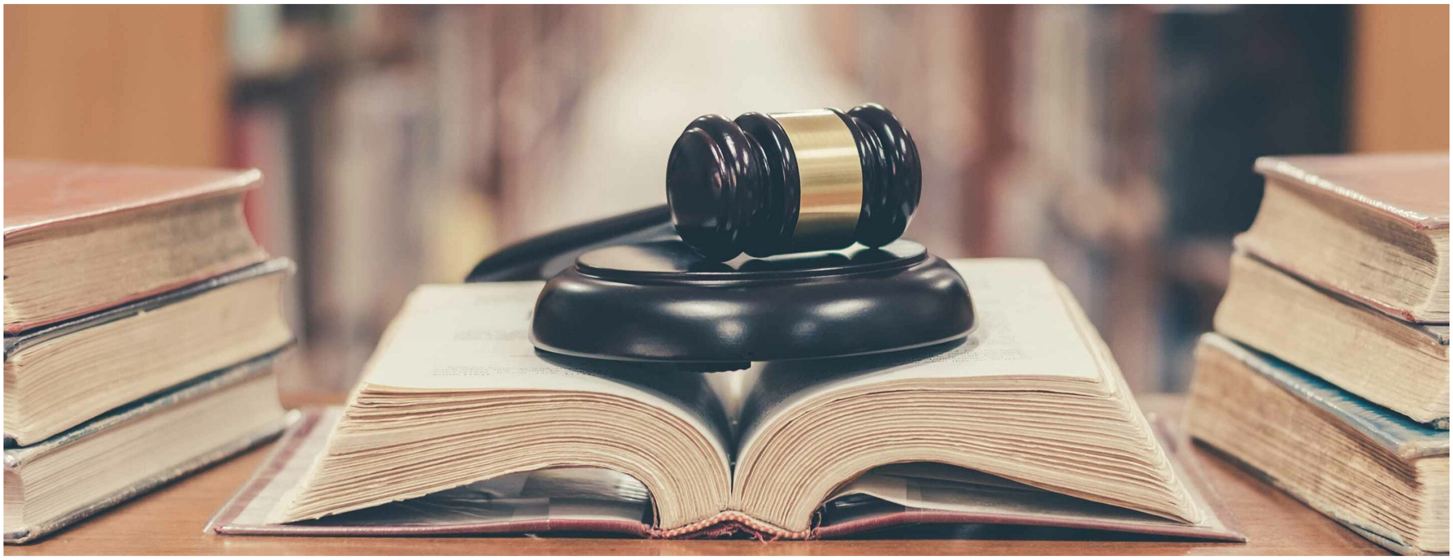

Fiduciary Update | February 2023

SECURE 2.0: Investment and Fiduciary Issues

The widely reported SECURE 2.0 law includes more than 90 provisions, most of which pertain to retirement plan design and operation. As a point of reference, the first SECURE Act included only 31 provisions. A few provisions of the new law relate directly to fiduciary and investment issues.

- 403(b) plans, which are a close cousin to 401(k) plans, have not been permitted to use collective investment trusts (CITs). CITs have long been used in 401(k) plans for stable value investments, and CIT versions of traditional mutual funds are increasingly used in 401(k) plans to reduce investment expenses. The new law permits 403(b) plans to use CITs. Although the rule is effective as of December 29, 2022, this provision will not be available until corresponding changes are made in securities laws.
- Under current fiduciary law, when a plan participant is overpaid from plan assets, plan fiduciaries must take reasonable steps to recover the overpayment. SECURE 2.0 leaves recovery of overpayments to the discretion of plan fiduciaries. Under tax law, if the exact terms of a retirement plan are not followed, including overpayments to participants, the planâ??s tax-preferred status can be challenged by the Internal Revenue Service (IRS). The IRS has previously issued guidance providing some relief if overpayments are not recovered, and SECURE 2.0 codifies preservation of a planâ??s tax-preferred status if overpayments are not recovered. Plan sponsors experiencing a situation like this should consult with their ERISA attorneys for guidance.

A few other aspects of SECURE 2.0 touch on topics that have been covered in earlier Fiduciary Updates.

