

ERISA Update Presentation

FIRMA National Training Conference

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Presenter



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Agenda

- ERISA Update
 - Legislation
 - Regulation
 - Litigation

Legislation

SECURE 2.0

- Enacted December 29, 2022
- More extensive, potentially more impactful than SECURE 1.0
- Various effective dates

SECURE 2.0 Impacts ERISA Fiduciaries

- Investment-related provisions
- PEP-related provisions
- Pension Risk Transfer Provisions
- Communication and Disclosure Provisions
- Other Important Provisions

SECURE 2.0 Implementation Priorities

- Per DOL 2024 budget request:
 - Retirement Savings “Lost & Found”
 - Automatic Portability Transactions
 - Emergency Savings Accounts
 - Performance Benchmarks for Asset Allocation Funds

Regulation

Investment Advice - Recap

How did we get here?

- 2016 - Final fiduciary rulemaking package issued - intended to become effective in 2017
- 2018 - Entire package vacated by the Fifth Circuit Court of Appeals
- 2020 - DOL issues PTE 2020-02 - a prohibited transaction class exemption for fiduciary investment advice
 - Included DOL's "final interpretation" of fiduciary investment advice under existing 5-part test under which many rollover recommendations would be viewed as fiduciary investment advice
 - Established conditions for receipt of conflicted compensation by advice fiduciaries

Investment Advice - Status

- What is happening now?
 - PTE 2020-02 is seen as extremely burdensome and investment in compliance processes has been slow
 - Lack of clarity about DOL's final interpretation; potential for new investment advice regulation and changes to existing exemptions have contributed to disparate compliance approaches
 - Three related court cases are also important

Investment Advice – Court Cases

- Three recent / current court cases interpreting existing DOL regulation on ERISA investment advice, which provides that a person is a fiduciary by reason of providing “investment advice” if, for a fee, he or she:
 - Advice or recommendations about securities or other property;
 - On a regular basis;
 - Pursuant to a mutual understanding;
 - Advice will serve as a primary basis for investment decisions; and
 - Advice is individualized to the needs of the plan.

Investment Advice – Court Cases

Carfora decision (September 2022):

- Addressing allegations that a provider of rollover recommendations acted as an investment advice fiduciary, court focused on “regular basis” prong of current test, finding:
 - 2-3 interactions insufficient;
 - Plan-level recommendations are required, not series of interactions with multiple participants in a plan;
 - Rollover recommendations are one-time; and
 - Actions after rollover don’t count as money has already left the plan

Investment Advice – Court Cases

ASA decision (February 2023)

- Court vacated policy underlying one FAQ issued by DOL following PTE 2020-02, finding:
 - DOL’s new interpretation of “regular basis” element of 5-part test was arbitrary and capricious because it contradicted with plain language of regulations
 - Like *Carfora*, court in *ASA* found that regulation is limited to advice given to a plan and found that rollover recommendations are not captured by the regular basis prong of the test
- Court upheld a second FAQ, determining that it contained a permissible interpretation of PTE 2020-02

Investment Advice – Court Cases

FACC v. Walsh - filed in N.D. Tex., February 2022

- FACC sued DOL, asking the court to vacate the DOL's interpretation of the investment advice regulation as articulated in the preamble to PTE 2020-02
- In a March 2023 filing in the case, DOL argued that the court in ASA misunderstood DOL's authority to interpret the fiduciary definition of both ERISA and the Code and asked the FACC court to reject the ASA court's analysis
- DOL also noted that it is considering an appeal of the ASA case

Investment Advice – What’s Next?

- Fall 2022 DOL regulatory agenda added a plan to propose a new definition of fiduciary investment advice to, “take into account practices of investment advisers, and the expectations of plan officials and participants, and IRA owners who receive investment advice, as well as developments in the investment marketplace, including in the ways advisers are compensated that can subject advisers to harmful conflicts of interest. In conjunction with this rulemaking, EBSA also will evaluate available prohibited transaction class exemptions and propose amendments or new exemptions to ensure consistent protection of employee benefit plan and IRA investors.”

QPAM Exemption Amendments

DOL Proposed Amendments to QPAM Exemption in July 2022 – Proposal:

- Clarifies that foreign convictions do trigger loss of exemption.
- Requires QPAMs to register with DOL
- Requires contractual amendments and contractual terms to indemnify plans should a QPAM lose the ability to rely on the exemption
- Provides QPAMs with a one year winding down period if exemption lost

QPAM Exemption Amendments

DOL Proposed Amendments to QPAM Exemption (Cont.)

