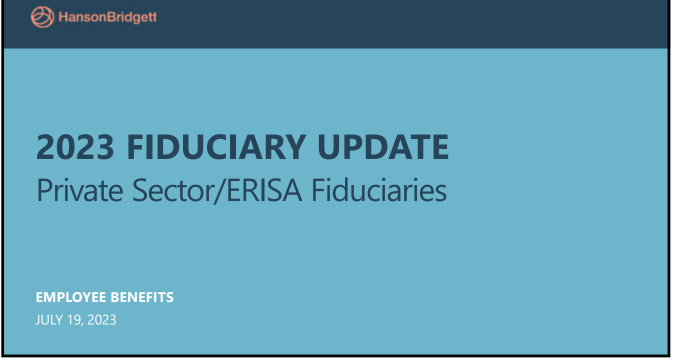

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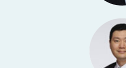

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SECURE 2.0 Fiduciary Changes

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Changes for Error Corrections

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SECURE 2.0: New Rules for Pension Plan Overpayments

- Effective as of 12/29/22, new rules apply to recoupment of inadvertent overpayments from pension plans under Section 301 of SECURE 2.0
- Plan fiduciaries will not be considered to have failed to comply with ERISA merely because the fiduciaries determine, "in the exercise of [their] fiduciary discretion," not to seek recovery of all or part of the inadvertent overpayment from the participant or the plan sponsor/contributing employers
- Plan fiduciaries, "in an exercise of [their] fiduciary discretion," also may determine to seek recovery of overpayments from participants

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SECURE 2.0: New Rules for Pension Plan Overpayments

- If pension plan seeks recoupment from a participant, then certain restrictions apply:
  - No interest or collection costs can be applied to overpayment amount
  - Limits apply to reduction of future benefit payments
  - Cannot recoup from participant's spouse or other beneficiary
  - Cannot recoup if first overpayment occurred more than 3 years before participant is notified in writing, except in case of participant's fraud or misrepresentation
- Overpayments that are not recovered may be treated as eligible for rollover

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SECURE 2.0: New Self-Correction Options Under EPCRS

- Effective as of 12/29/22, Section 305 of SECURE 2.0 expanded use of self-correction for inadvertent plan errors under EPCRS
- Self-correction period is now indefinite, but corrections must be made "within a reasonable period" after error is discovered
- Applies to significant and insignificant errors that occur despite having practices and procedures reasonably designed to promote compliance
  - Does not apply to errors discovered by IRS prior to start of self-correction process
  - Does not apply to errors that are egregious or involve diversion or misuse of plan assets or abusive tax avoidance transaction

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SECURE 2.0: New Self-Correction Options Under EPCRS

- VCP filings are no longer required to correct inadvertent loan failures
- Only applies if correction conforms to general correction principles
- EPCRS to be updated by IRS within two years
- IRS guidance needed during interim

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New IRS Notice 2023-43

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IRS Issues First Interim Guidance on SECURE 2.0 Self-Correction Changes

- Whether correction has been made "within a reasonable period" after error is discovered will be determined based on all relevant facts and circumstances
  - If corrected by last day of the 18th month following identification of the error, IRS will treat as within a reasonable period
  - Exception for employer eligibility failures: must be corrected by last day of 6th month following identification of the failure to be treated as within reasonable period
- Plan sponsor must have demonstrated a "specific commitment" to implement self-correction—cannot be reference to general annual audits or a general intent to correct failures when discovered

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IRS Issues First Interim Guidance on SECURE 2.0 Self-Correction Changes

- Errors occurring prior to SECURE 2.0 may be corrected using the new methodology
- Certain errors cannot be self-corrected until EPCRS is updated
  - Not adopting a 401(a) or 403(b) plan document
  - Correcting an operational error by retroactive conforming amendment if involves a cutback of benefits
- Prior to EPCRS update, an "insignificant" failure can be self-corrected when under audit, even if discovered during the audit

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Fiduciary Breach Litigation

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Fiduciary Breach Litigation – Overview

