HansonBridgett

Fiduciary Education Program

ERISA PLAN FIDUCIARIES:
2021 UPDATE


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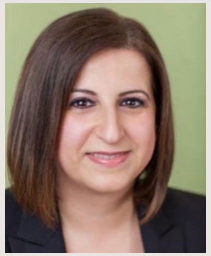
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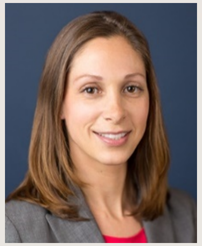
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Agenda

- Legislative and Regulatory Priorities
- Remote Governance Issues
- Update on General Fiduciary Issues
  - Claims and Appeals Issues
  - Service Provider Issues
  - Data Security/Fraud Prevention
- Fiduciary Breach Litigation

Agenda (continued)

- Update on Fiduciary Investment Issues
  – ESG Investing
  – Proxy Voting
  – DOL Fiduciary Rule
  – DOL Private Equity Investments Guidance
- Annual Review Process
  – Plan Document Compliance
  – Operational Compliance
- Questions?

Legislative and Regulatory Priorities

- Legislative Priorities
  - Some priorities already included in the Consolidated Appropriations Act of 2020 (CAA) and the American Rescue Plan Act of 2021(ARPA)
    - Overcoming the pandemic and restoring the economy/employment
    - Health policy issues
      - COVID-19 health-related
      - ACA-related
      - Surprise billing reform
      - Prescription drug prices
      - Anti-trust considerations; lots of consolidation in the health space

Legislative and Regulatory Priorities

- Legislative Priorities (continued)
  - Some priorities already included in the Consolidated Appropriations Act of 2020 (CAA) and the American Rescue Plan Act of 2021(ARPA)
    - Retirement policy issues
      - Multi-employer pension funding
      - Expanding coverage by either expanding State plans or federal auto-IRA legislation
      - SAVERS credit expansion
      - SECURE 2.0
      - On May 3, House Ways and Means Committee Chair Richard Neal (D-MA) and the committee's ranking Republican, Kevin Brady (R-Tx), released the Securing a Strong Retirement Act (the SSRA). Then on May 20, 2021, U.S. Senators Ben Cardin (D-MD) and Rob Portman (R-OH) reintroduced their Retirement Security and Savings Act (RSSA). Both are bipartisan efforts to enhance retirement security.
    - Other issues impacting benefits broadly
      - Mental health coverage and costs
      - Immigration
      - Funding Social Security and Medicare

Legislative and Regulatory Priorities

- Regulatory Priorities
  - DOL
    - Strengthening the ACA (Requires Tri-Agency Regulations)
    - Mental health and substance abuse guidance/enforcement
    - COVID-19 issues
    - Fiduciary/Conflict of interest rule
    - ESG/proxy voting, private equity
    - Expanding coverage; portable benefits
    - State retirement initiatives
    - E-delivery
    - Lifetime income options
    - Open MEPs
    - Solvency of PBGC/multi-employer plans
  - DOL: enforcement likely back on the front burner

Legislative and Regulatory Priorities

- Regulatory Priorities (continued)
  - IRS/Treasury
    - Allocating responsibility for retirement and health policy
    - Strengthening the ACA
    - Surprise billing
    - Mental health and substance abuse guidance/enforcement
    - COVID-19 issues—both health and retirement
    - E-delivery
    - Lifetime income options
    - RMD guidance
    - Expanding coverage/MEPs/State programs
    - EPCRS updates
  - IRS: New resources funded for compliance and audit activity

Legislative and Regulatory Priorities

- Regulatory Priorities (continued)
  - PBGC
    - Multi-employer plans
    - COVID-19 impacts
    - Funding outlooks

Remote Governance Issues

- What is plan governance?
  - Flexible framework that assists plan fiduciaries in making effective decisions about their employee benefit plans
    - Including documents, operations, compliance, investments, reporting, etc.
    - Identifies who has authority to make decisions and delegate authority
  - Proper and effective plan governance helps ensure compliance with IRC and ERISA, including ERISA's fiduciary requirements
- Despite having to deal with COVID-19 and its effect on the workplace
  - ERISA's fiduciary requirements continue to apply
  - DOL investigations and enforcement have not stopped
  - Still lots of fiduciary litigation (you'll hear more about this later!)

Remote Governance Issues (continued)

- Consider how remote work impacts plan governance process and make changes as needed
- Best practices:
  - Meet regularly, keep meeting minutes, review plan documents, record who is there (whether in-person or virtually)
  - Learn techniques for better virtual meetings (using “hand raise” feature, having sufficient technical assistance available, etc.)
  - Onboard new members with fiduciary training and share the history of past decisions made
  - Continue to provide regular fiduciary training and investment education for all members

UPDATE ON GENERAL FIDUCIARY ISSUES

Claims and Appeals

- Case law says the regulations call for a "meaningful dialogue" between the ERISA plan administrator and the participant (*Booton v. Lockheed Medical Benefit Plan*, 110 F.3d 1461,1463 (9th Cir. 1997)).
- ERISA claims procedures are reasonable if:
  - Comply with timing requirements of Reg. 2650.503-1
  - Are described in the SPD (following model language)
  - Don't unreasonably limit access to appeals process (i.e. charging a fee to appeal)
  - Authorized representatives may appeal on participant's behalf
  - There are no more than 2 mandatory levels of appeal
  - Meet specific requirements for health and disability plans

Claims and Appeals (continued)

- On April 29, 2020, joint DOL, IRS and Treasury notice issued extending certain deadlines for retirement and health & welfare plans
  - Extends deadlines for COBRA enrollment and premium payments, filing a benefit claim or appeal, or requesting external review
  - Retroactively extends all deadlines from March 1, 2020, to 60 days after announced end of the COVID-19 national emergency
  - Relief also applies to SPDs, claims procedure extension and denial notices, and responses to requests for plan documents for administrator during the COVID-19 national emergency—to as soon as administratively practicable given the circumstances

Claims and Appeals (continued)

- On February 26, 2021, DOL's Employee Benefits Security Administration issued EBSA Disaster Relief Notice 2021-01 providing guidance on how the extension of deadlines announced in 2020 would be handle given that the DOL and IRS only have statutory authority to grant a maximum 1-year extension
  - Clarified that extension applies individually to each extended deadline.
  - Deadlines are extended until the earlier of (a) 1 year from the date the individual or the plan was first eligible for relief, or (b) 60 days after the announced end of the COVID national emergency.
  - While stopping short of requiring plans and fiduciaries to take certain actions, the Notice emphasizes the importance of plan fiduciaries making participants aware that certain deadlines are expiring. This likely means a new communication will be required where prior communications did not reflect the 1-year limitation but only referred to the 60 days after the COVID emergency ends.

