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DC lens

Our flagship series of market insights and news updates written exclusively for defined contribution practitioners

Second Quarter 2022

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Source: Schroders. Please read the important information slide in the back of this material.

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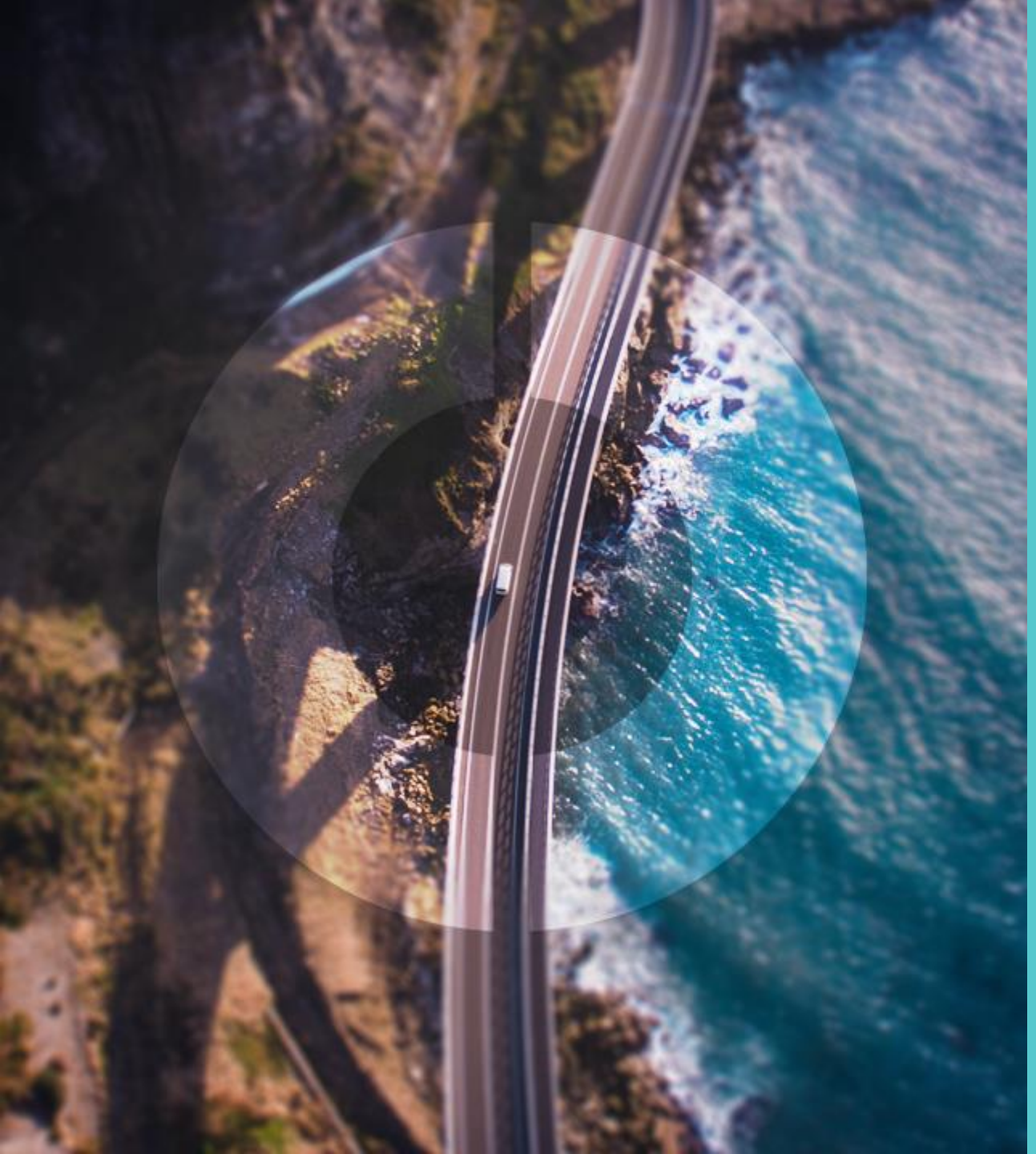

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ESG update

ESG update

Investor interest is rising; Does your plan offer ESG?

ESG investment interest is on the rise

Studies show that investor interest in Environmental, Social & Governance ("ESG") investing is on the rise along with flows into ESG investments.

- An estimated $120 billion was placed into Sustainable investments in 2021 – more than double the $51 billion of 2020.[1]
- An estimated one third of all US assets under professional management contain Sustainable investments.[2]

Benefits of implementing ESG in retirement portfolios

- While many investors are thinking about ESG, few have a firm plan on how to implement ESG in their retirement portfolios.
- Many plans still do not provide ESG options and/or participants are unaware of available options.
- Plan sponsors and plan advisors should work to understand the needs of plan participants, provide menu options to meet those needs, and educate participants on their availability.
- Meeting investors needs could mean increased deferral rates and higher plan balances, which will better equip participants for retirement.
- A recent survey by Schroders of DC plan participants indicated that:[3]
  - Almost 9 out of 10 (87%) want their investments to be aligned with their values.
  - Just 31% knew their plan offered ESG options.
  - When aware of ESG options, 9 out of 10 invested in those options, and 73% estimate they allocate 50% or more of their assets to such choices.
  - 74% said they would or might contribute more when given ESG options, a 5-point increase over the 2021 survey results.

