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# Fiduciary Update | November 2023

## DOL Challenges $1.3 Million Reimbursement of Plan Sponsor Expenses: Inadequate Records and Process

The Department of Labor (DOL) has challenged a plan sponsor's receipt of $1.3 million from its three retirement plans as reimbursement for staff time spent on plan administration. According to the complaint, the plan sponsor and fiduciaries did not track the services provided to each of the three plans. Rather, the amount of staff time spent was determined by asking employees at the end of the year to estimate how much time they had spent working on the plans. An hourly rate was applied, and the total amount was assessed from the plans pro rata based on their respective assets. No steps were taken to ensure the reasonableness of the amounts reimbursed.

The DOL alleged the fiduciaries breached their duties by "instituting and maintaining a faulty process rather than doing their jobs as fiduciaries to protect participants' and beneficiaries' interests." A motion to dismiss the complaint was recently denied, so the case will proceed. *Su v. CSX Transportation, Inc.* (M.D. Fla. 10.11.2023).

This case is a reminder to fiduciaries to be careful when paying expenses from plan assets, particularly the reimbursement of staff expenses. When asking permission to charge staff expenses to a plan, the DOL usually directs that detailed records be kept, and it challenges reimbursing the services of an employee who does not spend at least 50 percent of their time on plan matters. The assumption here is that if the employee spent more than half of their time on non-plan matters, the sponsor would have hired them—and incurred the corresponding expense—regardless of whether the plan existed.

## We Can Use Forfeitures to Offset Future Employer Contributions, Right?

Participants who leave employment before meeting a plan's vesting requirements forfeit the non-

vested portions of their accounts. It is common practice for plan sponsors to use these forfeitures to offset employer matching or other contributions in 401(k) plans. Four nearly identical lawsuits have been filed alleging that it is a fiduciary breach to use forfeitures in this way, under the applicable plans' terms. The same law firm has sued Clorox, Intuit, Qualcomm, and Thermo Fisher Scientific.

In the case against Intuit, as an example, the complaint acknowledges that the plan document allows forfeitures to be used either to pay plan expenses or to offset future employer-matching contributions. As a result, plan fiduciaries have discretion over how to use forfeitures. The argument is that the plan fiduciaries chose to use forfeitures to offset future matching contributions, thereby benefiting the plan sponsor, rather than using them for the payment of plan expenses, which would have benefited participants. This approach allegedly violates the ERISA *exclusive benefit rule* that says plan fiduciaries must always act in the best interests of plan participants and beneficiaries. *Rodriguez v. Intuit Inc.* (N.D. Cal. Filed 10.2.2023).

The use of forfeitures to offset employer contributions is a longstanding and widely accepted practice, permitted under IRS regulations and consistent with guidance from the DOL. Legal commentators have expressed skepticism about the legitimacy of this novel argument. It will be interesting to see if these cases survive motions to dismiss. In the meantime, plan fiduciaries should confirm that they are following their plan documents, and they should track finalization of the IRS's proposed regulation on forfeitures, which is scheduled to go into effect on January 1, 2024.

**Flow of 401(k) and 403(b) Fee Cases Continues**

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. Here are a few updates from the last quarter:

- Approximately 10 cases were settled, with settlement amounts ranging from $61 million (GE) to $975,000 (Estée Lauder).
- Approximately 15 cases had motions to dismiss decided, with about one third being dismissed and two thirds proceeding.
- One case went to trial before a judge, with the plan fiduciaries prevailing. Plan participants sued fiduciaries of the B. Braun Medical Inc. Savings Plan, which has approximately $800 million in assets, alleging that the plan fiduciaries failed to investigate and select lower-cost alternatives to the plan's investments and failed to monitor or control the plan's recordkeeping expenses. After a three-day trial, the judge found that the plan committee had:
    - Appropriately selected and monitored investment options.
    - Met regularly, including annually for some of the applicable time period, and quarterly thereafter.
    - Engaged financial advisors who presented reports on the performance of investment options.
    - Had an investment policy statement.
    - Used a watchlist and removed underperforming funds.

  - Monitored whether to move into lower-cost share classes.
  - Monitored recordkeeping fees using benchmarking and requests for proposals (RFPs).
  - Negotiated lower recordkeeping fees.
  - Changed recordkeepers during the applicable period after issuing an RFP.
  - Kept regular minutes documenting the actions above.

The judge took into account industry trends and standards with respect to plan fees and noted that the committee had acted in line with industry practice. Based on all of this, the judge found the committee's conduct regarding plan investments and recordkeeping fees was objectively prudent, and the investments used and recordkeeping fees paid were objectively prudent. *Nunez v. B. Braun Medical, Inc.* (E.D. Pa. 2023).

This case is a reminder of some key elements of a good fiduciary committee governance process and their importance.

- In one dismissed case, the judge rejected the claim that plan fiduciaries are required to use the least expensive share class of plan investments—net of any revenue sharing allocated to plan participants. The court said, "While a prudent fiduciary might consider the net expense ratio, no court has said that ERISA requires a fiduciary to choose investment options on this basis." *England v. Denso International America, Inc.* (E.D. Mich. 2023).