- Continued high volume of litigation dealing with breach of fiduciary duty has focused on several alleged deficiencies:
  - Lack of oversight monitoring of plan investments
  - Excessive cost
  - Poor performance
  - Proprietary bias
- In 2022, the U.S. Supreme Court issued an important decision dealing with ERISA fiduciary issues *((Hughes v. Northwestern University*, 142 S. Ct. 737 (2022))
  - The Supreme Court's decision left many questions unanswered about pleading standards;
  - Circuit Courts have attempted to fill in the gaps left by the Supreme Court in suits brought alleging excessive fees
- Plans holding Blackrock TDFs have been subject to frequent litigation dealing with alleged plan sponsors breached their fiduciary duties by selecting low-cost TDFs that underperformed, but without much plaintiff success

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Fiduciary Breach Litigation

- 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))

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Fiduciary Breach Litigation – Burden of Proof

- 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

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Fiduciary Breach Litigation – Standing Issues

- When can the participant sue for investment losses under a retirement plan?
  - 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
  - U.S. Supreme Court Decision – *TransUnion LLC v. Ramirez,* 141 S. Ct. 2190 (2021)
    - Not all members of the class suffered actual harm, and the Supreme Court held the mere "risk of harm" alone is insufficient to establish standing in a *suit for damages* unless the risk of future harm itself causes a separate concrete harm;
    - A plaintiff exposed to a risk of future harm, however, may pursue forward looking injunctive relief to prevent the harm from occurring

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Fiduciary Breach Litigation – Standing Issues

- When can the participant sue for investment losses under a retirement plan?
  - *TransUnion LLC v. Ramirez* and *Thole v. U.S. Bank* - Together, these cases provided ERISA defendants the opportunity to argue that all plan participants lack concrete harm sufficient to confer standing in a class action, and limitations on available remedies (injunctive relief v. damages)
  - Circuit Courts have declined to extend to defined contribution plan participants, because their benefits are typically tied to the value of their accounts, and can turn on fiduciaries' particular investment decisions regarding investment offerings
    - 5th Circuit: *Ortiz v. American Airlines, Inc.* 5 F.4th 622 (5th Cir. 2021)
    - 3rd Circuit: *Boley v. Universal Health Services, Inc.* 36 F. 4th 124 (3rd Cir. 2022)

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Fiduciary Breach Litigation – *Hughes v. Northwestern Univ.* and Beyond

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Fiduciary Breach Litigation – *Hughes v. Northwestern University* (Sup. Ct. 2022)

- Participants in two 403(b) defined contribution plans alleged that the defendants breached their fiduciary duty of prudence under ERISA by:
  - Neglecting to provide cheaper and otherwise-identical alternative investments
  - Retaining plan recordkeepers that charged excessive fees
  - Offering too many investment options (over 400), likely confusing plan participants and resulting in poor investment decisions
- The Supreme Court rejected the lower courts' dismissal of the case for failure to adequately plead a breach of the fiduciary standard of prudence, holding that a plan cannot rely on participants' ability to choose alternative investments to avoid claims relating to imprudent investments or excessive fees
- The Supreme Court relied on its decision in *Tibble v. Edison Int'l*, 575 U.S. 523 (2015), in which it held that ERISA's duty of prudence requires plan fiduciaries to continually monitor plan investments and remove imprudent investments from the plan within a reasonable time

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Fiduciary Breach Litigation – *Hughes v. Northwestern University* (Sup. Ct. 2022)

- Practical implications from *Hughes v. Northwestern*
  - The Supreme Court's decision reinforces its ruling in *Tibble* regarding the duty of ERISA plan fiduciaries ***to continually monitor plan investments***
  - ERISA plan fiduciaries also should:
    - Maintain an investment policy and periodically review plan investments
    - Record the review of plan investments in writing
    - Remove imprudent investments from the plan within a reasonable period of time
- The Supreme Court did not address certain issues relating to:
  - Recordkeeping fees
  - Use of multiple recordkeepers
  - Prohibited transaction allegations
- As a result, a few Circuit Courts of Appeals attempted to address the gaps post-*Hughes* with differing results

