

Q3 | 2024

Happenings On and Off the Hill

Everything you need to know about current regulation, legislation and litigation

REGULATION

Fiduciary: New and expanded definition in final Retirement Security Rule

What happened? On April 23, 2024, the Department of Labor (DOL) released a final version of the Retirement Security Rule and updates to various prohibited transaction exemptions (PTEs). Updated exemptions include PTE 2020-02, which broadly applies to advice arrangements, and PTE 84-24, which applies to independent insurance agents. As part of this update, a new test replaces the five-part test that has defined fiduciary status since 1975.

The regulation draws a specific focus on rollover transactions: A financial services provider will be a fiduciary with respect to a recommendation to roll over assets from a workplace retirement plan to an IRA if every element of the fiduciary definition is satisfied.

What's the latest? Within a month of issuing the final regulation, two suits were filed challenging the rule, arguing that the DOL exceeded its authority and that the rule was essentially attempting the same extension of its authority that the Fifth Circuit Court of Appeals rejected in 2018. Two separate federal courts (both in Texas) have now granted a stay in the effective date of the regulation while the lawsuits are pending. The DOL has 60 days to appeal the ruling. The fiduciary rule (technically the Retirement Security Rule) was set to go into effect September 23, 2024, although there was a one-year transition period after the effective date for certain conditions in the PTEs.

What's the fiduciary consideration? With the recent litigation (and the upcoming election and possible change in Administrations), fiduciaries may want to put implementation plans for the new Retirement Security Rule on hold for the time being. Thus, fiduciaries may be well served to:

- Monitor the status of the litigation and potential DOL appeal in the two Texas cases
- Identify whether financial professionals interacting with a committee, trustees or participants are serving in a fiduciary or non-fiduciary role for various activities and whether that may change depending on the outcome of the pending cases

LEGISLATION

Expanding access to collective investment trusts (CITs)

What happened? On July 31, 2024, a bipartisan group of senators introduced the Retirement Fairness for Charities and Educational Institutions Act of 2024.¹ This bill would allow 403(b) plan sponsors that could not previously access collective investment trusts (CITs) to offer them a part of their plans.

What's the latest? In March 2024, the House of Representatives passed the nearly identical version of this bill, which was attached to a larger bill.² Although there is bipartisan support, few legislative days remain in this cycle before the lame-duck session begins. That said, the CIT legislation may still be finalized during 2024 as a part of a larger spending bill.

What's the fiduciary consideration? CITs are regulated under the Office of the Comptroller of the Currency (OCC) and are not required to register with the Securities and Exchange Commission (SEC). Because of the regulatory requirements, CITs are often a lower cost option than mutual funds, which makes them an appealing option for plan sponsors. This legislation seeks to allow plan sponsors to make CITs available in 403(b) plans, potentially expanding access to 15 million plan participants.

LITIGATION

SCOTUS and the demise of Chevron deference

What happened? In a 6-3 decision, the United States Supreme Court overturned the so-called Chevron deference. The Chevron deference is a legal standard that since 1984³ has held that when federal law is ambiguous, courts would defer to the opinion or interpretation of federal government agencies — such as the DOL or the Securities and Exchange Commission.

What's the latest? Based on the Supreme Court decision, courts can consider the perspective of government agencies in areas of law deemed to be ambiguous. But they are not required to do so in their assessment of the best interpretation of the law.

What's the fiduciary consideration? Now that the courts have the right to decide for themselves whether or not to consider a government agency's interpretation of ambiguous legislation, confidence in those interpretations may falter and further litigation may ensue. Fiduciaries may also consider their reliance on regulatory guidance, given that this new Supreme Court ruling has been cited by parties challenging the Retirement Security Regulation (discussed above) as well as a case involving environmental, social and governance (ESG) factors for investments in a 401(k) plan. While it's too early to tell, the long-term outcome of this case may likely include:

- Increased litigation over guidance from the agencies
- Congressional activity that requires more bipartisan support in drafting very clear legislation that doesn't require as much interpretation

Forfeiture reallocation: Similar suits, different results

What happened? To date there have been about a dozen suits filed against a series of national employers in California's federal court. These suits allege that plan fiduciaries breached their fiduciary duties by offsetting employer contributions with forfeited balances rather than using them to reduce fees borne by participant accounts. The argument is that this action was not in the best interests of participants, as required by ERISA.

What's the latest? The suits have begun working their way through the courts, and while the premise of each case appears to be quite similar, the results have been varied:

- The first case was sent to arbitration (Tetra Tech).
- In the second case, the fiduciary defendants won their motion to dismiss without going to trial (HP).
- In the third case, the fiduciaries' motion to dismiss the suit was rejected (Qualcomm).

New plaintiffs have initiated similar suits, alongside more traditional charges like excessive fees.

What's the fiduciary consideration? Fiduciaries should note that if they use forfeitures to offset employer contributions, they should make sure the plan document includes language permitting that action. As an additional protection, fiduciaries may want to replace plan document language that provides discretion in applying forfeitures with language that simply directs how they will be used.

Managed account or expensive target-date fund?

What happened? A recent suit alleges a fiduciary breach by plan fiduciaries of the Bechtel Trust and Thrift Plan. The claim is that the fiduciaries defaulted participants into a managed account option that the participant-plaintiff claims was nothing more than an expensive target-date fund.

What's the latest? While not yet reviewed by a judge, the suit claims that there was no gathering of any personal information about the participants' demographic or financial background, nor did she "receive any in-person financial planning advice as part of her enrollment in the managed account program." The suit alleges that without additional personalization, managed accounts are essentially expensive target-date funds, focused solely on age.

What's the fiduciary consideration? Target-date funds purport to deliver an age-appropriate asset allocation (known as a glide path) based on a single demographic point: age. Specifically, the glide path is based on an individual's projected retirement age. Managed accounts are typically positioned as providing a more personalized asset allocation, based on a variety of factors. In view of ERISA's requirement that fees and services provided be reasonable and solely in the best interests of participants, fiduciaries should be aware of the cost and service differences between managed accounts and target-date funds when considering which is appropriate for a particular plan.

The best defense is a prudent process

What happened? Several recent court decisions confirm that evidence of a prudent process in reviewing plan design and investment options may be a successful defense in suits alleging a breach of fiduciary duty.

What's the latest? The most recent case involved the \$6.5 billion Humana Inc. 401(k). The judge in this case found evidence of prudent process involving both requests for proposals (RPFs) and annual benchmarking was enough to fend off excessive fee allegations — even though the fiduciary defendants admitted that they did not "seek to continually negotiate the lowest possible recordkeeping fee." The judge also found that attempted fee comparisons with plans of a similar size alone, without detail as to the range of services provided for those fees, were insufficient to establish a basis for the allegation of excessive fees.

What's the fiduciary consideration? The consistent rulings, across several federal court jurisdictions, continue to support the importance and impact of having in place a documented prudent process for the review of plan options, fees and investment options. As always, fiduciaries should take care to both have prudent processes in place and see that those are properly documented.

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¹ Senate Bill 4917.

² H.R. 2799, Expanding Access to Capital Act of 2023.

³ *Chevron USA Inc. v. NRDC* was a case involving Chevron and the Environmental Protection Agency.

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