Sources:
1. See, https://www.fastcompany.com/90706552/esg-investing-continued-to-soar-in-2021- the-government-could-boost-it-even-more.
2. See, https://www.cnbc.com/2020/12/21/sustainable-investing-accounts-for-33percent-of-total-us-assets-under-management (citing, the Forum for Sustainable and Responsible Investment's 2020 trends report).
3. See, ESG Report, *2022 US Retirement Survey*, Schroders (2022).

The views shared are those of Schroders and are subject to change.

ESG update (cont'd)

Investor interest is rising; Does your plan offer ESG?

Benefits of implementing ESG in retirement portfolios (cont'd)

In addition to increasing deferral rates, meeting workers' ESG requirements could mean a more loyal and stable workforce, particularly with younger employees.

- A recent EY study revealed that 63% of Gen Zers feel it's "extremely important" to work for an employer that shares their values.[1]
- Almost 70% of professional Gen Zers are likely to switch industries to find jobs that better align with their values compared to 59% of millennials, 45% of Gen Xers and 40% of baby boomers.[2]

Plan sponsors, advisors, and investment fiduciaries should look at ESG alternatives, understand the desires of plans and plan participants, and consider implementing appropriate ESG investments.

Schroders Can Help

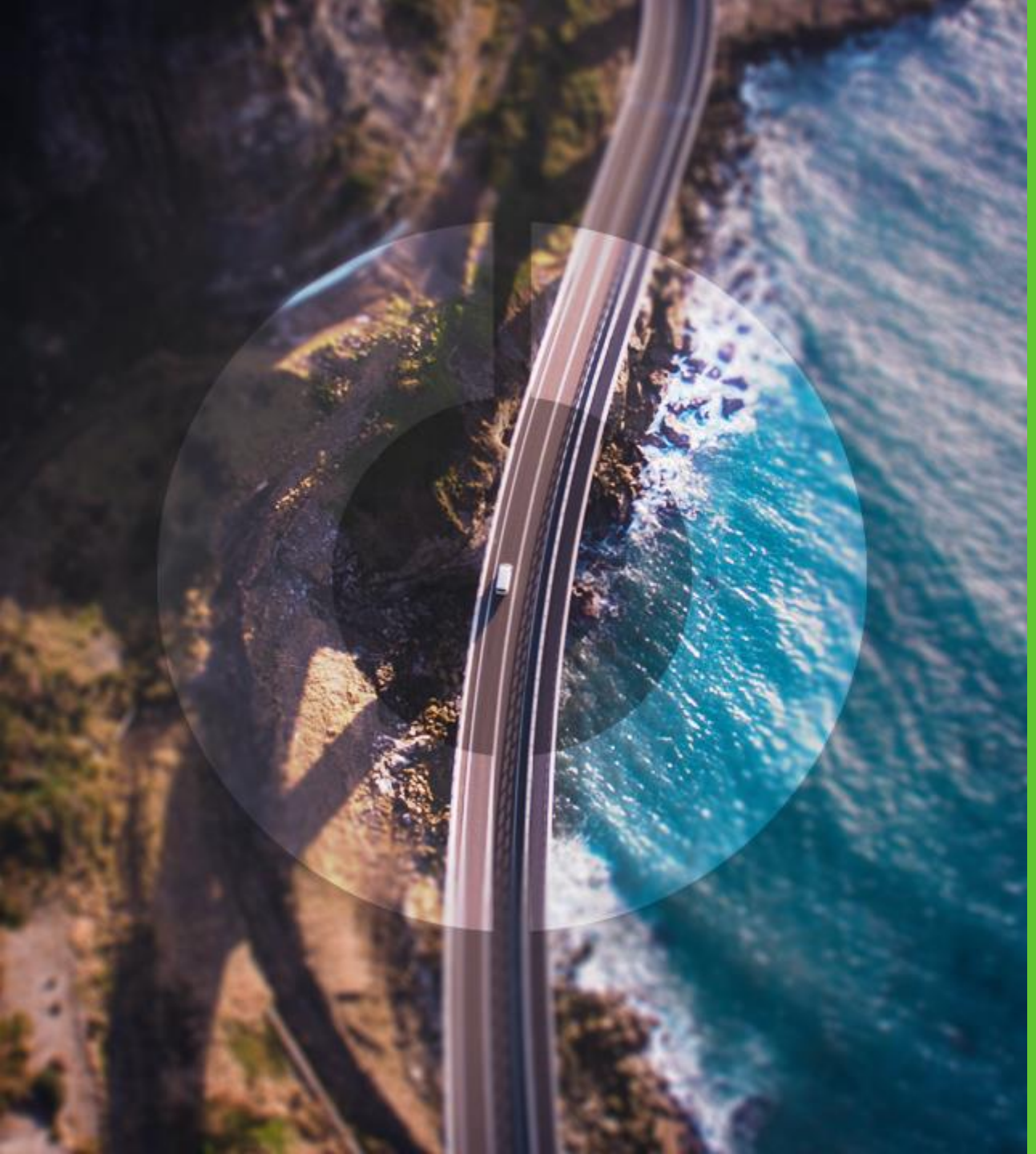
Ten things to consider when implementing ESG in your DC plan

Working with an ESG/investment professional can help set investors on a path to incorporate ESG into their portfolios. But recent studies indicate that plan advisors should be more proactive in discussing ESG with clients.