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Fiduciary Breach Litigation – Post-*Hughes* Circuit Decisions

- *Albert v. Oshkosh Corp.*, 47 F. 4th 570 (7th Cir. 2022)
  - Narrow reading of *Hughes* - a plan fiduciary cannot dismiss a breach of duty claim because the plan offers lower-cost investment options
  - Setting a new pleading standard – plaintiffs must allege (1) high plan fees and (2) substandard services or performance compared to other plans
- *Smith v. CommonSpirit Health*, 37 F. 4th 1160 (6th Cir. 2022)
  - Merely pointing out that passively managed investment funds outperformed actively managed funds does not plausibly plead imprudence
  - 3- and 5-year performance is too narrow to support allegations of imprudence.
- *Matousek v. MidAmerican Energy Co.*, 51 F. 4th 274 (8th Cir. 2022)
  - Plaintiffs must provide meaningful benchmarks that show "like-for-like comparisons"

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Fiduciary Breach Litigation – Post-*Hughes* Circuit Decisions

- 9th Circuit Court of Appeals appears to be the outlier of its sister courts.
- *Kong v. Trader Joe's Co.*, 2022 WL 1125667 (9th Cir. Apr. 15, 2022); *Davis v. Salesforce.com, Inc.*, 2022 WL 1055557 (9th Cir. Apr. 8, 2022)
- The Plaintiffs in both cases alleged that each plan offered more-expensive share classes when other cheaper share classes were available. They alleged that essentially all characteristics were the same except the price
- The district courts dismissed the claims, holding that fees alone are insufficient to create a cause of action because plan fiduciaries have the latitude to look at other factors than price in investment selection
- On appeal, the 9th Circuit reversed, and allowed the claims to move forward based on the failure to control the number of "retail" share class funds with higher fees than those charged by otherwise identical "institutional" share class funds in the plan

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Fiduciary Breach Litigation – Post-*Hughes* Circuit Decisions

- *Vellali v. Yale Univ.*, Case No. 3:16-cv-01345 (D. Conn. jury verdict 6/28/2023)
  - A rare jury verdict in an ERISA fiduciary breach lawsuit
  - Plaintiffs alleged a breach of the fiduciary duty of prudence, claiming excessive fees and a failure to monitor plan investments
  - The jury found there was a breach of fiduciary duty by allowing the plan to pay excessive record keeping fees but rejected the failure to monitor claims
  - The jury also found that Yale followed a prudent process when negotiating and managing the fees, and a fiduciary also following a prudent process could have made the same decisions as to recordkeeping and administrative fees
  - Plaintiffs did not prove that the plan suffered any losses or damages. The jury awarded $0 in damages

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Fiduciary Breach Litigation – Post-*Hughes*

BEST PRACTICES:

- Consider maintaining a written plan investment policy and abide by it
- If not already in place, plan fiduciaries or investment committees may want to consider submitting periodic formal reports to the Board of Directors, so that the Board has a record of independent evaluation of investment selection process. (1) Continually monitoring of investments and a thoughtful analysis of different types of investment funds offered, including price and performance, and (2) removal of imprudent investments from the plan within reasonable time (as required under *Tibble*) will increase the likelihood of getting an excessive fee/cost claims made against plan fiduciaries dismissed early on
- Document the decision making and negotiation process when selecting providers, negotiating and managing fees, and monitoring investments

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Fiduciary Breach Litigation – Blackrock TDFs

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Fiduciary Breach Litigation – Blackrock TDFs

