GAO Highlights

Highlights of GAO-18-398, a report to congressional requesters

May 2018

RETIREMENT PLAN INVESTING

Clearer Information on Consideration of Environmental, Social, and Governance Factors Would Be Helpful

Why GAO Did This Study

ESG factors have emerged as a way for investors, such as retirement plans, to capture information on potential risks and opportunities that may otherwise not be taken into account. For example, climate change is expected to have widespread impacts according to a key federal study and may pose significant financial risks for long term investors, such as retirement plans that must manage risk to provide benefits for many years to come. A number of large plans in other countries have adopted ESG strategies, but less is known about their use among U.S. plans. Given the emerging use of ESG factors, GAO was asked to examine how such factors are used by retirement plans in the United States and other countries.

GAO examined: (1) the use of ESG factors by U.S. retirement plans, (2) the use of ESG factors by selected retirement plans in other countries, and (3) DOL's guidance on the use of ESG factors by private sector U.S. retirement plans. GAO reviewed available private sector survey data and other documentation and interviewed government officials, asset managers, and plan representatives in the United States, France, the Netherlands, and the United Kingdom—from retirement plans that were identified as leading examples in the use of ESG factors.

What GAO Recommends

GAO is making two recommendations to DOL, including that DOL clarify whether the liability protection offered to qualifying default investment options allows use of ESG factors. DOL neither agreed nor disagreed with GAO's recommendations.

View GAO-18-398. For more information, contact Charles A. Jeszeck at (202) 512-7215 or jeszeckc@gao.gov.

What GAO Found

Few retirement plans in the United States incorporate environmental, social, and governance (ESG) factors into their investments according to available data. ESG factors that may affect investment returns include climate risk, executive compensation, and workplace safety issues among others. According to GAO's interviews with seven asset managers, inconsistent data and regulatory uncertainty create challenges to incorporating ESG factors in plan investment management. However, those plans considering ESG factors use various strategies to do so (see figure). Asset managers and plan representatives said they incorporate ESG factors to better manage risks and improve performance.

Strategies Used to Incorporate ESG Factors into Investment Management

Source: GAO analysis of documentation from CFA Institute and other sources. | GAO-18-398

The retirement plans GAO reviewed in France, the Netherlands, and the United Kingdom (UK) reported using integration and other strategies to incorporate ESG factors across their investments, particularly to address the risk of climate change. For example, the UK's National Employment Savings Trust—a defined contribution plan—used an ESG integration strategy in developing its default fund for participants who are automatically enrolled and do not select another investment. As part of their ESG strategies, representatives from these plans described targeted efforts to address climate risk related to financial performance. These representatives also said they are subject to governmental policies that encourage plans to address ESG risks.

In the United States, the Department of Labor's (DOL) guidance for private sector plans identifies ESG factors as proper components of investment analysis, but does not fully address uncertainties plans may face. In particular, sponsors of defined contribution plans face uncertainty about whether they may use ESG factors in a qualifying default fund—a widely used option in which a fiduciary is generally not liable for investment losses. DOL's mission includes assisting and educating plan fiduciaries. Providing clearer information about how to use ESG factors would help fiduciaries better understand whether and how to consider these potentially material risks. DOL is also considering steps to collect data on the use of ESG factors by retirement plans.