- One concluded that 43% of advisors wait for clients to bring up ESG before discussing it.[3]
- Another found that just 28% of respondents were at all familiar with ESG, and only 21% were able to identify what the acronym stands for.[4]

Sources:

1. See, Press Release, *EY Releases Gen Z Survey Revealing Businesses Must Rethink Their 'Plan Z'*, EY (November 4, 2021).
2. See, LinkedIn, *What inspires Gen Zers to stay or quit? These clues put loyalty in a new light*, Workforce Confidence Index (November 17, 2021).
3. See, Cerulli, *Climate Change Investing – Part 2* (November 2021).
4. See, Mottola, Valdes, Ganem, Fontes and Lush, *Investors say they can change the world, if they only knew how: Six things to know about ESG and retail investors*, FINRA and NORC (March 2022).



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Q1’22 Litigation summary

Q1’22 Litigation summary

Decisions – SCOTUS reignites cases on hold

SCOTUS lays down the law

In January, the Supreme Court ruled in *Hughes v. Northwestern University*, and its impact was immediately felt.[1]

- SCOTUS unanimously overruled the 7th Circuit, which had dismissed an excessive fee litigation case, and cured a split with the 3rd, 8th and 9th Circuits, which had allowed lawsuits with virtually identical allegations.
- It found that defendant’s inclusion of low-cost options was given to much weight by the lower courts in deciding that they had met their fiduciary obligations.
- SCOTUS sent the case back to the 7th Circuit and ordered it to “reevaluate the allegations as a whole, considering whether petitioners have plausibly alleged a violation of the duty of prudence as articulated in Tibble under applicable pleading standards.” (In *Tibble v. Edison International*, SCOTUS ruled that plan fiduciaries have an ongoing duty to monitor plan investments.)

Many 401(k) excessive fee suits that had been put on hold pending SCOTUS’s clarification in Hughes, immediately moved forward.

Other courts quickly applied SCOTUS’s guidance.

Sources:
1. See, *Hughes v. Northwestern University et al.*, U.S., case number 19-1401 (January 24, 2022).

Q1’22 Litigation summary (cont’d)

Decisions – SCOTUS reignites cases on hold

Follow *Hughes* – a federal judge in Georgia refused to dismiss an excessive fee suit one day after the decision in *Hughes*.[1]

Participants in Columbus Regional’s $183 million retirement plan alleged that defendant breached its fiduciary duties, including failing to select and monitor prudent investment options, choosing funds with “unjustifiably high” management fees, and failing to disclose to participants information needed to make informed investment decisions.

- Columbus Regional had moved to dismiss the claims, “arguing that Plaintiffs are merely second-guessing Columbus Regional’s investment decisions with the benefit of hindsight,” but the judge waited for SCOTUS’s decision before ruling on the motion.
- The judge noted that “Taking the allegations in Plaintiffs’ complaint as true and drawing all reasonable inferences in Plaintiffs’ favor… [plaintiffs] adequately allege that some of Columbus Regional’s investment decisions were imprudent.”

Defendants cited the 7th Circuit’s original decision in *Hughes* to argue that by offering a variety of options, including lower-cost passive ones, the plaintiffs couldn’t establish that the other investment decisions were imprudent.

- Relying on SCOTUS, the judge found that “the fact that Plaintiffs in this action had some lower cost index fund options is not dispositive of whether Columbus Regional satisfied its duty of prudence as a matter of law.”
- The judge reasoned that “the Supreme Court has suggested that a defined contribution plan participant may state a claim for breach of ERISA’s duty of prudence by alleging that the plan fiduciary offered higher priced retail-class mutual funds instead of available identical lower priced institutional-class funds,” and that “the Court is satisfied that Plaintiffs state a plausible claim that continuing to offer underperforming mutual funds with excessive expense ratios despite a consistent history of underperformance would violate ERISA’s duty of prudence.”

Takeaway from *Hughes* – ensure that all plan options are selected, documented and monitored for prudence by plan fiduciaries.

Sources:
1. See, *Goodman v. Columbus Reg’l Healthcare Sys., Inc.*, M.D. Ga., No. 4:21-cv-00015 (2/2/21).

Q1’22 Litigation summary (cont’d)

Decisions – DOL backs SCOTUS

Following SCOTUS’s remand to the 7th Cir., the Department of Labor (“DOL”) submitted a letter to the court asking it to reverse the district court’s decision and send the case go back to the district court for trial.[1]

- The DOL argued that plaintiffs should have the opportunity to prove that Northwestern imprudently managed the plan because plaintiffs laid out a strong case that showed that Northwestern’s recordkeeping fees were higher than they should have been.