- In the past few years, there has been a trend in increased fiduciary breach lawsuits against plans' offering Blackrock Target Date Funds (TDFs) as part of an investment option
- Several large requirement plan sponsors have been sued for selecting BlackRock's low-cost target date funds (TDFs) for their 401(k) plans
  - *Motz et al. v. Citigroup Inc. et al.*, No. 3:22-cv-00965-RNC (D. Ct. filed July 29, 2022); *Kistler et al. v. Stanley Black & Decker Inc et al.*, No. 3:22-cv-00966-KAD (D. Ct. filed July 29, 2022); *Bracalente et al. v. Cisco Systems, Inc. et al.*, No. 5:22-cv-04417-VKD (N.D. Cal. filed July 29, 2022); *Trauernicht, et al. v. Genworth Financial Inc., et al.*, No. 3:22-cv-00532-REP (E.D. Va. filed Aug. 1, 2022); *Antoine et al. v. Marsh & McLennan Companies Inc. et al.*, No. 1:22-cv06637-JPC (S.D.N.Y. filed Aug. 4, 2022); *Abel v. CMFG Life Ins. Co.*, No. 3:22-cv-00449-wmc (W.D. Wis. filed Aug. 19, 2022); *Pizarro et al. v. The Home Depot et al.*, No. 1:18-cv-01566-SDG (N.D. Ga. order Sept. 30, 2022); *Beldock et al. v. Microsoft Corporation et al.*, No. 2:22-cv-01082-JLR (W.D. Wash. order Feb. 7, 2023); *Tullgren v. Booz Allen Hamilton Inc. et al.*, No. 1:22-cv00856-MSN-IDD (E.D. Va. order Mar. 1, 2023); *Hall et al. v. Capital One Financial Corporation et al.*, No. 1:22-cv00857-PTG-JFA (E.D. Va. order Mar. 1, 2023); *Anderson v. Advance Publications, Inc.*, No. 1:22-cv-06826-AT (S.D.N.Y. order June 13, 2023); *Luckett v. Wintrust Financial Corp. et al.*, No. 1:22-cv-03968 (N.D. Ill. order July 14, 2023)
- Plaintiffs generally claim breach of duty of prudence and/or duty to monitor because plan fiduciaries selected a suite of BlackRock TDFs that underperformed against four of BlackRock's largest peers in terms of market share
- A June 2022 Captrust article noted that almost 31% of plan assets for ERISA defined contribution plans are invested in the plan's QDIA, usually target date funds — this makes that investment decision a big litigation target
- Callan's 2022 Defined Contribution Trends Survey indicates that nearly every respondent to the survey had a QDIA as the default investment fund, and 92% used a TDF as the default for non-participant directed monies, an all-time high

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Fiduciary Breach Litigation – Blackrock TDFs (continued)

- **BEST PRACTICES**: If not already in place, plan fiduciaries or investment committees may want to consider submitting periodic formal reports to the Board of Directors, so that the Board has a record of independent evaluation of investment performance. A thoughtful analysis of different types of investment funds, including price and performance, will increase the likelihood of getting an underperformance claims made against plan fiduciaries dismissed early on. Additionally, routinely examining other similarly situated funds for their fees and performance may be prudent for plan fiduciaries

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Fiduciary Breach Litigation – Importance of Recording "Prudent Deliberations"

- ERISA fiduciaries are 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)

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General Fiduciary Issues

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ESG Investing & Proxy Voting

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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:
  - Socially responsible investing
  - Sustainable and responsible or "green" investing
  - Impact investing
  - Economically targeted investing
- Significant growth in amount of sustainable investing assets under management in US and worldwide in recent years

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ESG Investing, continued

- Between 1994-2018, subregulatory guidance from DOL has varied based on policy considerations
- Since 2020, ESG investing has become even more political
  - Department of Labor issued a proposed rule in October 2021 to rescind 2020 rule that discouraged consideration of ESG factors
    - DOL was concerned "uncertainty with respect to the current regulation may deter fiduciaries from taking steps that other marketplace investors would take in enhancing investment value and performance, or improving investment portfolio resilience against the potential financial risks and impacts often associated with climate change and other ESG factors"
  - New final rule was published in December 2022

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ESG Investing, continued

2020 Rule: "pecuniary and non-pecuniary factors" replaced references to "ESG"

- 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
- In March 2021, DOL announced it would not enforce the 2020 Rule

