrastructure projects are not economically competitive but yield important social benefits, public officials can openly appropriate public funds for such projects. The projects most likely to be undertaken by employee benefit trustees as ETIs are investments which do not attract capital in the open market and do not attract sufficient political support for the appropriation of public funds. This is not a reassuring prospect.

V. CONCLUSION

IB 08-1 was a missed opportunity. By attenuating ERISA's exclusive benefit rule, the ETI moniker opens the decisionmaking of employee plan fiduciaries to pressures and concerns which the rule should foreclose. The assets held in trust by employee benefit plans constitute compensation earned by plan participants. Per ERISA's duty of loyalty, fiduciaries should invest plan assets with single-minded concern for the welfare of plan participants and their beneficiaries. Economically targeted investing contradicts this duty of loyalty by permitting, indeed encouraging, trustees to invest plan assets to generate collateral benefits for third parties other than the participants whose labor is embodied in those assets.

Rather than repudiating economically targeted investing as inconsistent with ERISA's exclusive benefit rule, IB 08-1 purports to limit such investing. Like most such half measures, IB 08-1 proves wanting.