Selecting and Monitoring Service Providers

- ERISA's prudent person standard extends to the selection and monitoring of a plan's service providers.
- When selecting service providers for an ERISA plan, the DOL recommends:
  - Asking for and comparing information about the:
    - service provider's financial condition;
    - service provider's experience with retirement plans of similar size and complexity;
    - quality of the firm's services; and
    - reasonableness of fees.
  - Using service providers that follow strong cybersecurity practices. Ask about the service provider's:
    - information security standards, practices and policies, and audit results, and compare them to the industry standards;
    - validates its cybersecurity practices;
    - track record in the industry;
    - breach history, what happened, and how the provider responded; and
    - level of insurance coverage for cyber and identity theft losses.

Selecting and Monitoring Service Providers (continued)

- Ensure contracts contain provisions that will allow access to all plan records necessary to fulfill fiduciary obligations, including the ability to monitor plan service providers
  - Consider including provisions that require ongoing compliance with cybersecurity and information security standards; and enhance cybersecurity protection for the Plan and its participants; require annual third party audits
- With respect to monitoring service providers, best practices include:
  - Reviewing performance, including adherence to contractual performance standards
  - Review fees for reasonableness, and negotiate fees where appropriate
  - Follow-up on any participant complaints
  - Perform periodic RFPs
- Documenting the information review and the selection process

Data Security and Fraud Prevention

- Retirement plan transactions are increasingly occurring through online tools.
- Law is evolving to broaden opportunities for electronic transmission of plan data.
  - Final DOL Electronic Disclosure Rules *(29 CFR § 2520-104b-31)*
  - IRS Electronic Disclosure Rules *(Treas. Reg. § 1.401(a)-21)*
- How Data Breaches Can Occur:
  - Transmittal of unencrypted data.
  - Unauthorized disclosures.
  - Stolen/lost devices.
  - Ransomware, phishing, etc.

Data Security and Fraud Prevention (continued)

- Fiduciary Litigation Resulting from Cyber Related Fraud
  - *Barnett v. Abbott Laboratories, et. al*., Case No. 2020 CV 2127 (ND.Ill 2020)
    - Participant sued the employer, the plan, the plan administrator and third-party administrator (“TPA”) for failing to follow the plan’s security protocols and failing to act prudently to protect the plan’s assets, resulting in the theft of $245,000 from participant 401(k) accounts.
  - *Leventhal v. MandMarblestone Grp., LLC*, (2020, E.D. PA) 2020 WL 2745740
    - A third-party administrator (TPA) who was sued for breach of fiduciary duty after $400,000 was fraudulently withdrawn from the plan was allowed to countersue co-fiduciaries.

Data Security and Fraud Prevention (continued)

- One comprehensive body of law governing data security does not exist.
- California State Law:
  - Data Security Breach Notification Law
    - If an entity owns personal information of a California resident, there is a duty to notify the resident when there is a breach of that information and provide residents affected by the breach with identify theft monitoring. *(Civ. Code § 1798.82(a)).*
  - California Consumer Privacy Act of 2018
  - California Privacy Rights and Enforcement Act of 2020

Data Security and Fraud Prevention (continued)

- California State Law (continued):
  - California Protection Agency (created by CPRA)
  - California Attorney General Enforcement
- Other State Laws
  - May be subject to privacy and security laws of other States by virtue of having former employees, participants and/ or beneficiaries reside in other states.
- Federal Law
  - ERISA/ Department of Labor
  - SEC
  - Federal Trade Commission

Data Security and Fraud Prevention (continued)

- Best Practices
  - Create a cybersecurity policies and procedures
    - Understand how and where plan data is stored and transmitted
    - Establish data control monitoring plan
  - Establish breach response procedures
    - Identify individuals responsible for monitoring and breach response
  - Train employees on data security and the plan’s established cybersecurity policies and procedures
  - Periodically test monitoring and data breach procedures and address control weaknesses
  - Incorporate recommendations released by the DOL on April 14, 2021:
    - Cybersecurity program best practices;
    - Tips for hiring a service provider with strong cybersecurity practices; and
    - Online Security tips.
  - Cybersecurity insurance
  - Periodic assessment of legal landscape

Fiduciary Breach Litigation

- U.S. Supreme Court issued four decisions dealing with ERISA issues (most in any year since ERISA was passed in 1974)
- Approximately 200 ERISA class actions were filed in 2020—an all-time high
  - Includes increase in lawsuits against smaller plans (under 1,000 participants and less than $100M in assets)
- Appears to be no slowing down on the litigation front in 2021…

Fiduciary Breach Litigation (continued)

- ERISA Fiduciary Breach - Burden of Proof for Plaintiff
  - Fiduciary Status - Are the persons accused of the breach fiduciaries?
  - Fiduciary Scope - Was the action within the duties and responsibilities of this fiduciary?
  - Breach of Duty - Were the acts or failures to act alleged inconsistent with their fiduciary duties?
  - Actual Harm or Windfall - Did the participant suffer harm or was the fiduciary improperly enriched?
  - Causation - Was the harm suffered by participants caused by acts or failures to act of a fiduciary that were a breach of fiduciary duties?
    - Note: Can include harm by another entity if the breach was a failure to properly monitor and proper monitoring and intervention could have prevented the harm

Fiduciary Breach Litigation (continued)

- Ninth Circuit places burden on plaintiff to show causal link between breach and injury (*Wright v. Oregon Metallurgical Corp*., 360 F.3d 1090 (2004))
- Current Circuit split on shifting the burden of proof on the causation element, if the other elements are established
  - *Tatum v. RJR Pension Investment Committee*, 2017 WL 1531578 (4th Cir. 2017): absent proof of **prudent deliberations**, defendant can only prevail on causation by proving the act/inaction alleged was the only thing a prudent fiduciary would have done, not merely one of many courses of conduct a prudent fiduciary could have taken.
  - *Brotherston v. Putnam Invs., LLC,* 907 F.3d 17 (1st Cir. 2018): holding burden shifts to fiduciary when breach and loss are established (same in 4th, 5th, and 8th Circuits, but not in 6th, 9th, 10th and 11th Circuits)
- Supreme Court declined to hear appeal of *Brotherston* last year
- In all cases, evidence of **prudent deliberations** by the fiduciary will be critical to outcome.

