CAPTRUST

# Fiduciary Update | August 2024

## Indirect Recordkeeper Compensation Coming into Focus

We previously reported on a case from the U.S. Court of Appeals for the 9th Circuit requiring plan fiduciaries to consider all compensation received by plan recordkeepers, including indirect compensation, when evaluating the reasonableness of fees. In that case, the judge said plan fiduciaries were required to consider the revenue the recordkeeper received from managed account services provided to plan participants. *Bugielski v. AT&T Services, Inc.* (9th Cir. 2023)

This principle has also been endorsed by a federal court in New York. In that case, the plaintiffs claim that TIAA-CREF, a recordkeeper with significant exposure in the higher-education market, undertook an aggressive campaign to increase revenue by selling ancillary services to plan participants. The district court refused to dismiss the case, noting that fiduciaries are required to monitor administrative fees and all compensation that the service provider receives relative to the services delivered. The case will proceed to determine whether plan fiduciaries appropriately considered all compensation received by the recordkeeper. *Carfora v. Teachers Insurance Annuity Association of America* (S.D. N.Y. 2024)

## Use Forfeitures to Offset Employer Contributions? Maybe Not.

We recently reported on several cases challenging the use of plan forfeitures. Forfeitures result from participants leaving employment before being fully vested in their employer contributions. Historically, forfeitures routinely have been used either to offset the employer's matching contributions or to pay plan expenses. Plan documents often say that forfeitures may be used for either purpose. The argument in these cases is that plan fiduciaries are obligated to do what is in the best interest of plan participants, and, when given a choice in the use of forfeitures, they should first pay plan expenses, which would otherwise be charged against participant accounts. Using forfeitures to first reduce the employer's matching contributions is allegedly a fiduciary breach.

Ten lawsuits have been filed making these allegations. Initial decisions in these cases conflict. In a case against Qualcomm, the court accepted the basic argument that, given the choice, plan fiduciaries have a duty to use forfeitures in the best interest of plan participants. The defendant's motion to dismiss was denied. *Perez-Cruet v. Qualcomm Incorporated* (S.D. Cal. 2024)

In a similar case against HP, the court acknowledged that plan fiduciaries exercise discretion when deciding how to use plan forfeitures. However, the court found it implausible to require that plan forfeitures always be used first to pay plan expenses and then to reduce the employer's contribution. The case was dismissed with leave to file an amended complaint. *Hutchins v. HP Inc*. (N.D. Cal. 2024)

Using forfeitures to offset employer contributions is a longstanding and widely accepted practice, permitted under Internal Revenue Service (IRS) regulations and consistent with guidance from the Department of Labor (DOL). In view of the conflicting initial decisions in these cases, plan fiduciaries should review their approaches to plan forfeitures and confirm that they are following their plan documents.

**Cybersecurity Nuggets**

- In public remarks, a DOL representative reiterated the importance of cybersecurity in protecting participants' retirement assets and noted the DOL's focus on this issue. In the context of these remarks, the representative noted that artificial intelligence is making it harder to protect against cyberlosses. For instance, estimates say that it would take artificial intelligence only six seconds to duplicate a person's voice to circumvent voice-recognition technology.
- In a recent interview with a DOL agent as part of a random DOL plan audit, the agent asked the plan sponsor detailed questions about cybersecurity protocols and about information transfer protocols between the plan sponsor and its vendors. The DOL agent also wanted to know what steps plan fiduciaries had taken to confirm that their vendors' cybersecurity programs met the DOL's best practice guidelines.
- Merrill Lynch has alerted state authorities in Maine that, in an isolated incident, the personal data of more than 1,800 Walmart retirement plan participants was inadvertently sent to an external party. The Walmart plan reportedly has more than $35 billion in assets and more than 1.6 million active participants. Affected plan participants will be provided a two-year

membership in an identity theft protection program.