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ESG Investing, continued

- DOL Issued new final rule in late 2022 - replaces 2020 "pecuniary factor" test with new standard
- Fiduciary's evaluation of an investment must be based on risk and return factors prudently determined to be relevant to investment value, depending on the facts and circumstances
  - Fiduciary may not subordinate the interests of participants and beneficiaries to objectives unrelated to the provision of benefits or take on additional investment risk to promote benefits or goals unrelated to interests of the participants and beneficiaries
  - Risk and return factors "may include the economic effects of climate change and other environmental, social, or governance factors on the particular investment or investment course of action"
- Removes prohibition on using ESG fund as Qualified Default Investment Alternative ("QDIA")
- New tiebreaker test: no documentation requirement, investments need not be indistinguishable
  - Selection between competing prudent investments can be based on "collateral benefits"
- Fiduciary may consider participants' preferences, e.g., to encourage greater participation thereby increasing retirement security

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ESG Investing, continued

- Lawsuits in Texas and Wisconsin filed by 25 Republican state attorneys general seeking to vacate 2022 final DOL rule
- Recent participant litigation:
  - Class action fiduciary breach lawsuit filed in June 2023 by plan participants against American Airlines over ESG funds available through self-directed brokerage account option in 401(k) plan
  - New York City employees' pension plan sued by participants over fossil fuel divestments
    - Three public NYC employee plans have committed to "net zero emissions" portfolio by 2040

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ESG Investing, continued

- Several Republican-led states have enacted anti-ESG policies
- In March 2023, 21 Republican state attorneys general published open letter to asset managers claiming ESG investing and proxy voting violates fiduciary duties and raises anti-trust issues
- Several Democratic-led states have proposed rules to increase consideration of ESG factors or require climate-related disclosures
- California bill (SB 252) would require CalPERS and CalSTRS to divest from fossil fuels
  - Passed California Senate but will not be voted on by Assembly this year
    - Converted to a two-year bill for possible action next year
  - Both CalPERS and CalSTRS oppose the bill based on fiduciary principles

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ESG Investing, continued

Congressional Activity

- In March, Congress passed disapproval resolution of 2022 final DOL rule
  - President Biden vetoed the resolution – Congress lacked votes to override.
- House Oversight Committee held ESG hearings in May-June 2023
- Republican representatives reintroduced "Ensuring Sound Guidance (ESG) Act" to codify provisions from 2020 rule regarding use of non-pecuniary factors
  - Bill would require U.S. Comptroller General to study impact of underfunded state and local pensions on federal government and extent to which public plans consider ESG factors in their investments
- In February 2023, House Financial Services Committee formed "ESG Working Group" to counter ESG policies and proxy voting activities

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Proxy Voting

- Proxy voting applies to 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
- 2020 DOL Final Rule on Proxy Voting published in December 2020:
  - Plan fiduciaries must act solely with the economic interest of the plan and its participants and beneficiaries in mind when managing plan assets, including proxy voting decisions
  - Plan fiduciaries must have a process, consistent with their duties of prudence and loyalty, for proxy voting

– As with ESG rule, current DOL declined to enforce 2020 proxy voting rule

- Final 2022 ESG rule includes new proxy voting rule to replace rescinded 2020 rule

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Proxy Voting, continued

- 2022 final rule revises 2020 rule that "created uncertainty" about whether a fiduciary may consider ESG and other factors in making proxy voting decisions
- Eliminates "no vote" statement = "fiduciary duty to manage shareholder rights…does not require the voting of every proxy or the exercise of every shareholder right"
– Removes specific monitoring requirement when proxy voting is delegated
  - – General fiduciary duty to monitor service providers applies
- Eliminates two safe harbor polices that DOL does not believe are "necessary or helpful"
- Removes specific recordkeeping requirement
  - – Separate requirement in 2020 final rule could create misperception that proxy voting and other exercises of shareholder rights are disfavored or carry greater fiduciary obligations than other fiduciary activities

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DOL Fiduciary Rule

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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
  - – Allowed 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

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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.