- DOL Solicitor Seema Nanda wrote:
  - "In light of the Supreme Court's opinion clarifying the legal standard," the 7th Cir. should "reverse the district court's judgment of dismissal and remand the case for further proceedings."
  - "If plaintiffs here succeed in proving that Northwestern had the opportunity to offer materially identical investments and services at a lower cost, then there is no apparent justification for Northwestern's failure to do so."

Sources:
1. See, Seena Nanda, Request for Reversal and Remand, DOL Letter to 7th Cir. (March 18, 2022).

Q1’22 Litigation summary (cont’d)

Decisions – other new cases

Two out of three ain’t bad

The Northern District of California sided with Intel Corp. in an ERISA lawsuit.[1]

- Plaintiffs took issue with Intel including non-traditional asset classes, such as hedge funds and commodities, in the plan.
- They further alleged that Intel allocated high percentages of assets to those funds against professional asset management standards and for the benefit of Intel Capital Corp.

The Court found for the defendants in all but one of the allegations.

- With regard to the dismissed claims, the court stated that “a complaint cannot simply make a bare allegation that costs are too high, or returns are too low, and an allegation that a fund is mismanaged must be fact-specific, because there is no one-size-fits-all approach to investment.”
- As such, without “a meaningful benchmark, the court cannot evaluate if an allegation of a violation of the duty of prudence is plausible because a plaintiff’s comparison of apples to oranges is not a way to show that one is better or worse than the other.”
- The Court was not convinced that Intel sought to benefit itself via the plan’s private equity investments, as there was no evidence that the “investment committee acted in order to aid Intel Capital in its venture capital investments at the expense of investors.”

The court did allow plaintiffs’ claim that the plan’s committee failed to provide documents upon request in violation of ERISA.

Sources:
1. See, *Anderson v. Intel Corp. Investment Committee*, N.D. CA, Case 5:19-cv-04618-LHK (01/08/22).

Q1’22 Litigation summary (cont’d)

Decisions – other new cases

Second chances – be precise

Plaintiffs’ excessive fee claim against Kimberly Clark Corporation’s $4 billion 401(k) plan was dismissed.[1]

- The judge noted that a plaintiff must plead “enough facts to state a claim to relief that is plausible on its face” and that the plausibility test is met “when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged.”
- The judge reasoned that “while a complaint need not contain detailed factual allegations,” it must set forth “more than labels and conclusions, and a formulaic recitation of the elements of a cause of action will not do.”
- The judge did give plaintiffs the opportunity to rewrite/amend their claims sufficiently to meet the low bar outlined by the court.

We’ll see if the plaintiffs make specific enough allegations to survive another motion to dismiss.

CalSavers gets the Nod

As we previously reported, the Howard Jarvis Taxpayers Association claimed that ERISA preempts the CalSavers Retirement Savings Program, and therefore invalidates it, because ERISA is federal legislation and CalSavers is state law.

- Both the Eastern District of California and the 9th Circuit Court of Appeals rejected the claims.
- SCOTUS denied a petition filed by the Howard Jarvis Taxpayers Association seeking to prevent the $186 million CalSavers Retirement Savings Program from going forward, thereby upholding the 9th Circuit’s decision.[2]

This decision could pave the way for state-run retirement programs.

Sources:
1. See, *Seidner, et al. v. Kimberly-Clark Corp. et al*, case number 3:21-cv-867, N.D. TX (03/23/22).
2. See, News Release, *CalSavers Prevails in Federal Court*, CA State Treasure, PR 22:05 (February 28, 2022).

Forward looking views may not materialize.

Q1’22 Litigation summary (cont’d)

Settlements also impacted by *Hughes*

Unique terms

Plaintiffs sued Costco’s $15 billion retirement plan alleging unreasonably high fees, failure to review plan investments, and keeping funds despite lower cost and/or better performing options being available.[1]

- The crux of the complaint was that Costco included “more costly ‘actively managed funds’ rather than ‘index funds’ that offered equal or better performance at substantially lower cost.”
- In light of that allegation, the case had been put on hold pending SCOTUS’s decision in Hughes.
- Costco agreed to pay some cash but to the bulk of the settlement is in the form of a fee reduction.

SCOTUS’s decision appears to have forced Costco’s hand.

Bottled up the case

Participants in the 10,170 person Coca-Cola Consolidated 401(k) plan took issue with the plan’s choice of the “active” version of the Fidelity Freedom target-date funds.

- Defendants agreed to pay relief of $3,500,000.00, as well as certain non-monetary terms.[2]
- The non-monetary terms have become standard – the plan will issue an RFP for the provision of new recordkeeping services and the investment committee will evaluate its process for replacing investment funds.

This is not the first case brought against the Fidelity Freedom Funds.

Sources:
1. See, *Soulek v. Costco Wholesale Corp. et al.*, E.D. Wis., No. 1:20-cv-00937 (3/14/22).
2. See, *Jones v. Coca-Cola Consolidated, Inc.*, W.D.N.C., No. 3:20-cv-00654 (2/22/22).