**Recordkeeping and Investment Fees Cases: Process Wins and Courts of Appeals Resurrect Dismissed Cases**

The flow of fees cases continues. Several were settled, were dismissed, or lost motions to dismiss and will proceed. In three instances, courts of appeals have reinstated fees cases that had been dismissed by district courts. The district courts found that the cases filed did not include sufficient allegations to state a plausible claim. The courts of appeals found otherwise, so the cases will go back to their district courts for further proceedings. *Kruchten v. Ricoh USA Inc.* (3rd Cir. 2024), *Mator v. Wesco Distribution Inc.* (3rd Cir. 2024), *Perkins v. United Surgical* (5th Cir. 2024)

In one case, after the facts of the case had been developed through depositions and document requests, the plan fiduciaries filed a motion for summary judgment. Based on the fiduciaries' thorough process and reasonable decision-making, summary judgment was entered in their favor. *Silva v. Evonik Corp.* (D. N.J. 2024) The judge particularly noted the following:

- Meetings were held quarterly, and, prior to meetings, investment reviews were prepared and distributed to committee members, including asset allocations, fees, and performance versus industry benchmarks.
- Regular review of expenses included evaluation of recordkeeping fees, investment fees, and the use of revenue sharing to offset plan expenses.

**Pension Nuggets**

- When pension plan liabilities are settled by transferring them from a plan to an insurance company, plan fiduciaries must select the "safest" available annuity provider, unless circumstances indicate that doing otherwise would be in the best interest of participants and beneficiaries. Several lawsuits have been filed challenging the selection of Athene as an annuity provider as not meeting the Pension Benefit Guaranty Corporation's safest available provider requirement. Athene is characterized by the plaintiffs as a "highly risky private-equity-controlled insurance company with a complex and opaque structure." *Bueno v. General Electric Company* (N.D. N.Y., filed 2024) Allegations of this nature are novel.
- Cases challenging the use of outdated actuarial tables to calculate joint, survivor, and early retirement benefits are proceeding and reaching different conclusions.
    - The case against Kellogg was dismissed because the judge found that the Employee Retirement Income Security Act (ERISA) does not contain a requirement that mortality tables be reasonable, and there is no requirement in ERISA that defendants regularly update their tables. *Reichert v. Bakery, Confectionary, Tobacco Workers, and Grain Millers Pension Committee* (E.D. Mi. 2024) This is an unusual outcome as most of these cases have been permitted to proceed to trial.
    - In a case against Citgo, the judge refused to enter summary judgment for the company, concluding—at least initially—that the actuarial assumptions used in calculating actuarial equivalents must be reasonable. He also observed that plan fiduciaries may not follow the terms of their plans if doing so would violate ERISA, suggesting that plan fiduciaries

should ignore unreasonable actuarial assumptions. *Urlaub v. Citgo Petroleum Corporation* (N.D. Ill. 2024)

**DOL's Expanded Fiduciary Rule on Hold**

The DOL's latest rule expanding fiduciary coverage has been put on hold. The DOL sees significant risks to retirement plan participants from brokers and insurance agents as money is withdrawn from retirement plans. To address this issue, the DOL issued a regulation in 2024 expanding ERISA's fiduciary definition to include those advising on rollovers out of retirement plans, regardless of the frequency of the interaction. The DOL's prior, similar regulation was struck down in 2018 as exceeding the DOL's authority. The new regulation has also been challenged, and a federal judge in Texas has put the new rule on hold until the court orders otherwise. In issuing the order, the judge expressed his expectation that the new regulation will ultimately be struck down. *American Council of Life Insurers v. U.S. Department of Labor* (5th Cir. 2024)

**Managed Accounts Challenged as Default Investments**

A participant in the Bechtel 401(k) plan has filed a class action lawsuit alleging that it was a breach for plan fiduciaries to use managed accounts as a 401(k) plan's qualified default investment alternative (QDIA). The complaint alleges that few participants provided personalized information about their financial situations but were still charged managed account fees. The lawsuit claims that, without personal input from plan participants, the managed accounts were essentially very expensive target-date funds and that target-date funds could have been used instead. *Hanigan v. Bechtel Global Corporation* (E.D. Va., filed May 2024) The DOL's 2006 regulation establishing QDIAs included the potential use of managed accounts, so it will be interesting to see how this case develops.