Fiduciary Breach Litigation (continued)

- Fiduciary has responsibility over the assets of the plan
- Decisions to which fiduciary duties apply:
  - Developing and maintaining the investment policy statement
  - Selecting types of investment options and managers to be offered
  - Selection of default investment option (See Preamble to final DOL regulations regarding selection of default investment for ERISA plans at 72 Fed. Reg. 60452 (Oct. 24, 2007); see also DOL FAB 2008-3 regarding target date funds (TDFs) as the plan's qualified default investment alternative (QDIA))
    - A July 2020 Plan Sponsor article noted that almost 30% of plan assets for ERISA defined contributions plans are invested in the plan's QDIA, usually target date funds — this makes that investment decision a big litigation target
    - Callan's 2020 Defined Contribution Trends Survey indicates that 87.3% of plans used TDFs as their QDIA.

Fiduciary Breach Litigation (continued)

- **Statute of Limitations Issues—When does participant "know" of breach?**
  - New U.S. Supreme Court Decision-*Intel Corp. Investment Policy Committee et al. v. Sulyma*, 140 S.Ct. 768 (2020)
    - Alleged fiduciary breach of over-investing in alternative assets, such as hedge funds, private equity and commodities
    - Plaintiff filed a lawsuit **more than three years, but less than six years**, after receiving plan disclosures that included information about the investments
    - Intel moved to dismiss based on ERISA's three-year statute of limitations
    - Intel provided evidence showing Plaintiff repeatedly accessed information made available on plan website, including numerous ERISA-required disclosures–QDIA notices, SPDs and fund fact sheets about the investments.
    - Plaintiff testified that he had not seen the disclosures.

Fiduciary Breach Litigation: *Sulyma* (continued)

- District Court granted summary judgment for Intel, finding no genuine dispute that plaintiff had actual knowledge of underlying facts
  - Would not allow claims to survive merely because plaintiff did not look further into the disclosures made to him
- The Ninth Circuit reversed and held that "actual knowledge" means the plaintiff was actually aware of the facts constituting the breach, not merely that those facts were available to the plaintiff
- On appeal, the U.S. Supreme Court affirmed the Ninth Circuit's decision, holding that a plaintiff does not necessarily have "actual knowledge" under ERISA of the information contained in disclosures that he receives but does not read or recall reading.

Fiduciary Breach Litigation: *Sulyma* (continued)

- The Court said fiduciaries can still prove actual knowledge in the “usual ways”
  - Plaintiffs are bound by oath to testify truthfully about whether they read the disclosures = they had actual knowledge
  - Can be inferred from circumstantial evidence, e.g., evidence that disclosures were sent to the plaintiff and electronic records showing plaintiff viewed the disclosures
- Plaintiff’s claims can survive summary judgment only when there is a genuine dispute as to facts about actual knowledge
- Fiduciaries could still win motion for summary judgment if plaintiff’s denial of knowledge is “blatantly contradicted by the record.”

Fiduciary Breach Litigation: *Sulyma* (continued)

- **BEST PRACTICES IN RESPONSE TO SULYMA :**
  - – Consider using DOL's new electronic disclosure safe harbor rule issued on May 27, 2020
    - Requires "notice of internet availability" and electronic posting of disclosures
  - – Confirm that plan or employer's intranet website tracks the number of times a participant views each plan disclosure and the amount of time spent viewing it.
  - – Consider adding "scroll wrap" to disclosures = requires participant to click button at the end of the disclosure to confirm they read and understood it.

Fiduciary Breach Litigation

- **Standing Issues—When can the participant sue for investment losses under a retirement plan?**
  – New U.S. Supreme Court Decision-*Thole v. US Bank N.A.*, 140 S.Ct. 1615 (2020).
    - Defined benefit pension plan participants whose own benefit payments were not affected cannot sue on behalf of the plan – no concrete stake in lawsuit because their benefits won't change, win or lose
    - Contrasted with defined contribution plan participants, because their benefits are typically tied to the value of their accounts, and can turn on fiduciaries' particular investment decisions
    - *Universal Health* case on appeal in Third Circuit – fiduciaries seek to apply *Thole* to 401(k) plan participants who were not invest in challenged funds

Fiduciary Breach Litigation: Monitoring of Investment Options/Managers

- Recent litigation dealing with investment option selections by fiduciaries have focused on a number of alleged deficiencies:
  - Lack of oversight monitoring of plan investment committee
  - Excessive cost
  - Proprietary bias
  - Poor performance
  - Lagging index returns
  - Excessive risk

Fiduciary Breach Litigation: How do you show "prudent deliberations"?

- ERISA fiduciaries not guarantors of favorable performance as long as follow prudent process.
- Despite losses, fiduciaries should prevail if engaged in **substantial deliberations** concerning the challenged investments, as evidenced by frequent (more than 40 meetings), well attended deliberations **documented by minutes** reflecting **ongoing consideration of reports from qualified professionals**. *Pfeil v. State Street Bank & Trust Co*. 806 F. 3d 377, 388 (6th Cir. 2015); rehearing en banc denied (1/14/16); cert denied 136 S. Ct. 2511 (6/27/16) (ESOP case)

Fiduciary Breach Litigation: How do you show "prudent deliberations"?