- The penalty for not taking required minimum distributions (RMDs) has been reduced from 50 percent of the late distribution amount to 25 percent of the late distribution amount. This penalty is further reduced to 10 percent if the corrective distribution is made during a two-year correction window.
- The 10 percent withdrawal penalty for early retirement plan distributions will be waived for individuals with an illness that is reasonably expected to result in death within 7 years, per a doctorâ??s certification.

401(k) and 403(b) Fee Cases Continue

The flow of cases alleging fiduciary breaches through the overpayment of fees and the retention of underperforming investments in 401(k) and 403(b) plans continues but without significant new developments. Here are a few updates.

- Two of the approximately 10 cases alleging that it was a fiduciary breach to retain the BlackRock LifePath Index Funds have been dismissed and amended complaints have been filed. The challenged funds are an indexed target date series with a to-retirement design. *Tullgren v. Booz Allen Hamilton v. Hall* (E.D. Va. 2022); *Hall v. Capital One Financial Group* (E.D. Va. 2022).
- We previously reported on three Court of Appeals decisions dismissing fees suits because the initial claims did not sufficiently make a case that plan fiduciaries had breached their duties. District courts have applied the reasoning of these cases and dismissed other cases early in the litigation process. *Nohara v. Prevea Clinic* (E.D. Wis. 2022); *Glick v. Thedacare* (E.D. Wis. 2022).
- In a rare victory for a plaintiff in an ERISA fiduciary breach case, a judge in Connecticut has permitted a jury trial on some claims. *Garthwait v. Evercore Energy Co.* (D. Conn. 2022). Over the years, judges have written many pages on whether a jury trial is available in ERISA cases, with virtually all concluding no. Juries decide cases where the resolution would be legal, such as resolving an alleged breach of contract, and judges decide cases where the resolution would be equitable in nature. This is generally understood to be the situation with issues involving trusts, which fund retirement plans.

$750,000 Cybersecurity Loss Case Progresses with One Defendant Out

We have previously reported on a participantâ??s lawsuit attempting to recover more than $750,000 taken from her 401(k) account through cyber-fraud. The suit was filed against the recordkeeper, the plan fiduciaries, and the asset custodian/trustee, alleging various fiduciary breaches in making or allowing the fraudulent distribution. All three defendants filed motions to dismiss.

The asset custodian/trustee was released from the case, but the recordkeeper and plan fiduciaries were not. The court concluded that the asset custodian/trustee was not a fiduciary because it did not exercise any discretion or independent control over the plan or its assets. Its role was exclusively to follow the directions of others. This directed trustee role is different from the role discretionary common law trustees play in retirement plans, such as deciding which investments to offer in a 401(k) plan.

The judge noted that plan fiduciaries could be liable for the loss if they failed to reasonably select or monitor the recordkeeper. However, he observed that, â??ERISAâ??s duty of care requires prudence not prescience. [Fiduciaries] must adopt reasonable procedures, but not absolutely air-tight procedures, to protect against the possibility of what happened here, which was a heinous crime.â?•

With respect to the recordkeeper, Alight, the court found that it may be considered a functional fiduciary but cautioned that it might not be. Under ERISA, a person or institution is a fiduciary if they exercise discretion or control over plan assets, regardless of whether they have been appointed as a fiduciary. The judge took the unusual step of recommending that the participant file a negligence suit against Alight. He went on to point out that the statute of limitations would run out in March 2023, concluding with, â??the clock is ticking.â?• *Disberry v. Employee Relations Committee of The Colgate-Palmolive Company* (S.D. NY 2022).

Surprise! Ex-husband Inherits 401(k) Account Balance

A plan participant was divorced in 2002, and it was agreed that her ex-husband would have no claim to her 401(k) account. At that time, the ex-husband was the sole beneficiary. In 2008, the participant changed her 401(k) plan beneficiary from her ex-husband to her three siblings, with each to receive 33 1/3 percent. Unfortunately, the beneficiary designation form required that the allocation be in whole percentages. As a result, the beneficiary change was rejected.