Q1’22 Litigation summary (cont’d)

Settlements also impacted by *Hughes*

University schooled

Plaintiffs’ excessive fee claims against Washington University’s 24,000 participant 403b plan were originally dismissed for failing to state a claim.

- The 8th Cir. reinstated the claims, and Defendants again moved to have the claims dismissed.
- Prior to Plaintiffs’ response, the parties announced that they were negotiating a settlement, the terms of which have not yet been disclosed.[1]

In house funds can be costly; require novel solutions

Plaintiffs alleged that T. Rowe Price breached its ERISA fiduciary duty by only offering T. Rowe funds.[2]

- The parties agreed to a $7 million cash payment, the addition of a brokerage window allowing plan participants “for the first time to invest in funds other than T. Rowe Price Funds,” and “a 2019 payment by T. Rowe Price of $6.6 million to many Class members that resulted from this lawsuit.”
- T. Rowe agreed to the back-dated $6.6 million 2019 payment to “mitigate their liability for Plaintiffs’ claims that Defendants violated ERISA’s self-dealing proscriptions by causing Plan assets to be used to pay fees for the use of T. Rowe Price’s own mutual funds.”

Sources:
1. See, *Davis v. Wash. Univ. in St. Louis*, E.D. Mo., No. 4:17-cv-01641 (2/28/22).
2. See, *Feinberg v. T. Rowe Price Grp., Inc.*, D. Md., No. 1:17-cv-00427 (1/7/22).

Q1’22 Litigation summary (cont’d)

New cases – TDFs, TDFs, TDFs

Novel claim

Plaintiff alleged that Hyatt failed to honor his request to increase the amount of his salary that would be deferred into his 401(k) account.[1]

- Hyatt’s policy of requiring tipped employees to be paid all charged tips in cash, rather than through payroll, interfered with “Plaintiff’s and Class members’ ability to defer income under the terms of the Plan.”
- Plaintiff noted that the policy is particularly egregious since Hyatt includes credit card tips when determining taxable earnings.
- The policy is alleged to cause affected employees to have to make after-tax contributions to the Plan to make up for the shortfall, despite the fact that the Plan Document “neither excludes tip income from their compensation nor provides for Hyatt’s mandatory Tips Policy which has the effect of discriminating against employees who receive tips as part of their income when compared to employees who do not receive tipped income.”

The Devil is in the details when following the terms of a plan document.

The “B” is for big… or Boston

An excessive fee suit has been filed against the $1.1 billion Boston Children’s Hospital Corporation Tax-Deferred Annuity Plan, alleging that the plan: failed to fully disclose the expenses and risk of the Plan’s investment options to participants; allowed unreasonable expenses to be charged to participants; and selected, retained, and/or otherwise ratified high-cost and poorly-performing investments.[2]

- Brought by Capozzi, Adler, the suit contains their standard claim that fees “far exceeded the reasonable market rate.”
- And, once again, plaintiffs specifically targeted (pun intended) the Fidelity Freedom Fund target-date suite.

Sources:
1. See, *Baird v. Hyatt Corp.*, C.D. Cal., No. 2:22-cv-01620 (3/10/22).
2. See, *Monteiro v. Children’s Hosp. Corp.*, D. Mass., No. 1:22-cv-10069 (1/18/22).

Q1’22 Litigation summary (cont’d)

New cases – TDFs, TDFs, TDFs

Untested TDFs

The law firm Schlichter Bogard & Denton has been involved in multiple decisions and settlements involving flexPATH Index target date funds.

Schlichter brought a new suit against the $741 million, 15,686 participant Molin Healthcare plan alleging excessive fees and that the plan invested in flexPATH’s “untested target date funds, which replaced established and well-performing target date funds used by participants to meet their retirement needs.”[1]

- Plaintiffs alleged that the flexPATH funds are only a few years old, that their target date fund management style has “never been used in any target date fund solution offered in the marketplace,” that “the novel and untested target date fund management style combined index or passive management strategies with multiple glidepaths,” and that the funds consistently underperform peers.
- Plaintiffs found it particularly egregious that flexPATH utilized a “fund of funds” structure, which resulted in fees that are 18 bps higher than necessary.
- Plaintiffs also allege that selecting funds without a minimum five-year performance was not prudent, particularly in light of the established and well-performing target date funds that flexPATH replaced.
- the fact that the Plan Document “neither excludes tip income from their compensation nor provides for Hyatt’s mandatory Tips Policy which has the effect of discriminating against employees who receive tips as part of their income when compared to employees who do not receive tipped income.”

Target date focus

Plaintiffs brought suit against the 15,062 participant, $3.45 billion Fluor Corp. retirement plan, alleging that the defendants: “failed to fully disclose the expenses and risk of the Plan’s investment options to participants, allowed unreasonable expenses to be charged to participants; and selected, retained, and/or otherwise ratified high-cost and poorly-performing investments, instead of offering more prudent alternative investments.”[2]

- Plaintiffs specifically criticized the suite of nine custom target-date funds, managed by BlackRock, as being “significantly worse performing than many of the mutual fund alternatives offered by TDF providers.”
- Plaintiffs further alleged that a reasonable examination of the TDF funds would have resulted in their removal, and such failure to remove was particularly egregious given the funds were designated as the plan’s qualified default investment alternative (QDIA).

