
Legal Updates on Changing DOL Guidance for 401(k) Investments and Fiduciary Rule

Presentation for:
Employee Benefits Academy
March 25, 2021

Presentation by:
Kelly Ultis, Partner
Michelle Lewis, Associate

Housekeeping: Questions

- Questions during this presentation
 - We encourage questions (even though your audio lines are muted)
 - To submit a question, simply type the question in the blank field on the right-hand side of the menu bar and press return
 - If time permits, your questions will be answered at the end of this presentation. And if there is insufficient time, the speaker will respond to you via e-mail after this presentation

- Recording
 - This presentation is being recorded for internal purposes only
- Continuing education credits
 - A purpose of the webinar series is to provide FREE CE credits
 - To that end, each presentation is intended to provide 1 credit hour in the following areas:
 - CLE: 1 credit hour (CA, FL, GA, NC, NY, TX and VA)
 - CPE: 1 credit hour (Texas)
 - HRCI: This activity has been approved for 1 (HR (General)) recertification credit hours toward California, GPHR, PHRI, SPHRI, PHR, and SPHR recertification through the HR Certification Institute
 - SHRM: This program is valid for 1 PDC for the SHRM-CPSM or SHRM-SCPSM
 - If you have any questions relating to CE credits, please contact Anna Carpenter at acarpenter2@huntonak.com.
- Disclaimer
 - This presentation is intended for informational and educational purposes only, and cannot be relied upon as legal advice
 - Any assumptions used in this presentation are for illustrative purposes only
 - No attorney-client relationship is created due to your attending this presentation or due to your receipt of program materials



Partner

Email: kellyultis@HuntonAK.com
Phone: 713-220-4462

600 Travis St.
Houston, TX 77002

Kelly practices in the tax group with a concentration in the area of executive compensation and employee benefits.

She has worked with both public and private companies on an array of employee benefit matters, focusing on qualified retirement plans, health and welfare plans and executive compensation arrangements. Her experience includes helping clients navigate and comply with the complex and numerous legal requirements associated with the administration of equity compensation and employee benefit plans and advising companies on fiduciary duties with respect to qualified retirement plans.

She works with entities on all stages of benefit plan matters, including advising companies on the design and implementation of new plans, drafting documents, counseling companies on the maintenance and correction of plans and finally, assisting in merging or termination of plans. She is experienced in design and implementation of employee stock ownership plans (ESOPs) as well as ESOP transactions.



Michelle concentrates her practice in the areas of health and welfare plans, qualified retirement plans, and executive deferred compensation plans.

She delivers insightful and practical advice to clients in addressing a broad spectrum of employee benefit issues, including drafting plan documents, preparing IRS submissions, resolving ERISA and Internal Revenue Code compliance issues, advising on benefit claims and appeals, addressing various litigation issues, and negotiating employee benefit vendor contracts and HIPAA business associate agreements.

Partner

Email: mlewis@HuntonAK.com

Phone: 202-955-1859

2200 Pennsylvania Avenue NW
Washington, DC 20037

Upcoming 2021 Webinars

- **2021 webinars:**
 - **April 22:** ERISA Fiduciary Litigation Update
 - **May 20:** Public Company ESOP Issues
 - **June 24:** Key Issues for HSAs, HRAs and FSAs
 - **July 22:** Employment and Benefits Issues in M&A Transactions
 - **August 26:** Basics and Update on IRS and DOL Correction Programs
 - **September 23:** Self-Directed IRAs and investments relating to the same
 - **October 28:** Navigating controlled group and affiliated service group rules
 - **November 18:** Year-End Benefit Plan Requirements/End of Year Benefits "To Do" List
 - **December 16:** Benefits Year in Review and a Look Ahead to the Upcoming Year
- Sign up here: [Employee Benefits Academy Webinar Series - Subscribe](#)

- Fiduciary duties in general with respect to 401k plan investments
- Overview of 2020 401k investment/fee lawsuits
- Suggested practices for reducing risk of breach of fiduciary duty
- DOL guidance and changes:
 - Fiduciary rule
 - ESG
 - Private Equity

General ERISA fiduciary obligations:

- Loyalty
 - Act with the exclusive purpose of providing benefits to participants and beneficiaries
- **Prudence***
- **Diversification***
- Must follow the plan terms

Why is this important?

