Tuesday, August 11, 2020

Fiduciary Update | August 2020

In this installment of Fiduciary Update, CAPTRUST's Drew McCorkle looks at recent developments on cases, decisions, and settlements alleging the overpayment of fees and the retention of underperforming investments in 401(k) plans. McCorkle also provides perspective on why ESG investments are getting increased attention, the latest in participant suits filed to recover cyberlosses, and more.

Supreme Court: No Harm No Foul

Following the financial crisis in 2008 and 2009, U.S. Bank was sued for breaching its fiduciary duty managing its pension plan investments, which resulted in losses of approximately $750 million. The pension plan was underfunded when the lawsuit was filed. However, as a result of employer contributions and market performance, the plan became overfunded in 2014. As a result, the alleged injury—inability of the plan to pay benefits when due—was eliminated. The case was dismissed by the lower courts and then appealed to the Supreme Court of the United States. The U.S. Department of Labor (DOL) filed briefs in support of reinstating the case and finding the U.S. Bank fiduciaries liable.

Under a traditional pension plan like U.S. Bank's, plan participants receive a fixed payment each month so long as the plan is operating. Unlike a 401(k) plan, the amount of the participants' benefit does not change based on the value of the plan assets or the fiduciaries' good or bad investment decisions. Both plaintiffs in this case were retirees, one receiving $2,198.38 a month and the other $42.26. The court emphasized that the outcome of the case would not affect either participant's future benefits. Whether they won or lost the case, the participants would not receive a penny more or a penny less than their current benefit.

To maintain a lawsuit, a plaintiff must have a concrete stake in the case, which is referred to as having standing. Because the plaintiffs here would not be affected by the outcome of the case, they lacked standing and the case was dismissed. However, if they had missed a pension payment, they would have been able to maintain the case. Justice Kavanaugh observed that the plaintiff's attorneys

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certainly had a stake in the lawsuit—winning their attorney's fees—but that is not enough to permit a case to proceed. A plan participant must have a stake in the outcome of the case. *Thole v. U.S. Bank, N. A.* (S. Ct. 2020)

Cyberloss Cases Proceed and DOL Gets Involved

We have previously reported on suits filed by participants to recover cyberlosses from plans maintained by a small law firm and by Abbott Laboratories. Attention in these cases is turning to the plan sponsors. Recent filings allege that plan sponsors have responsibility for the losses. In addition, the DOL is investigating the recordkeeper in the Abbott Laboratories case, Alight Solutions, and has filed suit to compel Alight to produce records related to its improper release of plan assets. Following are current developments:

- In the small law firm case, both the recordkeeper, Nationwide Trust Company, and a third-party administrator (TPA), MandMarblestone, were involved in the ongoing operation of the plan. The TPA was acting in a fiduciary capacity. In late 2015, one plan participant withdrew $15,000 from his account. The appropriate form was reportedly emailed from the law firm's office administrator to the TPA. It was then processed through Nationwide and the distribution properly deposited into the participant's bank account. The office administrator is alleged to have used a personal email account while working remotely. The withdrawal process was apparently observed by cyberthieves and then duplicated. The remaining approximately $400,000 in the participant's account was distributed to a bank account belonging to the cyberthieves. Suit was filed against Nationwide and the TPA by the plan sponsor and the plan participant whose account was stolen. The participant happened to also be a plan trustee.

  The TPA has filed a counterclaim against the plan sponsor and the trustee/ participant alleging that their "own carelessness with respect to their employees and their computer/IT systems and policies… permitted" the cyberlosses to occur. The court has allowed the counterclaim to go forward. *Leventhal v. MandMarblestone Group LLC* (E.D. PA 2020) Courts around the country take differing positions on whether a counterclaim like this can proceed.

- In the Abbott Laboratories case, a participant's account was looted of $137,000. The cyberthief tried to access the participant's account using her date of birth and the last four digits of her Social Security number. When that was rejected, the cyberthief elected to receive a one-time email code from the recordkeeper rather than answer online security questions. With access to the account, the cyberthief added a new SunTrust bank account and processed a distribution to the new account. The participant sued both the plan sponsor and plan administrator as well as the plan recordkeeper, Alight Solutions.