- Clarifies that exemption cannot be used if another entity brings the investment idea to the QPAM
- Gives DOL broad discretion to revoke QPAM from entities – including for non-criminal “prohibited misconduct”
- Raises equity capital and net worth requirements to qualify as a QPAM
- Adds recordkeeping requirements – records must be available for inspection

QPAM Exemption Amendments

- Public hearings held in November 2022
- Initial comment period, post-hearing comment period and March 23-April 6 supplemental comment period
- In total, almost 200 comment letters filed

ESG and Proxy Voting

- **Trump Administration**
 - Finalized ESG and proxy voting rule in December 2021
 - Skeptical of economic value of ESG, proxy voting
- **Biden Administration**
 - Adopted non-enforcement policy and proposed new rule
 - Final ESG and proxy rule published in November 2022 and effective January 30, 2023 (a few provisions effective December 2023)

2020 and 2022 ESG Investing Rule Comparison

Issue	2020 Trump Rule	2022 Biden Rule
Consideration of ESG Factors	Fiduciaries may only make investment decisions based on “pecuniary” factors.	Eliminates “pecuniary” language; fiduciaries may, but are not required to, consider ESG factors if factors “economically relevant”.
Qualified Default Investment Alternatives (QDIAs)	Blanket ban on designating QDIA that considers or indicates the use of one or more non-financial factors, including ESG.	Lifts ban; same fiduciary standards apply in selection and monitoring of QDIA as applied to other investments, including consideration of economically relevant ESG factors.
Tie-Breaker	Collateral, non-pecuniary factors can be taken into account only when two investments are “indistinguishable”. Heightened documentation required in these cases.	Collateral factors can be taken into account when two investments “Equally serve” the plan. Removes heightened documentation requirement for these occurrences.
Participant Preferences	No direct statement, but generally assumed that participant preferences impermissible consideration in investment process.	Includes novel statement that it does not conflict with duty of loyalty to take participant preferences into account as part of otherwise prudent process.

2020 and 2022 Proxy Voting Rule Comparison

Issue	2020 Trump Rule	2022 Biden Rule
“No Vote” Statement	Included statement that fiduciary duty “does not require the voting of every proxy or the exercise of every shareholder right.”	Eliminates “No-Vote” Statement; states that proxies should be voted unless fiduciary determines that it’s not in the plan’s best interest.
Specific Monitoring Obligations	Included specific monitoring obligations with respect to third-parties authorized to vote proxies.	Eliminates specific monitoring obligations; states obligation is the same as applies to other plan service providers.
Safe Harbors	Included regulatory examples of permissible proxy voting policies, creating safe harbors for certain types of policies.	Removes safe harbors; states concern that they could lead fiduciaries to believe abstention from proxy voting permissible.
Records of Proxy Voting Activities	Included requirement that fiduciaries maintain certain types of records on proxy voting activities and other exercises of shareholder rights.	Eliminates this heightened recordkeeping requirement.

ESG and Proxy Voting

ESG has now become a “culture war” issue

- CRA Challenge
 - Passed House and Senate
 - Vetoed by Pres. Biden
 - House vote failed to override veto
- Lawsuits challenging ESG rule
 - Utah v. Walsh (25 State AGs)
 - Braun v. Walsh (plan participants)

Litigation

Hughes v. Northwestern

- Northwestern University was sued in case involving allegations of excessive investment fees
 - Lower court held that because the plan lineup offered diverse, prudent options, plaintiff could not proceed merely because the plan also included a few imprudent options
- In 2022, Supreme Court overturned lower court decision
 - Largely reiterated prior holdings
 - Each investment offered must be prudent
 - Declined to opine on procedural issues that could have slowed fee litigation

Hughes v. Northwestern

- On remand, 7th Circuit Court of Appeals refused to dismiss two of three counts, finding that plaintiffs adequately alleged:
 - Northwestern failed to properly monitor recordkeeping fees
 - Northwestern failed to utilize institutional share classes.
- The court dismissed the claim that Northwestern acted imprudently by retaining duplicative investment funds in the plan.
- Step backwards in the trend of dismissals

BlackRock LifePath Litigation

- Between July 29 and August 19, 2022, a single firm filed 11 class action complaints in 7 Federal District Courts alleging ERISA violations
- The complaints are virtually identical and all allege that plan fiduciaries breached their duties of prudence in selecting and retaining the LifePath TDFs as plan investment options

BlackRock LifePath Litigation

Plaintiffs allege that:

- The BlackRock funds' custom benchmark was not an adequate measure to monitor performance
- When compared to 4 other large TDFs (Vanguard, TRP, American Funds, Fidelity Freedom Index), the BR funds underperformed
- Defendants “chased the low fees” charged by BR rather than focusing on performance

BlackRock LifePath Litigation

Cases have not fared well thus far:

- Three cases dismissed; two with prejudice after plaintiffs' failed to remedy defects in pleadings
- Plaintiffs have appealed the dismissals

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