- ERISA litigation stems from breach of fiduciary duty
- Can implicate prohibited transactions
- DOL enforcement of ERISA fiduciaries

ERISA Fiduciary Responsibilities

Prudence

Prudence

- A fiduciary must act with the “care, skill, prudence and diligence under the circumstances then prevailing” that a prudent person “acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims.”
- This creates a prudent “expert” standard of care
- Fiduciaries should obtain expert assistance when they do not have the expertise
 - e.g., hire a professional investment advisor
- The focus is on process, not results – while prudence requires an appropriate process and investigation, it does not require perfect results on a hindsight basis
 - But, the process must be thorough and objective

ERISA Fiduciary Responsibilities

Prudence, con't

- The selection of outside service providers is a fiduciary act and is subject to the prudence standard
- Prudent selection of outside service providers carries with it a duty to monitor their performance on an ongoing basis
- Duty to monitor requires regular oversight to ensure that delegated duties are being properly discharged
 - Ensure that there is adequate ongoing oversight of third party service providers
 - Conduct a more in-depth review (RFP or RFI) approximately every 3-5 years, or earlier if needed
 - Obtain regular reports on investment performance and plan administration

ERISA Fiduciary Responsibilities

Prudence, con't

Special considerations for plan expenses

- The plan administrator has a general duty to prudently manage and control plan expenses and pay only those expenses that are reasonable and necessary expenses of administering the plan
- The plan administrator should know:
 - The fees and expenses of service providers and investment managers/funds, and
 - The sources of compensation for each service provider (direct or indirect), including revenue sharing

ERISA Fiduciary Responsibilities

Diversification

- Diversification
 - A fiduciary must diversify plan investments so as to minimize the risk of large losses, unless under the circumstances it is clearly not prudent to do so
 - Required to implement and follow an investment policy
 - Critical to maintain and monitor on an on-going basis a diverse and prudent set of investment alternatives for plan participants to select

Significant increase in class action lawsuits filed (200) with respect to excessive fees in 2020 compared to 2019

- Smaller plans with fewer than 1,000 participants and less than \$100 million are being targeted

U.S. Supreme Court ruled on four ERISA cases (more than any year in ERISA history)

- Plaintiffs in *Hughes v. Northwestern University* petitioned U.S. Supreme Court to hear its excessive fee case; Supreme Court requested U.S. Solicitor General for an opinion on the case

Allege Breach of Fiduciary Duty by:

- Failing to monitor and control plan administrative expenses
- Failing to monitor/prudently manage investment fees
- Including or failing to monitor imprudent investment options

More discussion in next month's webinar

Fiduciary Considerations for Self-Directed Brokerage Windows

- There has been some recent litigation regarding the duty to monitor fund offered through a brokerage window.
- So far, courts have been reluctant to impose a fiduciary duty to monitor traditional self-directed brokerage platforms and the DOL has not yet opined on the issue either.
- To minimize any fiduciary liability concerns, plan should properly disclose to participants the risks, responsibilities and costs associated with making self-directed brokerage window investments.

Limiting ERISA Fiduciary Liability

- Seek independent, expert advice when appropriate
- Meet regularly and maintain written records that demonstrate processes followed in making decisions, as well as the decisions made
 - Make sure to have a robust process for making decisions/selecting service providers
- Periodically review and, if necessary, revise investment policy
- Consistently monitor performance of investment funds
 - Select appropriate benchmarks for analyzing performance
 - Follow consistent process for replacing underperforming investments
 - Make sure to have a diverse portfolio of funds, including index funds
- Consistently review and monitor third party fees and expenses
 - Periodic RFPs for recordkeeper
 - Consider hiring expert on recordkeeping fees
- Consider cybersecurity responsibilities and ways to protecting participant info
 - Review agreements/coordinate with service providers regarding cybersecurity

Limiting ERISA Fiduciary Liability, con't

- Practical Considerations:
 - Standing Committee approval when opportunity to change to lower share class funds
 - Negotiate quoted recordkeeping fees
 - Consider recordkeeping fees as a fixed per participant rate versus percentage of assets
 - Determine whether your plan has revenue sharing paid to recordkeepers
 - Provide fiduciary education to Committee members
 - Review ERISA fiduciary and D & O insurance policies to ensure proper coverage
 - Make sure to provide substantial disclosure information to participants

DOL Changes to the Investment Advice Fiduciary Rule

- In December 2020, the DOL released Prohibited Transaction Exemption (PTE) 2020-02, “Improving Investment Advice for Workers & Retirees.”
- PTE 2020-02 reinterpreted and broadened the five-part test under DOL’s 1975 regulation defining who is an advice fiduciary.
- DOL had restored the five-part test as a consequence of the Fifth Circuit’s 2018 decision vacating the DOL’s 2016 publication of a new Fiduciary Rule providing a new, much broader definition of advice fiduciary.

DOL Changes to the Investment Advice Fiduciary Rule

- Under the DOL’s five-part test, for advice to constitute “investment advice,” a financial institution or investment professional that is not an ERISA fiduciary must:
 - Render advice to the plan as to the value of securities or other property, or make recommendations as to the advisability of investing in, purchasing, or selling securities or other property,
 - On a regular basis,
 - Pursuant to a mutual agreement, arrangement, or understanding with the plan, plan fiduciary, or IRA owner, that
 - The advice will serve as a primary basis for investment decisions with respect to plan or IRA assets, and that
 - The advice will be individualized based on the particular needs of the plan or IRA.