**DOL Tries Again to Expand Fiduciary Responsibility—Plan Distributions Targeted**

On October 31, the DOL issued a proposed rule expanding ERISA's fiduciary protections to more retirement investors. The current fiduciary rules apply to participants and assets in plans like 401(k)s, 403(b)s, and pensions that are covered by ERISA. However, financial services providers are not subject to these rules in the context of retirement plan distributions. The DOL is concerned that they may act in their own financial interests rather than those of their clients. The new proposed rule would extend ERISA's fiduciary coverage to situations in which:

- Investment advice or recommendation is made to a retirement investor,
- The advice or recommendation is provided for a fee or other compensation, *and*
- The advice or recommendation is made in the context of a professional relationship, and the investor would reasonably expect to receive sound advice in which:
  - The provider has discretion,
  - The provider regularly provides individualized advice based on investors' particular needs, *or*
  - The provider states that it is acting as a fiduciary.

The proposed rule specifically nullifies written disclaimers of fiduciary status that conflict with what an investor is told.

It is clear from the DOL's guidance and announcements that the target of this is advice and sales efforts in the context of retirement plan distributions. There is a 60-day comment period for the

proposed rule. The DOL's last effort in this area was overturned by the U.S. Court of Appeals in 2018. A spirited debate on the new rule can be anticipated.

**Rare Employee Win in ERISA Retaliation and Benefits Interference Claim**

Thomas Kairys was hired by a small trucking company, and soon after diagnosed with degenerative arthritis. He had to have hip replacement surgery, and a second hip replacement was expected. Medical costs for the first hip replacement were paid through the trucking company's health plan. However, the health plan was self-insured, so the costs passed through to the employer. When Kairys returned to work after his surgery, his supervisor advised him to "lay low" because the company owner was unhappy with the additional medical costs. In the weeks following, Kairys was seen as a high-performing employee and earned a bonus for good work. Even so, four months after the first surgery, he was fired, allegedly because his work was no longer needed. Soon after, another person was hired to replace him.

ERISA prohibits a plan sponsor from firing an employee in retaliation for using their employee benefits or to prevent them from using those benefits. Kairys sued, alleging that he was fired because he had used his health benefits and was likely to continue using them. Following a trial, the district court judge found that Kairys was fired because of his past and anticipated future use of health benefits. The former employer was ordered to pay attorney's fees and front pay of $180,000. The decision was upheld on appeal. *Kairys v. Southern Pines Trucking Inc.* (3rd Cir. 2023).

**Securities and Exchange Commission: Neutralize AI Bias in Favor of Broker-Dealers and Advisory Firms**

The Securities and Exchange Commission (SEC) has issued a broad proposed rule that is intended to prevent broker-dealers and investment advisers from using *predictive data analytics* and similar technologies, including artificial intelligence (AI), to place the firms' interests above those of their investors. The concern is that a firm could use these technologies to advance the firm's revenue or otherwise change investor behavior to benefit the firm at the detriment of the investor.

The proposed rule would require a firm to "eliminate or neutralize" situations in which technology optimizes the firm's interests over those of the investor. It would not regulate investment advice provided to ERISA plans but would apply to advice provided to plan participants, including recommendations about investments and distributions—when assets are leaving an employer-sponsored retirement plan.

This rule has been openly criticized, with industry groups calling for its withdrawal. However, withdrawal seems unlikely. On October 30, President Biden issued an Executive Order calling on federal agencies to address AI issues and potential misuse. A White House release says, "The Executive Order establishes new standards for AI safety and security, protects Americans' privacy, advances equity and civil rights, stands up for consumers and workers, promotes innovation and competition, advances American leadership around the world, and more." If not already the case, it

seems likely that the DOL will soon weigh in on AI issues.

Although Congress has been considering AI regulation, action on that front is not expected in the near term.

**DOL Approves Diverse Investment Manager Support by Plan Sponsors**

Citigroup (Citi) sought and received DOL approval for its racial equity program to support diverse-owned investment managers. As part of this program, Citi identified diverse investment managers as firms with at least 50 percent minority or female ownership. To support diverse managers, Citi will pay directly—in its capacity as the plan sponsor—some or all of the investment managers' fees on investments used in Citi's retirement plans.

Citi will not be acting as a fiduciary in the selection of firms to participate in this program or in the payment of fees; these would be settlor functions. However, not having investment management fees deducted from investment returns can be factored into the Citi investment committee's fiduciary investment review and selection process.

The DOL cautioned that investment decisions should not be made based solely on an investment manager's participation in the program or to further Citi's public policy goals. This DOL letter serves to emphasize the difference between settlor and fiduciary functions. And it is a reminder to plan sponsors to only consider relevant financial factors in their manager selection and monitoring processes. DOL Adv. Op 1023-01A (9.29.2023).

**DOL Wins Challenge to Most Recent ESG Rule**

In 2022, the DOL finalized the Prudence and Loyalty in Selecting Plan Investments and Exercising Shareholder Rights rule, neutralizing the prior rule's restrictions on consideration of ESG factors by plan fiduciaries in the selection of retirement plan investments. Twenty-six states and other parties sued to have the DOL's new ESG rule thrown out. The court refused to set aside the DOL's new rule. It noted that ESG factors could be considered even under prior rules if they are expected to have a material effect on the risk and/or return of an investment. The judge noted that some scholars have observed that changes from the prior rule are merely cosmetic. Indeed, the ERISA provisions these rules are based on have not changed since their 1974 passage. *State of Utah v. Walsh* (N.D. Tex. 2023).

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