  In recent filings, Alight and Abbott Laboratories have both alleged that the other is responsible for the losses. *Bartnett v. Abbott Laboratories* (E.D. IL 2020)

- The DOL began an investigation of Alight Solutions after discovering that Alight processed unauthorized distributions from participant accounts as a result of cyber breaches. It issued an administrative subpoena in November 2019. However, apparently unable to get information requested from Alight, the DOL filed suit in US District Court to compel production of the requested documents. The petition reportedly states that Alight failed to report cyber breach losses to its clients for months, if at all, and failed to restore unauthorized distribution amounts to participant accounts. *Scalia v. Alight Solutions* (E.D. IL 2020)

Cyber breaches can occur at various points in the chain of distribution processing. As cybersecurity

continues to be a hot topic within the retirement industry, and with accusations being made against plan sponsors, it would be appropriate to consider:

- The respective contractual obligations of those involved in plan administration;
- Whether fiduciary insurance in place would cover a cyberloss if plan fiduciaries were found to be liable;
- Review of plan sponsor and vendor processes, protocols and IT systems related to retirement plan operations;
- Participant education on cybersecurity prevention; and
- Whether plan recordkeepers permit participants to freeze their accounts to distributions or permit other enhanced security.

Challenges to 401(k) Plan Fees and Investments Continue

The flow of cases, decisions, and settlements in cases alleging fiduciary breaches through the overpayment of fees and the retention of underperforming investments in 401(k) plans continues. In situations where cases are decided by a court rather than settled, fiduciary process continues to prevail. Following is a sampling of this quarter's developments:

- Career Builder
  - Case dismissed in favor of plan fiduciaries and the plaintiffs may re-file.
  - In the Seventh Circuit, courts may not paternalistically interfere with plans' slates of funds so long as the fiduciaries do not engage in self-dealing and offer a comprehensive-enough menu of options.
  - Nothing in ERISA requires every fiduciary to scour the market to find and offer the cheapest possible fund (which might, of course, be plagued by other problems).
  - Removal or modification of the majority of a plan's funds over a 5-year period demonstrated the presence of a prudent review process.
  - *Martin v. Careerbuilder*, LLC (N.D. IL 2020)

- JP Morgan Chase
  - Settlement for $9 million following allegations of using proprietary and expensive investments.
  - *Beach v. J.P. Morgan Chase Bank* (S.D. NY 2020)

- Banner Health
  - Split decision after a 6-day trial. Fiduciaries won on investment issues, and participants won on recordkeeping fees and reimbursements to the plan sponsor.
  - A mutual fund window with 300 to 400 different options was offered. However, investments in the mutual fund window were not monitored. Plaintiffs did not establish that maintaining the mutual fund window caused any losses to plan participants. So, this issue was decided for the plan fiduciaries. This was not a self-directed brokerage window.
  - The plan used the Fidelity Freedom Funds, which were alleged to be an imprudent investment. The Freedom Funds were replaced in 2015. The court found that the fiduciary committee's quarterly and annual review process was sufficient. The process led to replacement of these funds, demonstrating the presence of a review process.
  - The plan was alleged to have overpaid for plan recordkeeping fees. The court found there to be an insufficient process for monitoring the recordkeeper's fees, resulting in an overpayment of approximately $1.7 million.
  - The plan was alleged to have improperly reimbursed plan sponsor expenses such as fees to service providers and the costs of staff who worked on the plan. A DOL audit found an

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overpayment from the plan to Banner Health of approximately $1.5 million from 2012 to 2017. This amount was reimbursed to the plan. The DOL audit did not cover 2010 and 2011, during which approximately $700,000 was paid to Banner by the plan. No records were produced at trial to support those expenses, so the judge ordered them reimbursed to the plan as well.