DOL Changes to the Investment Advice Fiduciary Rule

- Under the new exemption, a financial institution or investment professional that meets the five-part test, and receives a fee or other direct or indirect compensation is an investment advice fiduciary under ERISA and under the Code.
- The five-part test also applies to IRA rollovers by including advice related to such rollovers as within the scope of “investment advice” in the class of transactions covered by the exemption.
- The DOL also stated that advisers providing rollover advice might avoid fiduciary status if they make it clear in their communications that they do not intend to enter into an ongoing relationship to provide advice and then act accordingly.

DOL Changes to the Investment Advice Fiduciary Rule

- DOL provides that the non-enforcement policy will remain in effect until Dec. 20, 2021.
- The guidance does not directly place new compliance requirements on plan sponsors.
- Plan sponsors, as fiduciaries, have a duty to ensure that if their retirement plan service providers counsel participants, the advisors act in the participants' best interest under ERISA and related DOL regulations.
- Plan sponsors' fiduciary oversight includes understanding how and by whom investment advisors are being paid and whether those payments result in conflicts of interest.

- In October 2020, the DOL issued a Final Rule amending the investment duties regulation under ERISA Section 404(a).
- The Final Rule updated the existing investment duties regulation framework to provide minimum standards a fiduciary must meet in order to satisfy ERISA's duty of loyalty in selecting plan investments.
- The Final Rule came after years of DOL guidance focused on the appropriateness of environmental, social and governance ("ESG") investments.
- The Final Rule formalized the DOL's long standing position that plan fiduciaries should focus solely on pecuniary factors when making investment decisions.

- Specifically, the Final Rule provides:
 - The duty of loyalty is satisfied where an investment or investment course of action is based solely on pecuniary factors.
 - Where (and only where) an investment or investment course of action cannot be distinguished based upon pecuniary factors alone, the fiduciary may use non-pecuniary factors as decisive in the investment decision
 - Qualified Default Investment Alternatives (QDIAs) may *not* consider non-pecuniary factors.
 - The Final Rule makes it clear that the fiduciary duty of prudence only requires fiduciaries to consider *reasonably available* alternatives when evaluating investment options.

- On March 10, the DOL announced that it will not enforce the Final Rule.
- The DOL noted that a wide variety of stakeholders had expressed numerous concerns with the changes, including:
 - The rushed nature of the rulemaking
 - Whether the DOL considered and addressed the substantial evidence on how the use of ESG considerations positively affects investment value and long-term returns
 - How the changes have already had a “chilling effect” on the use of ESG considerations in investment decisions.
- The DOL stated that it “intends to revisit the rules,” and, until then, will not enforce them or otherwise pursue enforcement actions against any plan fiduciary for violating these rules.

- ERISA fiduciaries need not worry about being investigated by the DOL for violating the ESG rule.
- But, as long as the rule is on the books, ERISA fiduciaries' conduct will be measured against it in any lawsuit by plan participants and beneficiaries, which presents a significant litigation risk.
- For the time being, ERISA fiduciaries should tread carefully when it comes to ESG or ESG-themed investing.

Private Equity Investment Fiduciary Considerations

- In June 2020, the DOL released an “information letter” regarding the potential inclusion of private equity investments in DC plans.
 - Note: Information letters are not formal guidance and reflect the DOL’s thinking regarding a specific circumstance, and are not broadly applicable nor precedent.
- The DOL indicated that it will allow DC plans to offer indirect investment in private equity funds in certain circumstances.
- The DOL guidance only covers allocation decisions made by the fund’s asset managers when private equity would be one of multiple categories of equity investments within the fund (e.g., target date funds).
- The guidance does not cover a DC plan allowing individual participants to invest their accounts directly in private equity investments.

Private Equity Investment Fiduciary Considerations

- The DOL letter states that plan fiduciaries considering a private equity investment option in multi-asset class funds should consider:
 - Whether the fund has managers with “the capabilities, experience, and stability” to handle private equity.
 - Whether the proportion of the fund’s allocation to private equity investments is appropriate based on the “cost, complexity, disclosures, and liquidity” considerations.
 - Whether the fund has “adopted features related to liquidity and valuation” that give participants the ability to move their investment allocations “consistent with the plan’s terms.”
 - The fund suitability in light of the plan’s “participant profile,” including their ages, contribution and withdrawal tendencies.

Private Equity Investment Fiduciary Considerations

- Bottom line – a plan fiduciary must act with due diligence in determining the suitability of private equity investments as part of the plan’s portfolio.
- Very careful thought should be given as to whether allowing private equity investments into the plan is suitable and prudent for your participants.
- Consult with your financial advisors and legal counsel before taking any steps to introduce private equity investments into your plan’s portfolio.