- Allegation that Board appointing Committee failed to adequately monitor ERISA fiduciary committee
  - See e.g., *Sulyma v. Intel Corporation Investment Policy Committee; Bell v. Pension Committee of ATH Holding Co., LLC (Case No. 1:15-CV-02062-TWP-MPB(9/4/19)) settled in 2019 for $24M one week prior to trial;; Johnson v. Fujitsu Technology and Business of America, Inc. (250 F. Supp.3d 460 (N.D. Cal 2017))(settled for $14M; Main v. American Airlines, Inc. (248 F.Supp.3d 786 (N.D. Tex 2017)) settled for $22M; White v. Chevron (82 EB Cases 1602 (N.D. Cal 2016))decision for defendant upheld in 2018; Marks v. Trader Joe's Co. (2020 WL 2504333 (C.D. Cal. 4/24/20) decision for defendant; Davis v. Salesforce, Inc. (2020 WL 5893405 (N.D. Cal. 10/5/20) decision for defendant.*

- **BEST PRACTICES**: Consider periodic Committee reports to Board or appointing authority so that Board has record of independent evaluation of Committee process. This will make it hard for plaintiff to bear burden of proving: (1) that Board should have known of a Committee breach; and (2) that Board did nothing about the breach.
  - (See *In re BP P.L.C. Securities Litigation re proving board oversight (922 F. Supp.3d 600 (S.D. TX 2013)); Brotherston v. Putnam Invs., LLC (907 F. 3d 17 (1st Cir. 2018)).*

Fiduciary Breach Litigation: How do you show "prudent deliberations"?

- Allegation of excessive record-keeping fees based on failure to: (1) use competitive bidding; (2) seek flat per participant fees; or (3) regularly monitor fees as was required in *Tussey v. ABB (746 F. 3d 327 (8th Cir. 2014).*
  - *See e.g., Bell v. Pension Committee of ATH Holding Co., LLC ; Sims v. BB&T Corp (2019 WL 1993519 (5/6/19)) settled 4 days before trial in 2019 for $24M ; Troudt v. Oracle Corp. (2019 WL 8348317 (D. Co. 5/30/19) settled in 2020 for $12M; Pledger v. Reliance Trust Company (240 F. Supp 3d (N.D. Ga. 2017) settled in 2020 for $40M; Johnson v. Fujitsu Technology and Business of America, Inc.; Terraza v. Safeway, Inc.; Lorenzo v. Safeway, Inc. (241 F. Supp. 3d 1057 (N.D. Cal. 2017) settled for $8.5M in 2019;*
  - *See also Columbia University* case involving 28,000 participants settled in April 2021, days before going to trial-- in March, 2020, SDNY court denied fiduciaries' motion to dismiss claims based on failure to (1) conduct competitive bidding for recordkeeper; (2) negotiate per-participant recordkeeping fees; and (3) consolidate to a single recordkeeper.

- Note: *Tussey v. ABB* involved a $55M settlement in 2019 ending 12 years of litigation over fees charged in the 401(k) plan that allegedly supported services provided by Fidelity to other corporate plans. ABB was previously ordered by the courts to use a competitive bidding process, including RFPs, to select a new record-keeper; to choose the share class of investments that has the lowest expense ratio; and to make recordkeeping and asset management fees more transparent.
- But see: *Divane v. Northwestern University* (953 F.3d 980 (7th Cir. 2020) upholding lower court's dismissal of claims that plan's record-keeping fees should have been a fixed per-participant fee rather than paid through revenue sharing. Court found no support for claim that flat fee structure is required by ERISA or that would always benefit plan participants.

Fiduciary Breach Litigation: How do you show "prudent deliberations"? (continued)

- Allegation of excessive record-keeping fees based on failure to: (1) use competitive bidding; (2) seek flat per participant fees; or (3) regularly monitor fees as required by *Tussey.*
- **BEST PRACTICES:** Undertake periodic RFPs or other market-based benchmarking of services/fees; record history of negotiated improvements to record-keeping agreements, including progress towards unbundling fees; increase transparency of fee determinations

Fiduciary Breach Litigation: How do you show "prudent deliberations"? (continued)

- Allegation of failure to use market power to seek and obtain favorable fund share class
  - See e.g., *Bell v. Pension Committee of ATH Holding Co., LLC; Sims v. BB&T Corp; Pledger v. Reliance Trust Company; White v. Chevron Corp.; Johnson v. Fujitsu Technology and Business of America, Inc.; Moreno v. Deutsche Bank Americas Holding Corp.(2018 WL 2727880 (S.D. NY 6/16/2018)) settled in 2018 for $22M.*
  - *See also Davis v. Washington University* (960 F.3d 478 (8^{th} Cir. 2020) reversed lower court's dismissal and recognized "inference of mismanagement" based on (1) size of plan ($3.8B), fiduciaries should have been able to negotiate lower fees, and (2) active monitoring requires replacing retail-class shares with institutional shares.
  - *See also Davis v. Salesforce, Inc*. ND Cal granted fiduciaries' motion to dismiss; claims were (1) excessive fees related to actively managed funds and high-cost share classes, and (2) failure to monitor Committee. Fiduciaries argued that revenue sharing from higher cost share classes benefitted the plan by paying for recordkeeping and admin fees. Failure to monitor claim was derivative of excessive fee claim so it also failed On April 15, 2021, court dismissed amended complaint on similar grounds. Plaintiffs have appealed.
  - *See also Marks v. Trader Joe's Company.* Court granted defendant's motion to dismiss claims that: Trader Joe's breached the fiduciary duty of prudence in five ways: by (1) paying unreasonable recordkeeping fees; (2) failing to seek competitive bids every three years; (3) choosing higher cost mutual fund share classes; (4) allowing record-keeper to collect and invest excessive fees before giving them back to the Plan; and (5) failing to adequately monitor Committee members.