- *Ramos v. Banner Health* (D. CO 2020)

Environmental, Social, and Governance Investments: DOL Weighs in—Again

Environmental, social, and governance (ESG) investments are getting increased attention and have been requested by some plan participants and fiduciaries. In recent years, the DOL has issued varying guidance interpreting the applicable law, either supporting or discouraging the use of ESG investments in retirement plans depending on prevailing political winds. During the previous administration, the DOL issued Interpretive Bulletins embracing a broader use of ESG investments in retirement plans than had previously been endorsed. In June this year, the DOL issued a proposed regulation with a more restrictive view of how ESG factors may be considered by retirement plan fiduciaries.

There are legal hurdles to using ESG investments in retirement plans. Retirement plans are highly regulated, falling under the Employee Retirement Income Security Act (ERISA). ERISA places significant restrictions on plan fiduciaries as they make investment decisions. A key element of ERISA is the Exclusive Benefit Rule. This rule says that the only things plan fiduciaries are permitted to take into consideration in making investment—and other—decisions are providing benefits for plan participants' and beneficiaries' retirements and paying plan expenses. Fiduciaries are not allowed to be influenced by other factors no matter how laudable they may be. The result is that investments tailored to accomplish ESG objectives cannot be used in plans just because they endeavor to meet those objectives. However, ESG funds may be used if they perform as well as non-ESG funds relative to traditional investment measures like an appropriate index and peer group. In this situation the ESG factors are considered only incidental to the primary objective of helping retirement plan participants achieve a financially secure retirement.

In its most recent guidance, the DOL reiterated the Exclusive Benefit Rule, emphasizing that fiduciaries must select investments solely on the basis of economic factors. They must not let non-pecuniary factors divert them from getting the best economic results for the plan. In a new requirement, if two investments are considered economically equivalent, then the one with ESG factors can be used, but plan fiduciaries must document why the investments were economically indistinguishable and why the ESG-oriented investment was chosen. The proposed regulation also notes that there are no industry standards for what constitutes an ESG investment, which could make investors susceptible to misleading or misunderstood marketing.

If the proposed regulation becomes final as currently written, fiduciaries will find it more difficult to offer ESG-focused investments in ERISA-covered retirement plans. Any plan sponsor currently utilizing or considering an ESG fund should closely monitor the progress of this rule.

Mistaken Communication Leads to Potential $580,000 Liability

A former employee of Verizon, Sullivan, re-enrolled for post-employment life insurance benefits. The Verizon Benefits Center sent her a Retirement Enrollment Worksheet indicating that she was entitled to life insurance of 1 x Pay. This amount was calculated on the worksheet to be $679,700. However, when she was working, Sullivan's annual compensation was $18,600. It was later determined that the worksheet's life insurance benefit was calculated assuming that Sullivan's annual income was paid weekly.

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Sullivan enrolled for coverage and designated her daughter, Kristine, to be her beneficiary. Sullivan received various mailings from the Verizon Benefits Center, which was administered by Aon Hewitt, confirming the amount of her coverage. Some of the mailings prompted Sullivan to call Aon Hewitt, and in those calls she expressed surprise at the level of life insurance she was eligible for. Her calls to Aon Hewitt prompted an employee to point out to a colleague that Sullivan was an hourly employee and the life insurance amount seemed high. Another Aon Hewitt employee responded internally that Sullivan's annual income had been $970,920 and the life insurance amount was correct.

After Sullivan received assurance that the life insurance amount was correct, Kristine took over many of Sullivan's expenses and took a leave of absence from her job before her mother died. Upon Sullivan's death, Kristine was paid $11,400. (The coverage amount declined from $18,600 as Sullivan aged.) Kristine sued for the increased coverage her mother was promised. The district court ruled in favor of Verizon; however, the U.S. Court of Appeals for the Second Circuit has breathed new life into Kristine's claims. Verizon's repeated misstatements of the life insurance benefit amount, even after the potential issue was raised by Sullivan, amounted to gross negligence by the plan fiduciaries. In addition, Sullivan and Kristine relied on the incorrect information and changed their financial situation based on it. These factors form a sound basis for an equitable award of the amount of insurance that would have been due under the promised coverage: $582,600 at the time of Sullivan's death. The case was sent back to the district court for further consideration. *Sullivan-Mestecky v. Verizon Communications* (2nd Cir. 2020)

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