Sources:
1. See, *Mills v. Molina Healthcare, Inc.*, C.D. Cal., No. 2:22-cv-01813 (3/18/22).
2. See, *Locascio v. Fluor Corp.*, N.D. Tex., No. 3:22-cv-00154 (1/24/22).

Q1’22 Litigation summary (cont’d)

New cases – TDFs, TDFs, TDFs

Another target date fund challenge

Plaintiffs claim that the Milliman, Inc. retirement plan maintained a series of TDFs with a short, and allegedly poor, track record from Unified Trust.[1]

- As is typical with such cases, plaintiffs allege that at the time the funds were selected they were “brand new, had no investment track record, and were untested.”
- The complaint further alleges that over 9 years the funds “significantly underperformed meaningful benchmarks, which include both benchmark indexes (including the index preferred by the Unified Funds’ investment manager itself) and comparable target risk funds.”
- Specifically, it is alleged that over a five-year period, “the three Unified Funds have performed worse than 70% to 90% of funds within their recognized peer universe, according to Morningstar … [yet] Defendants did not remove any of the Unified Funds from the Plan.”

Plaintiffs claim a whopping “$85 million in losses.”

Integral to all these cases is the claim that defendants did not maintain a prudent process to monitor investment performance and identify imprudent investment options.

That should be an easy defensive measure for plans to implement.

Sources:
1. See, *Mattson v. Milliman, Inc.*, W.D. Wash., No. 2:22-cv-00037 (1/13/22).

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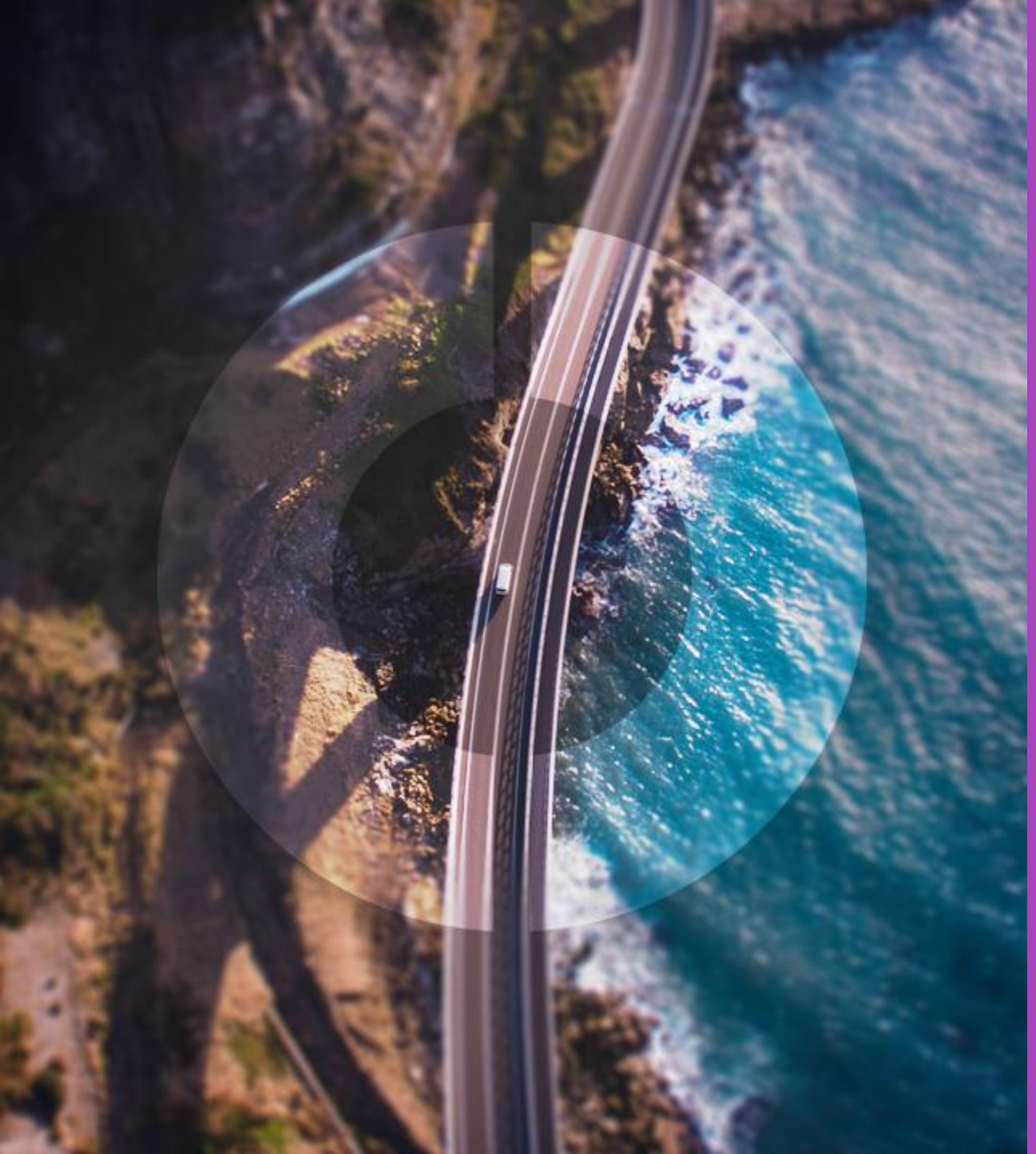