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DOL Fiduciary Rule, continued

- Final rule issued in 2016 that would have replaced the 5-part test was vacated by the Fifth Circuit in 2018
- DOL fiduciary rule issued in December 2020 reinstated 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

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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

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DOL Fiduciary Rule, continued

- In April 2021 DOL Issued FAQs for Investment Advisors
- Temporary non-enforcement policy through 2021 – DOL would not pursue claims against fiduciaries who are working in good faith to comply
  - – In October 2021 DOL issued Field Assistance Bulletin 2021-02 to further delay enforcement of the 2020 Rule
- Issuance of new rule was on the DOL regulatory agenda for December 2022, but was delayed
  - Now scheduled for August 2023

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DOL Fiduciary Rule, continued

- Two lawsuits filed in 2022 (Texas and Florida) challenging "expansion" of definition of fiduciary
- In February 2023, judge in Florida case struck down DOL FAQ regarding rollover advice
  - FAQ provided that the "regular basis" prong of 5-part test could be met for rollover advice if part of "the beginning of an intended future ongoing relationship that an individual has with an investment advice provider"
  - DOL will not appeal ruling
- In June 2023, magistrate judge in Texas case recommended that new "rollover" provision be vacated
  - – DOL exceeded its authority regarding new rollover rule by failing to distinguish between IRAs and employer-sponsored plans
  - – Recommended that remainder of rule stand

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DOL Guidance on Cryptocurrencies

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DOL Guidance on Cryptocurrencies

- DOL published Compliance Assistance Release No. 2022-01 in March 2022 regarding the prudence of making cryptocurrency investments available in a 401(k) fund line-up
  - Cautions plan fiduciaries to exercise "extreme care" before they consider adding a cryptocurrency investment option in a defined contribution plan, even through self-directed brokerage accounts
  - Lists "serious concerns" about investments in cryptocurrencies
    - Speculative and volatile nature of investments
    - Challenge for participants to make informed investment decisions
    - Risk of reliability and accuracy of valuations
    - Custodial and recordkeeping risks
    - Lack of regulatory framework

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DOL Guidance on Cryptocurrencies, continued

- Release announced DOL's intention to investigate plans that offer cryptocurrency investments and take "appropriate action" to protect participants
- *ForUsAll Inc. v. United States Department of Labor* (Case 1:22-cv-01551; filed 6/2/2022)
  - Lawsuit filed by retirement plan provider that claimed DOL's guidance was arbitrary and capricious and required formal rule-making
  - In September 2022, DOL asked court to dismiss the case because the Release is not formal agency action and does not preclude plans from offering cryptocurrency funds
  - In November 2022, ForUsAll agreed to dismiss the case, if DOL agreed not to enforce the Release
  - DOL asked court to dismiss the case without granting ForUsAll's request

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Data Security and Fraud Prevention

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Data Security and Fraud Prevention

- Retirement plan transactions are increasingly occurring through online tools.
- The 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.

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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 Act of 2020
  - Enforcement
    - California Protection Agency (created by CPRA)
    - California Attorney General

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Data Security and Fraud Prevention (continued)

- Recent DOL guidance confirms plan fiduciaries have a fiduciary responsibility to take steps to protect the plan against cybersecurity risks
- This includes ensuring that recordkeepers and other service providers responsible for plan-related IT systems and data appropriately safeguard participant information

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Data Security and Fraud Prevention Litigation Update

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Data Security and Fraud Prevention (continued)

- Fiduciary Litigation Resulting from Cyber Related Fraud
  - *Sherwood v. Horizon Actuarial Services, LLC,* Case No. 1:22 CV 01495 (April 19, 2022)
    - Class action alleging the defendant actuarial firm failed to secure, monitor, and maintain personally identifying information ("PII")
    - A criminal cyberattack in November 2021 caused unauthorized disclosure and theft of the class members' PII
    - The lawsuit alleges that Horizon had deficient cyber security measures in place, and could have prevented the attack
  - *Bartnett v. Abbott Lab'ys*, 2021 WL 428820 (N.D. Ill. Feb. 8, 2021)
    - Plaintiff, a victim of identity theft whose retirement accounts were stolen, alleged the plan fiduciaries breached their duty of prudence by hiring and then subsequently renewing the contract with a third-party administrator who had been previously involved in cybersecurity related incidents for other plans
    - Court held that the incidents occurred after the initial contract was put in place, and they were limited in size and scope and did not involve significant lapses in security, thus it was not a fiduciary breach to renew the contract
  - Trend in litigation alleging that plan fiduciaries have failed to properly secure plan data
    - *Disberry v. Emp. Rels. Comm. Of the Colgate-Palmolive Co.*, 2022 WL 17807122 (S.D.N.Y. 2022)