- **BEST PRACTICES**: Record history of monitoring for best investment options, including new share class availability as appropriate and hard bargaining for favorable terms particularly if plan is large

Fiduciary Breach Litigation: How do you show "prudent deliberations"? (continued)

- Allegation of inadequate attention to improvements in fund line-up, including failure to offer lower cost or better performing fund types such as: (1) passive versus active; (2) collective funds or separate accounts, not mutual funds; and (3) stable value versus money market
  - See e.g., *Bell v. Pension Committee of ATH Holding Co., LLC.; Sims v. BB&T Corp; Pledger v. Reliance Trust Company; White v. Chevron Corp; Main v. American Airlines, Inc.; Moreno v. Deutsche Bank Americas Holding Corp.; Bernaola v. Checksmart Financial LLC (322 F. Supp. 3d 830 (S.D. OH 2018)) dismissed in 2018 on statute of limitations; suit against JP Morgan Chase 401(k) Savings Plan alleged use of proprietary funds with high fees that inured to benefit of one of plan sponsor's close business partner, BlackRock Institutional Trust Co.settled for $9M in May 2020.*
  - *See also Davis v. Salesforce, Inc. court rejected claim based on failing to investigate collective trusts and separate accounts as less costly alternatives to mutual funds because (1) "plans are under no duty to offer alternatives to mutual funds, even when the plaintiffs argue they are markedly superior" and (2) collective trusts and separate accounts differ so much from mutual funds ... that other courts have found it impossible to make an 'apples-to-oranges' comparison of the two - it is inappropriate to compare these distinct investment vehicles solely by cost, since their essential features differ so significantly."*

- **BEST PRACTICES**: Document history of consideration of prudent review of fund choices and either orderly shift to newer, potentially advantageous fund types, or contemporaneous statement of defensible rationale for not doing so, including supportive professional advice

Fiduciary Breach Litigation: How do you show "prudent deliberations"? (continued)

- Allegation of loading the plan with proprietary funds and failing to replace despite continued under-performance; inadequate attention to improvements in fund line-up, including failure to offer lower cost or better performing fund types
  - See e.g., most recent suit against Northern Trust filed in November 2020 in Dist. Ct. for ND Ill. alleging $34M loss; *Brown-Davis v. Walgreen Co. (2020 WL 8921399 (N.D. Ill. 3/16/20))* alleged $300M loss, federal judge ruled against Walgreens efforts to dismiss; *Baker v. John Hancock Life Ins. Co. (2020 WL 8575183 (D. Mass. 1/23/20)* alleged $10M loss, federal judge ruled against John Hancock's efforts to dismiss in July 2020 ; *Kirk v. Retirement Committee of Community Health Systems, Inc. (Case No..* 3:19-cv-00689 (M.D. Tenn 4/29/21) *dismissed; settled for $580,000 in Dec. 2020).*

- **BEST PRACTICES**: Document history of consideration of prudent review of fund choices and either orderly shift to newer, potentially advantageous fund types, or contemporaneous statement of defensible rationale for not doing so, including supportive professional advice

Fiduciary Breach Litigation: How do you show “prudent deliberations”? (continued)

- Allegation of excessive risk and high cost in investment choices; failing to use plan size to get lesser fees
  - See e.g. *Anderson v. Intel Corp. Inv. Policy Comm. (2021 WL 229235 (N.D. Cal. 6/21/21)* This is a 2019 companion case to the *Sulyma* case decided by the Supreme Court discussed earlier.
    - $18B in plan assets for Intel plan
    - Complaint alleged use of risky component funds (i.e. hedge funds and private equity)—complaint used the term “hedge fund” 280 times; these funds made up 27%-37% of the custom TDFs and up to 56% of the model funds at various times
    - Alleged conflicts of interest—many of the high risk funds were managed by companies engaged in outside investments with Intel Capital
    - In June 2021, defendant’s motion to dismiss was granted based on failure by plaintiffs to provide evidence of a sound basis for comparison to other plans or a meaningful benchmark that would show that a prudent fiduciary in like circumstances would have made a different decision; just showing lower fees were available is not enough; Court found ERISA does not require a prudent fiduciary to mimic the industry standards when making investments; no evidence found of self-dealing or conflict of interest involved

- **BEST PRACTICES**: Document reasons for decisions; provide evidence of monitoring against “meaningful benchmarks” in the record; use outside professionals to bolster prudence arguments

Fiduciary Breach Litigation: Summary of Best Practices

- Best practices for monitoring of investment options/managers
  - Follow the plan's investment policy statement
  - Review performance – choose appropriate benchmarks and adjust as necessary
  - Review fees through RFPs and benchmarking studies– determine that fees remain reasonable in amount and appropriate to investment needs of the plan
  - Determine if any conditions have changed that affect the appropriateness of investment options
  - Conduct periodic RFPs to learn information about other qualified investment options
  - Document review and decision-making process and result

UPDATE ON INVESTMENT ISSUES

Update on Investment Issues: ESG Investing

- “ESG” investing = investing that takes into account collateral economic or social factors and effects on investment return
- Various terms used to describe this type of investing, including:
  - Environmental, social and governance (ESG) investing
  - Socially responsible investing
  - Sustainable and responsible or “green” investing
  - Impact investing
  - Economically targeted investing
- DOL guidance over past several years has varied based on policy considerations

ESG Investing (continued)

- A brief history…
  - 1994: Interpretive Bulletin 94-1 (IB 94-1) issued "to correct a popular misperception at the time that investments in [economically targeted investments] ETIs are incompatible with ERISA's fiduciary obligations"
  - IB 2008-1: "consideration of collateral, non-economic factors in selecting plan investments should be rare and, when considered, should be documented in a manner that demonstrates compliance with ERISA's rigorous fiduciary standards"
  - IB 2015-01: 2008 guidance unduly discouraged consideration of ESG factors, which may be "proper components of the fiduciary's primary analysis of the economic merits of competing investment choices" – fiduciaries can consider ESG factors as "tie-breakers" between investments with otherwise equal return and risk
  - FAB 2018-01: "fiduciaries must not too readily treat ESG factors as economically relevant to the particular investment choices at issue when making a decision"

ESG Investing (continued)

- From 2018 to 2020, sustainable investing assets under management in US grew 42%, to $17.1 trillion, up from $12 trillion
  - Represents 33% of total U.S. assets under professional management
- Significant growth in ESG investing in 2020
  - Climate change, social justice, corporate governance are major concerns
  - ESG funds captured $51.1 billion of net new money from investors in 2020
  - ESG funds accounted for approximately 25% of the money that flowed into all U.S. stock and bond mutual funds last year
  - Number of sustainable funds available to U.S. investors grew to almost 400 in 2020 – up 30% from 2019
- Only 3% of 401(k) plans have an ESG fund
  - Only 0.1 % of 401(k) plan assets are held in ESG funds

ESG Investing (continued)

What's Happening Now?