**Ex-Girlfriend from Decades Ago Awarded $750,000 401(k) Balance**

Jeffrey Rolison went to work for Procter & Gamble in 1987. At the time, when enrolling in the Proctor & Gamble 401(k) plan, he listed his girlfriend, Margaret Sjostedt, as his 401(k)-plan beneficiary. Twenty-eight years later, in 2015, Jeffrey died with a 401(k) account balance of just over $750,000. By that time, Jeffrey had not married and did not have children. The original beneficiary designation form naming Margaret was still on file.

Margaret and Jeffrey split up after a couple of years, in 1989, and Margaret went on to get married and have two children. After learning that Margaret was the designated beneficiary on file, Jeffrey's surviving brothers fought the issue, contending that Margaret was not who Jeffrey wanted as his beneficiary and the money should go to his estate—and eventually to the brothers.

Deciding that the beneficiary designation would be followed, the court noted that, over the intervening years, Jeffrey had from time to time accessed his account and had the opportunity to change his beneficiary. He had also received participant communications referencing beneficiary designations.

The only evidence the brothers had was their own, potentially self-serving statements of their prior conversations and their beliefs about what Jeffrey would have wanted. The judge was unpersuaded. *Procter & Gambel U.S. Business Services Company v. Estate of Jeffrey Rolison* (M.D. Penn. 2024)

**ESG Caution: American Airlines ESG Suit Survives Motion for Summary Judgment, Proceeds to Trial**

As previously reported here, plan participants sued American Airlines for including funds in their 401(k) plan that advance environmental, social, and governance (ESG) causes, alleging that they are not in the best interests of the plan participants. The judge denied American Airlines' motion to dismiss, accepting the general propositions that ESG investments underperform their non-ESG peers and that ESG investments are not exclusively focused on financial gain to plan participants. The claim is that these characteristics potentially violate ERISA's exclusive benefit rule.

Following the same logic, the judge has also denied American Airlines' motion for summary judgment. Unlike a motion to dismiss, which is filed early in a case, a summary judgment motion is filed after the facts of the case have been developed. *Spence v. American Airlines, Inc.* (N.D. Tex. 2024)

The bottom line is that ESG investing may continue to be a topic in litigation. Plan fiduciaries should be familiar with the DOL's rule on this topic, "The Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights" (also known as the *ESG rule*), which gives direction regarding how to approach selection and monitoring of ESG investments.

**Supreme Court's Elimination of Chevron Deference Already Impacting Retirement Plans**

A lawsuit against Chevron in 1984 included a challenge to how individual states were enforcing the Clean Air Act. The Supreme Court held that federal court judges must defer to reasonable agency interpretations of laws, creating the Chevron Deference rule. This ceded interpretation of federal law to the various agencies responsible for issuing regulations and enforcing the law when there was ambiguity. The Chevron Deference rule has been foundational to the decisions in countless cases—including many in the retirement and employee benefits area.

In its previous term, the Supreme Court reconsidered the Chevron Deference rule and abandoned it, finding that federal judges—not agencies—are responsible for interpreting laws. *Loper Bright Enterprises v. Department of Commerce* (S. Ct. 2024) This is already having a direct impact on cases involving retirement plans.

We also previously reported on an unsuccessful lawsuit by 26 states and other parties to throw out the DOL's new ESG rule. *State of Utah v. Walsh* (N.D. Tex. 2023). The district court's decision was appealed.

During the appeal, the Supreme Court issued its opinion in *Loper Bright*, throwing out Chevron Deference. Because the district court decision in *Utah v. Walsh* used Chevron Deference as a basis for its decision, the case was sent back to the Texas district court for it to once again consider the appropriateness of the ESG Rule under ERISA. *Utah v. Su* (5th Cir. 2024)

Even with elimination of Chevron Deference, in cases where there is statutory ambiguity, judges may still take due consideration of agency views, but they are not obligated to defer to agencies' interpretations. Eliminating Chevron Deference creates some uncertainty about whether previously settled issues will be reopened, and whether potentially more conflicting court decisions could work their way through the system, ultimately landing at the Supreme Court to be resolved.

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