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Cybersecurity Insurance and Employee Benefit Plans- ERISA Advisory Council

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Data Security and Fraud Prevention (continued)

- In December 2022, the ERISA Advisory Council issued a pair of Advisory Opinions related to cyber security in response to the continued concerns regarding cyber attacks, cyber theft, and the need for stronger cyber security measures for employee benefit plans
- The Council looked at cyber security insurance as it relates to employee benefit plans, including availability of coverage to benefit plans, what is typically covered by cyber security insurance, and the cost of the insurance
- The Council conducted research and heard from witnesses, including individuals from insurance companies, insurance brokers, insurance consultants, governmental organizations, and academics studying cybersecurity insurance as well as attorneys litigating cybersecurity insurance coverage issues. The Council also heard from representatives of the plan sponsor community--both multiemployer plans and single-employer plans--and plan service providers

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Data Security and Fraud Prevention (continued)

- Council Recommendation #1:
  - DOL continue to study cybersecurity insurance as it relates to employee benefit plans, including other forms of loss risk-mitigation such as:
    - Cybersecurity insurance
    - Fidelity/crime coverage
    - Fiduciary liability coverage
    - Third-party (service-provider) contractual obligations (including indemnification) and insurance

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Data Security and Fraud Prevention (continued)

- Council Recommendation #2:
  - Following further study, the DOL should consider developing education for employee benefit plan fiduciaries concerning the type of insurance coverages that are available to protect against losses resulting from cyber incidents. Education topics could include:
    - The primary types of cyber-threats faced by employee benefit plans
    - The types of losses typically covered by "cyber-insurance" policies vs. other types of policies (such as fidelity/crime policies and fiduciary insurance policies)
    - Other aspects of insurance policies--such as exclusions, the identity of the "named insured," deductibles, and coverage limits
    - The role that a benefit plan's cybersecurity policies, practices, and controls might play in the application and/or renewal process for cyber-related insurance coverage.

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Data Security and Fraud Prevention Best Practices

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Best Practices

- Create 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
- Provide education to participant on how they can protect their accounts from cyber fraud

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DOL Enforcement - Subpoenas

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DOL Enforcement –Subpoena Authority

- Litigation Involving DOL's Authority to Investigate ERISA Plan Cybersecurity Issues
  - U.S. Court of Appeals for the 7th Circuit recently upheld the DOL's broad authority to investigate any actual or potential ERISA violation. Authority extends to compelling a non-fiduciary service provider to turn over information so DOL could determine if provider's clients may have violated ERISA. *Walsh v. Alight Solutions, LLC*, 44 F. 4th 716 (7th Cir. 2022)
  - In this case, the court ruled in favor of the DOL in connection with the DOL's 2019 investigation into the processing of unauthorized distributions of plan benefits due to cybersecurity breaches in the ERISA plan accounts serviced by Alight Solutions, LLC, a third-party administrator
  - For plan sponsors, this case reinforces the DOL's broad subpoena authority in connection with plan-related requests, even if such requests are made to an independent third-party service provider. Plan sponsors may want to discuss these issues with their service providers and review contracts to determine how response to subpoenas would be handled under the agreement

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Annual Review Process

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Plan Document Compliance

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SECURE 2.0 Brings Big Changes

- Setting Every Community Up For Retirement Enhancement (SECURE) Act 1.0
- Coronavirus Aid Relief and Economic Security (CARES) Act
- Setting Every Community Up For Retirement Enhancement (SECURE) Act 2.0
  - No amendments are required to be adopted this year, even if plan administration is required to incorporate changes to provisions this year
  - SECURE Act 2.0 Amendment Deadline:
    - Dec. 31, 2025 for ERISA/private sector plans (Dec. 31, 2027 for public sector plans)
  - SECURE Act 2.0 conforms the SECURE Act 1.0 and CARES Act amendment deadlines to the SECURE Act 2.0 amendment deadline