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Administrative update

SECURE Act 2.0

The US is facing a looming retirement crisis, which is why on March 29th the Securing a Strong Retirement Act of 2022, a/k/a SECURE Act 2.0, was passed by the House by an overwhelming 414-5 margin.[1]

- The intent of the Bill is to expand 401(k) access for more Americans.
- Such overwhelming bipartisan support is rare, which underscores the importance that Congress is placing on making retirement plans more accessible.
- The bill is now awaiting Senate action.
- When passed, the Senate's SECURE 2.0 Bill will greatly expand 401(k) access.

Sources:
1. See,H.R.2954, *Securing a Strong Retirement Act of 2022*, 117th Congress, Referred in Senate (03/30/2022).

SECURE Act 2.0 (cont'd)

Key SECURE Act 2.0 provisions[1]

- Increase the small employer start-up credit from 50% to cover 100% of the cost to implement a 401(k) plan for the first three years;
- Create a new credit to encourage small employers to make direct contributions to their 401(k) plan for their employees, offsetting up to $1,000 for each participating employee;
- Require 401(k), 403(b) and SIMPLE plans to automatically enroll eligible participants in plans, with the ability for employees to opt out of coverage;
  - The initial auto-enrollment amount is at least 3% but no more than 10%.
  - Plans will auto-escalate each year by 1% until 10% is reached.
  - All current 401(k) and 403(b) plans are grandfathered into the new rule.
  - Exception for small businesses with 10 or fewer employees, new businesses, church plans and governmental plans;
- Give employers more time to adopt beneficial discretionary retirement plan amendments up until the due date of the employer's tax return;
- Broaden the scope of the SECURE Act's pooled employer plan provisions to allow unrelated public education and other non-profit employers to join a single 403(b) plan;
- Permit 403(b) custodial accounts to invest in collective investment trusts (CITs);
- Provide a safe harbor for corrections of employee elective deferral failures;
- Increase the age for beginning required minimum distributions (RMDs) from 72 to 73; and
- Treat student loan payments as elective deferrals for purposes of making contributions.

Sources:
1. See, H.R.2954, *Securing a Strong Retirement Act of 2022*, 117th Congress, Referred in Senate (03/30/2022).