- Proposed rule issued in June 2020; final rule issued in November 2020
- Focus on "pecuniary versus non-pecuniary factors" rather than "ESG"
- Duty of loyalty means fiduciaries must prudently evaluate investments based solely on pecuniary factors:
  - a factor the fiduciary ***prudently determines***
  - is expected to have a ***material effect*** on risk or return
  - based on ***appropriate investment horizons***
  - consistent with the plan's ***investment objectives and funding policy***

ESG Investing (continued)

What's Happening Now? - November 2020 Final Rule

- "Pecuniary and non-pecuniary factors" replaced references to "ESG"
  - DOL acknowledged that ESG factors could be pecuniary at times
- Evaluating non-pecuniary factors in a "tie-breaker" between otherwise similar investments would require enhanced scrutiny and documentation
  - Could apply only in limited circumstances where fiduciary cannot distinguish between alternative investments on the basis of pecuniary factors
  - Intended to prevent fiduciaries from "making investment decisions based on non-pecuniary benefits without appropriately careful analysis and evaluation"
- Would allow participant-directed plans to include investments that support non-pecuniary goals if other fiduciary requirements are met
- Would prohibit QDIAs that use any non-pecuniary factors in investment goals

ESG Investing (continued)

What’s Happening Now?

- On March 10, 2021 DOL announced it will NOT enforce the November 2020 final rule
  - Executive Order 13990 titled “Protecting Public Health and the Environment and Restoring Science to Tackle the Climate Crisis,” issued on January 20, 2021, directs federal agencies to review regulations issued during prior administration that may be inconsistent with the Order
  - DOL will revisit the rules based on information from stakeholders that the rules:
    - Created perception that fiduciaries are at risk if they include any ESG factors in the financial evaluation of plan investments, and “may need to have special justifications for even ordinary exercises of shareholder rights”
    - Failed to adequately consider and address the substantial evidence submitted by public commenters on the use of ESG considerations in improving investment value and long-term investment returns for retirement investors
  - DOL will conduct more stakeholder outreach to determine how to craft rules that better recognize the important role that environmental, social and governance integration can play in the evaluation and management of plan investments, while continuing to uphold fundamental fiduciary obligations

ESG Investing (continued)

What's Happening Now?

- Executive Order on Climate-Related Financial Risk issued on May 20, 2021
- Directs the Secretary of Labor to:
  - Identify DOL actions that can be taken under ERISA and the Federal Employees' Retirement System Act to protect the life savings and pensions of US workers and families from the threats of climate-related financial risk
  - **Consider publishing a proposed rule to suspend, revise or rescind ESG (and proxy voting) final rules, by September 2021**
  - Assess how the Federal Retirement Thrift Investment Board has taken environmental, social, and governance factors, including climate-related financial risk, into account

ESG Investing - Congressional Action

- “Financial Factors in Selecting Retirement Plan Investments Act’’ (May 20, 2021)
  - ESG factors can be taken into account as economically relevant or as a tiebreaker
  - No special documentation or substantiation required
  - Voids November 2020 final rule
- “ESG Disclosure Simplification Act of 2021” (HR 1187)
  - Would require disclosures to shareholders of certain ESG metrics and their connection to the long-term business strategy of the issuer
- “Improving Corporate Governance Through Diversity Act” (HR 1277)
  - Would require disclosure of racial, ethnic, and gender composition of boards of directors and executive officers, as well as diversity policies
- “Climate Change Disclosure Act of 2021” (HR 2570)
  - Would require disclosure of climate-related risks and their financial impact based on new SEC rules

Proxy Voting

- Proxy voting applies to employee benefit plans that own equities that require voting
  - A proxy vote is a delegation of voting authority to a representative on behalf of the original vote-holder.
- DOL published Proposed Rule on 9/4/2020 and issued Final Rule on 12/11/2020
  - Addresses plan fiduciaries' investment duties related to proxy voting and shareholder rights
  - Final Rule supersedes the DOL's prior guidance (Interpretive Bulletin 2016-1) and amends the "Investment Duties" regulation under 29 C.F.R. 2550.404a-1
- Final Rule provides that the fiduciary duty to manage plan assets that are shares of stock includes the management of "shareholder rights appurtenant" to those shares, such as the right to vote proxies
  - Not required to vote every proxy or exercise every shareholder right

Proxy Voting (continued)

- Who votes proxies?
  - Plan's trustee generally responsible for voting proxies, unless the trustee is subject to the instructions of a named fiduciary or an investment manager has been appointed
  - Review plan documents and investment policy
- Under Final Rule, plan fiduciaries must act solely with the economic interest of the plan and its participants and beneficiaries in mind when managing plan assets
  - Using plan assets to further policy-related or political issues, including ESG issues, violates ERISA's prudence and exclusive purpose requirements, unless doing so is exclusively in the economic interests of participants and beneficiaries
- Plan fiduciaries must have a process, consistent with their duties of prudence and loyalty, for proxy voting and other exercises of shareholder rights

Proxy Voting (continued)

- Final Rule imposes 6 requirements on plan fiduciaries who are deciding whether to exercise shareholder rights, including proxy voting:
  - Act solely in accordance with the economic interest of the plan and its participants & beneficiaries
  - Consider any costs involved
  - Not subordinate the interests of participants & beneficiaries in their retirement income or financial benefit under the plan to any non-pecuniary objective, or promote non-pecuniary benefits or goals unrelated to the financial interests of participants & beneficiaries
  - Evaluate material facts that form the basis for any particular proxy vote or other exercise of shareholder rights
  - Maintain records on proxy voting activities and other exercises of shareholder rights
  - Exercise prudence and diligence in the selection and monitoring of third parties, if any, selected to advise or otherwise assist with exercises of shareholder rights

Proxy Voting (continued)

- Plan fiduciaries may adopt either, or both, of the following safe harbor policies to satisfy their fiduciary responsibilities related to proxy voting:
  - A policy that voting resources will focus only on particular types of proposals that the fiduciary has prudently determined are substantially related to the corporation's business activities or are expected to have a material effect on the value of the plan's investment
  - A policy of refraining from voting on proposals or types of proposals when the size of the plan's holdings in the stock subject to the vote are below quantitative thresholds that the fiduciary prudently determines, considering its percentage ownership of the stock and other relevant factors, is sufficiently small that the matter being voted upon is not expected to have a material effect on the investment performance of the plan's portfolio (or assets under management in the case of an investment manager).
- Periodic review of proxy voting policies adopted under Final Rule required

Proxy Voting (continued)

What’s Happening Now?