In 2019, when the participant died, her $600,000 401(k) benefit was paid to her ex-husband. The participantâ??s estate sued the plan sponsor for breach of fiduciary duty in failing to correct the beneficiary designation form. At trial, it was revealed that, soon after the erroneous beneficiary designation form was submitted, the plan sponsor telephoned the participant and left a message notifying her of the error. The participant also received 11 annual account statements showing her ex-husband as the sole beneficiary. Award of the 401(k) account to the ex-husband was upheld at trial and on appeal. *Gelschus v. Hogen* (8th Cir. 2022).

Surprise! $24,000 Payment Resolves $2 Million Claim

An insurance company determined that it had overpaid a healthcare provider in Texas by more than $2 million through the payment of participant claims. The insurance company demanded repayment and months of discussions and correspondence ensued, but no agreement was reached. The provider eventually sent a letter and refund check for $24,000 to the insurance company.

The check included a notation saying it was in â??full and final paymentâ?• of the repayment claim. Copies of the letter and check were sent to seven different addresses and individuals at the insurance company who had been involved in the negotiations. The physical check was sent to the insurance companyâ??s lockbox where payments were received.

Five days after the letters were received by individuals at the insurance company, the check was deposited by the lockbox provider, and copies of the check and letter were scanned into the insurerâ??s tracking system. The next day, upon seeing the letter and check in the tracking system, an insurance company representative emailed the healthcare providerâ??s general counsel to reject the settlement offer.

The healthcare provider contended that acceptance of the check was full satisfaction of the insurerâ??s claim for reimbursement. Disappointed with that outcome, the insurance company sued. Applying Texas law, the trial court and court of appeals concluded that acceptance of the $24,000 check resolved the matter. *United Healthcare of Texas, Inc. v. Low-T Physicians Service* (Tex. App.â??Fort Worth 1-5-23).

Accidental Death Coverage: What Is an Accident?

In addition to traditional life insurance, many employersâ?? benefit programs include additional coverage if a death is the result of an accident. Two recent cases illustrate differing outcomes.

In *Goldfarb v. Reliance Standard Insurance Co.* (S.D. Fla. 2023), a covered employee was an avid mountain climber. He decided to go mountain climbing in Pakistan in the winter. After making reasonable preparations, he embarkedâ??but did not return. Aerial surveillance identified a body and what appeared to be his equipment in the area where he was climbing. The employee was then declared dead.

A claim for accidental death benefits was denied, with the insurance carrier taking the position that winter mountain climbing in Pakistan was so dangerous that death was not considered an accident. However, the policy did not have a mountain climbing exclusion. The trial court found that the deceased did not expect his mountain climbing expedition to cause serious injury or death. The accidental death benefit was ordered to be paid.

In another accidental death case, *McChristion v. Sun Life Assurance Co. of Canada* (W.D. Tex. 2022), a motorcyclist lost control and wound up under the trailer of an 18-wheel truck. He was dragged for some distance and did not survive. The crashed motorcycleâ??s speedometer was found locked at 105 miles per hour. Where the accident happened, the speed limit was 45 miles per hour.

The employer-provided accidental death insurance claim was denied. In this case, the denial was upheld because the behavior of the deceased was so intentionally reckless that it was excluded. The claim was also denied because it resulted from criminal behavior in the violation of motor vehicle laws, but the judge did not reach this issue.

DOL Finalizes ESG Regulation

In November 2022, the most recent volley of guidance from the U.S. Department of Labor on the use of environmental, social, and governance (ESG) factors, also known as socially responsible investment factors, in retirement plan investments became final. The bottom lines continue to be:

- In ERISA-covered plans, investment decisions must be made based on economic factors and in the best interests of plan participants and their beneficiaries.
- In certain cases, ESG factors may be considered economic factors by plan fiduciaries.
- Making socially responsible investments available to participants through a self-directed brokerage vehicle versus a core investment option can be advantageous.
    - If properly structured, plan fiduciaries are not responsible for specific investments available in the brokerage window.
    - If socially responsible funds will be made available, a brokerage window can permit a wide range of choices for plan participants to select what they are passionate about.

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