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Operational Compliance

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Operational Compliance-IRS OC List

- IRS last updated its Operational Compliance List ("OC List") in February 2023 providing information through 2022
- The OC List is provided by the IRS under authority in Rev. Proc. 2022-40, Section 8, 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 type of plan
  - May reference other significant guidance that affects daily plan operations
  - OC List is available on the IRS webpage only (just search for "IRS Operational Compliance List") NOTE: the IRS warns it is not comprehensive

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Operational Compliance-IRS OC List

- **OC List now contains a long list of operational compliance areas effective for 2022**
  - Use of electronic medium to make participant elections and spousal consents
  - Certain required minimum distributions for 2021 and 2022
  - Extension of plan amendment deadlines
  - Extension of temporary relief from physical presence requirement for spousal consents (through 12/31/22)
  - Proposed regulations relating to certain multiple employer plans
  - Proposed regulations relating to required minimum distributions
  - Guidance related to special financial assistance from PBGC to certain multi-employer DB plans
  - Special financial assistance program for financially troubled multi-employer plans
  - Final regulations relating to updated life expectancy and distribution period tables used for purposes of determining minimum required distributions
- **But, no information yet on SECURE 2.0 operational changes effective for 2023**

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SECURE 2.0 Plan Amendment Deadlines Delayed-But Compliance Is Required!

- No amendments are required to be adopted this year, even if plan administration is required to change and incorporate changes to provisions this year
  - SECURE Act 2.0 Amendment Deadline:
    - Dec. 31, 2025 for ERISA/private sector plans (Dec. 31, 2027 for public sector plans)
  - SECURE Act 2.0 conforms the SECURE Act 1.0 and CARES Act amendment deadlines to the SECURE Act 2.0 amendment deadline
- Operational compliance is required with changes effective in 2023 and changes in participant communications may be necessary to avoid confusion/misunderstandings

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Plan Operational Compliance—Continuous Efforts

- We recommend that you annually review requirements that continuously apply such as:
    - Has the plan's Code section 402(f) notice been updated for the latest IRS guidance?
    - 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 updated Code section 401(a)(9) distribution rules?
  - **During IRS Pilot Audit Program: Have appropriate representatives been alerted to notify leadership immediately of receipt of a plan audit notice? Very important due to the IRS pilot program giving the plan only 90 days to make all needed corrections following notice or IRS will open a full scope examination/audit**

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Plan Operational Compliance-Documentation of Self-Corrections

- **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?**
  - Recently issued IRS Notice 2023-43 included additional detail on the recordkeeping requirements to document compliance with self-correction requirements
    1. Information about the error(s) discovered, including years of occurrence, number of employees affected, date error was identified
    2. Explain how error occurred and demonstrate there were established practices and procedures (formal or informal) reasonably designed to promote and facilitate overall compliance in place when error occurred
    3. Identify and substantiate the correction method and the date of completion of the correction
    4. Identify any changes made to your established practices and procedures to ensure that the same failure would not occur again

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Summary of Annual Review Process

- Review information on monitoring of federal and state law tax and fiduciary compliance requirements with plan counsel
- Determine any required or desired plan document changes
- Plan for any required or desired changes in coming year that could affect operational requirements
- 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
- Verify that any periodic reports due to an appointing authority to support appropriate oversight have been filed

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Summary of Annual Review Process

- Record reviews of vendor performance completed for year (administrative, legal and investment)
- Determine any necessary or desirable participant communications (including updates to your website)
- Have counsel review with fiduciaries (try to maintain attorney-client privilege for discussion) any areas of risk or exposure for litigation that should be addressed or any concerns you have regarding plan compliance
- **Due to potential of only 90 days to correct any errors in the event of notice of an IRS pilot audit, annual review of plan document and operational compliance is strongly recommended during the IRS Pilot Audit Program**

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