- On March 10, 2021 DOL announced it will NOT enforce the Final Rule under Biden’s Executive Order 13990 (Protecting Public Health and the Environment and Restoring Science to Tackle the Climate Crisis)
  - Nonenforcement until DOL publishes further guidance on proxy voting
- On May 20, 2021, Biden issued Executive Order on Climate-Related Financial Risk
  - Directs Secretary of Labor to consider publishing a proposed rule to suspend, revise or rescind proxy voting (and ESG) final rule by September 2021

Update on Investment Issues - DOL Fiduciary Rule

- "Fiduciary rule" focuses on compensation paid to third parties that provide plan participants with "investment advice"
- Final "rule" issued in December 2020 in the form of Prohibited Transaction Exemption (PTE) 2020-02
  - Allows ERISA plan and IRA investment advisors to receive otherwise prohibited compensation for providing investment advice if the conditions in the PTE are met
- DOL allowed PTE to take effect as scheduled on February 16, 2021
- In April, 2021 DOL issued two pieces of guidance for ERISA plan advisors and participants
  - FAQs for investment advisors about compliance
  - Questions for investors to ask and information about choosing an investment advisor

DOL Fiduciary Rule (continued)

- A brief history…
  - In 1975 DOL established a 5-part test for determining when a recommendation is “investment advice” subject to fiduciary duties = a person must:
    - 1) Render advice to the plan, plan fiduciary, or IRA owner as to the value of securities or other property, or make recommendations as to the advisability of investing in, purchasing, or selling securities or other property,
    - 2) On a regular basis,
    - 3) Pursuant to a mutual agreement, arrangement, or understanding with the plan, plan fiduciary, or IRA owner, that
    - 4) The advice will serve as a primary basis for investment decisions with respect to plan or IRA assets, and that
    - 5) The advice will be individualized based on the particular needs of the plan or IRA.

DOL Fiduciary Rule (continued)

- In 2016, a new fiduciary rule was to take effect that would have replaced 5-part test
  - Expanded the activities that makes an investment professional a fiduciary
  - Required all persons who provide investment advice for a fee to put client's interests ahead of profit and to disclose conflicts of interest
- Effective date was delayed until 2017
- Fifth Circuit vacated the rule in 2018

DOL Fiduciary Rule (continued)

- New final fiduciary rule issued in December 2020
- Reinstates 5-part test from 1975
- Applies to covered transactions involving investment advice
- Does NOT apply to:
  - Educational presentations about plan or IRA investments
  - “Robo-advice” obtained from interactive website
- Withdraws 2005 “Deseret Letter” which exempted advice regarding a rollover from an ERISA plan from fiduciary standards
  - Rollover advice may not trigger the fiduciary rule if rollover is an isolated transaction

DOL Fiduciary Rule (continued)

- December 2020 final rule applies “impartial conduct” standards, including
  - “Best Interest” – advice must be in the best interest of the investor
  - Advisor receives only reasonable compensation and complies with “best execution” requirement under securities law
  - Advisor makes no misleading statements about investment transactions or other relevant matters
- Advisors must:
  - Acknowledge fiduciary status and disclose conflicts of interest in writing
  - Establish policies and procedures to mitigate conflicts of interest
  - Conduct retrospective review at least annually to confirm compliance

DOL Fiduciary Rule (continued)

- In April, 2021 DOL Issued FAQs for Investment Advisors
- Temporary non-enforcement policy from 2018 applies until December 20, 2021 – DOL will not pursue claims against fiduciaries who are working in good faith to comply
- FAQs restate and clarify requirements of PTE:
  - Using model language from preamble will satisfy fiduciary status disclosure requirement
  - Documentation of rollover advice must include details of basis for recommendation
    - Advisors should make diligent efforts to obtain information about investor's plan
  - Rollover advice can be basis of ongoing relationship, or the beginning of an intended future ongoing relationship
  - "Best Interest" means advice is subject to duties of prudence and loyalty
- DOL anticipates taking further regulatory and sub-regulatory action to "improve the exemption" and is considering "additional protections"

DOL Fiduciary Rule (continued)

- In April, 2021 DOL also issued guidance for investors – "Choosing the Right Person to Give You Investment Advice: Information for Investors in Retirement Plans and Individual Retirement Accounts"
- Explains the requirements of the new fiduciary rule
- Recommends asking advisor for written acknowledgment of fiduciary status, description of conflicts of interest, and statement of compliance with the rule
- Lists questions to ask about rollover advice, e.g., "why do you think a rollover is better than leaving my retirement savings in my current 401(k) plan?"
    - Includes example of long-term effect of increased fees on account growth
    - Recommends investor provide information about 401(k) plan investment options and fees to advisor who is giving rollover advice

Private Equity Investments

- DOL Information Letter 2020-06-03 (June 3, 2020)
  - ERISA • 403 and 404 are not violated solely because a fund with a private equity component is offered as an investment option in a defined contribution plan.
  - Fiduciaries must evaluate whether the fund:
    - offers the opportunity to invest among more diversified investment options within an appropriate range of expected returns net of fees and diversification of risks over a multi-year period;
    - is overseen by plan fiduciaries (using third-party investment experts as necessary) or managed by investment professionals with appropriate capabilities and skills;
    - has limited the private equity allocation in a way that accounts for the unique characteristics associated with private equity investments; and
    - is appropriate in light of the plan’s features and participant profile.
  - Provide participants with sufficient information about character and risk of the investment to make an informed decision.
  - Not binding guidance.
  - Information Letter does not address:
    - Direct investment in private equity.
    - Prohibited Transaction under ERISA ˛ 406.
    - Issues that may arise under SEC or banking laws, IRC, etc.

ANNUAL REVIEW PROCESS

Plan Document Compliance

- Fiduciary duties under common trust law include complying with the governing plan document *(also see ERISA § 404(a)(1)(D))*
- Compliance with written plan document is a tax-qualification requirement under Code section 401(a) *(grandfathered 401(k) plans, 401(a) and money purchase pension plans)*
- For other deferred compensation plans, common law of trusts provides that a fiduciary must administer the trust or plan in good faith and diligently according to the trust's or plan's terms and applicable law *(Restatement 3rd of Trusts § 76(1) (2007) & Supp. 3-4 (2011); Unif. Trust Code § 801, 7C U.L.A. 587-588 (2006) & Supp. 192 (2011))*
- Maintaining a plan's tax-qualified or tax-favored status likely a fiduciary act *(See DOL Op. Ltr. 2001-01A (Jan. 18, 2001)*; clarifying *DOL Op. Ltr. 97-03A (Jan. 23, 1997))*

Plan Document Compliance (continued)

- Best practices:
  - Be familiar with terms of the plan
  - Document decisions involving interpretation of plan terms (through issuance of regulations, policies and/or procedures)
  - Required to make corrections under the IRS error correction process (EPCRS) in consistent manner; need records to show consistency
  - Review and update plan document on a regularly scheduled basis to reflect operations, and to incorporate discretionary or required State law or tax law changes

Plan Document Compliance (continued)

- In the absence of the IRS Determination Letter Program, 401(a) plans will need to be reviewed annually and updated in accordance with the IRS Required Amendments List
  - Operational changes may need to be implemented prior to documents having to be updated
  - Certain investment managers may require something like a counsel's opinion regarding continued compliance of plan document with tax rules in absence of IRS issuing new determination letters
- Other deferred compensation plans also need to be reviewed to maintain tax favored status by complying with any required tax law changes

Plan Operational Compliance

- IRS issued a new Operational Compliance List for 2021 (and some for 2022) on April 27, 2021
  - The Operational Compliance List ("OC" List) is provided by the IRS per Rev. Proc. 2016-37, Section 10, and Rev. Proc. 2019-39, Section 9, to help plan sponsors achieve operational compliance by identifying changes in tax-qualification requirements and Code section 403(b) requirements effective during a calendar year.
  - Identifies matters that may involve either mandatory or discretionary plan amendments depending on the particular plan.
  - Is available on the IRS webpage only.
  - IRS caveat: The OC List is not intended to be a comprehensive list of every item of IRS guidance or new legislation for a year that could affect a particular plan (and, because the OC List is updated periodically, items may not appear on it before they're effective.) Current website has 2016-2022 items.

Plan Operational Compliance (continued)

- The item effective in 2022 is final regulations relating to updated life expectancy and distribution period tables used for purposes of determining minimum required distributions.
- Items effective in 2021 include items such as (1) qualified cash or deferred arrangements (CODAs) must allow long-term employees working at least 500 but less than 1,000 hours per year to participate (SECURE Act, Section 112) and other miscellaneous changes under the SECURE Act (Notice 2020-68); and (2) extension of temporary relief from the physical presence requirement for spousal consents under qualified retirement plans (Notice 2021-03).

Plan Operational Compliance (continued)

- In addition to the issues covered on the IRS Operational Compliance List, we recommend that you also review other requirements that continuously apply such as:
  - Are any assets held in a group trust? If so, have all the requirements for a group trust been met?
  - Have there been any over- or under-contributions to the plan? What process was used for correction? Have the facts been reviewed to determine if self-correction is appropriate under the IRS EPCRS guidance?
  - Have there been any over- or under-payments from the plan to participants or beneficiaries? What process was used for correction? Have the facts been reviewed to determine if self-correction is appropriate under the IRS EPCRS guidance?
  - Has the plan’s Code section 402(f) notice been updated for the latest IRS guidance?

Plan Operational Compliance (continued)

- Operational compliance items that continuously apply (continued)
  - Have benefits and contributions been appropriately limited for the Code section 415 limit?
  - Have benefits and contributions been appropriately limited for the Code section 401(a)(17) limit?
  - Are there procedures in place to verify compliance with the Code section 401(a)(9) distribution rules?
  - Has the plan established a process for tracking all operational error corrections to demonstrate compliance with IRS EPCRS requirements in the event of a future audit?

Annual Review Process

- Review best practices (look back at what you learned today and at other fiduciary education programs or reading you have done) and recommend adoption of those that are reasonable and appropriate for your plan
- Consider whether some type of at least annual summary report should be filed with appointing authority by plan Committee delegated administrative authority for plan
- Record reviews of vendor performance completed for year
- Review report on monitoring of federal and state law tax and fiduciary compliance requirements
- Review report of necessary or desirable participant communications (including updates to the website)
- Have counsel review with fiduciaries (try to maintain attorney-client privilege for discussion) any areas of risk or exposure for litigation that can be addressed

Closing and Q&A

- Submit a question using the ***Q&A*** engagement tool
- We will do our best to answer all questions. If we do not get to your question live, feel free to reach out to us after the event.
- Please share your comments about today's training webinar in the ***Evaluation*** tool
- Remember to download your CLE certificate under the ***Certification*** tool (for California attorneys only)

Thank you for attending today's webinar!

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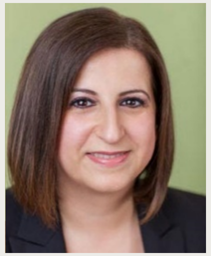

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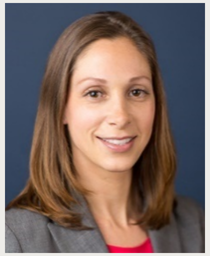

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