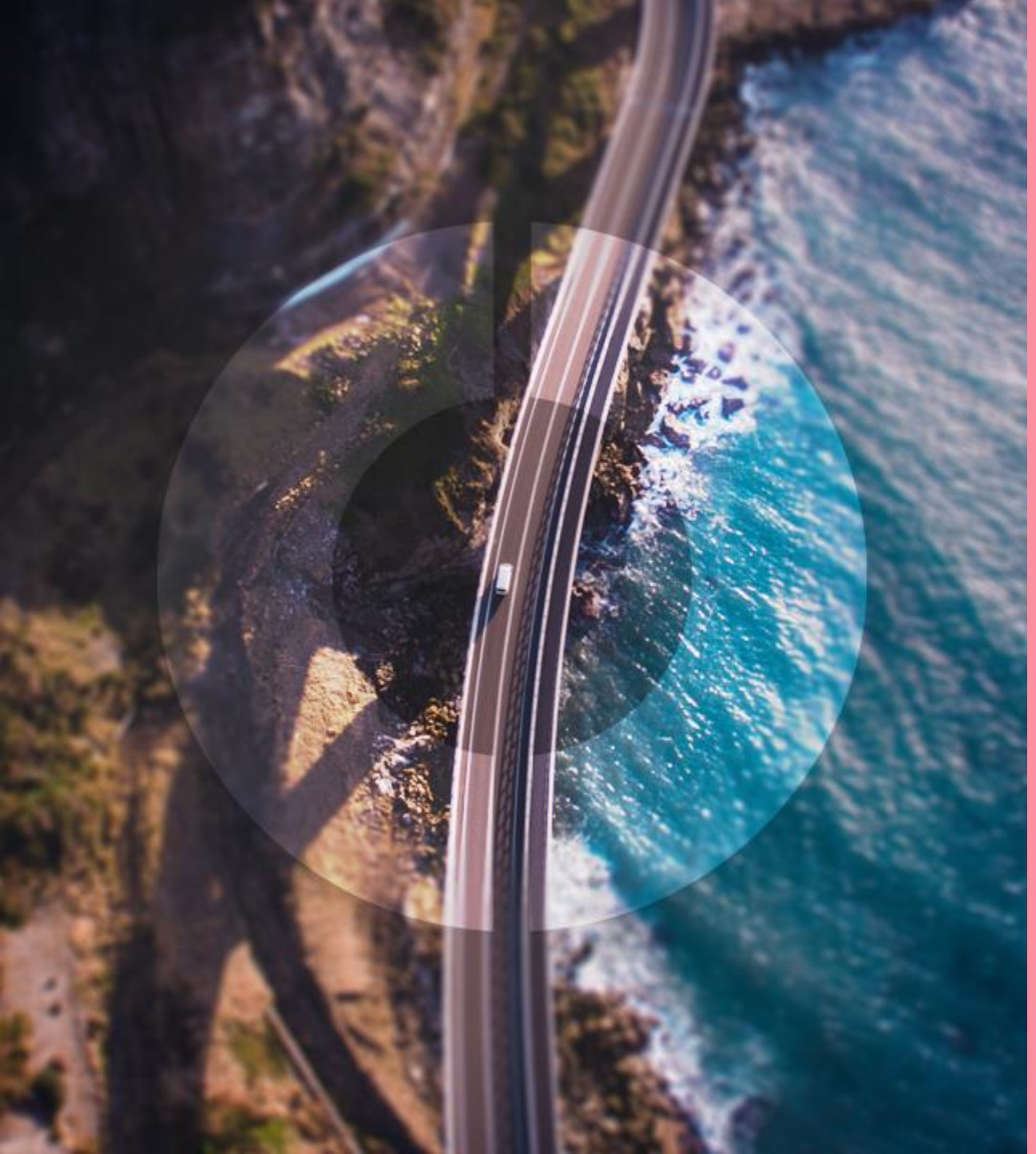
SEC – ESG disclosures for issuers

The Securities and Exchange Commission ("SEC") proposed a rule outlining the climate-related information that securities issuers must disclose about their greenhouse gas emissions and climate risks.[1]

- Issuers would be required to disclose emissions they produce (Scope 1) as well as emissions produced for their consumption (Scope 2).
  - The proposal includes a safe harbor provision for Scope 3 emissions, which are greenhouse gases emitted by vendors, supply chain companies and distributors.
  - Scope 3 emissions must only be disclosed if the issuer determines they are material or if the issuer includes them in a voluntary greenhouse gas reduction program.
- The proposal also requires issuers to disclose how certain climate-related risks could impact the company, including extreme weather, and how their boards and management oversee and govern climate-related risks. If they want, issuers my voluntarily disclose any business opportunities afforded from climate change.
- In an accompanying press release, SEC Chair Gary Gensler emphasized that "investors need reliable information about climate risks to make informed investment decisions" and that the proposed rule will "help issuers more efficiently and effectively disclose these risks and meet investor demand."[2]
- The proposal drew criticism as being a politically motivated overreach, including from inside the SEC.

The proposal now enters the comment phase.

Sources:
1. See, Proposed Rule, *The Enhancement and Standardization of Climate-Related Disclosures for Investors*, SEC (March 21, 2022).
2. See, Press Release, *SEC Proposes Rules to Enhance and Standardize Climate-Related Disclosures for Investors,* SEC, 2022-46 (March 21, 2022).



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Retirement fiduciary advice

Retirement fiduciary advice

Since the founding of the Employee Retirement Income Security Act of 1974 ("ERISA"), who is a fiduciary under ERISA and what constitutes fiduciary advice has evolved.

Background

- A retirement plan fiduciary is a person who is either formally designated by a plan as a "named fiduciary" or is considered one based on the activities they perform.[1]
- The DOL developed a five-part test for determining when someone acts as an investment advice fiduciary, which states that an investment advice fiduciary is someone who provides investment advice for a fee or other direct/indirect compensation with respect to a plan, provided:
  - They render advice as to the value of securities or other property, or makes recommendations as to the advisability of investing in, purchasing or selling securities or other property;
  - They do so on a regular basis;
  - They do so pursuant to a mutual agreement, arrangement or understanding with the plan, plan fiduciary or individual retirement account owner;
  - Their advice will serve as a primary basis for investment decisions with respect to the plan; and
  - Their advice will be individualized based on the particular needs of the plan.[2]

Sources:
1. See, ERISA Section 3(21) (A), 29 CFR § 2510.3-21 (1974).
2. See, 29 C.F.R. §2510.3-21(c)(1) (1975).

Retirement fiduciary advice (cont'd)

Since the founding of the Employee Retirement Income Security Act of 1974 ("ERISA"), who is a fiduciary under ERISA and what constitutes fiduciary advice has evolved.

Background (cont'd)

The 5-Part Test framework remained in place until 2016, when the DOL issued a package of new rules known as the "Fiduciary Rule."[1]

- The 2016 Rule expanded the term fiduciary to cover nearly all financial professionals who provide services to ERISA plans and IRAs.
- The regulation of investment decisions to roll over assets from ERISA plans to IRAs was pivotal in the DOL's decision to issue the 2016 Rule. The DOL believed that under the traditional 5-part test, the requirement that advice be given on a "regular basis to the plan," excluded one-time transactions like IRA rollovers.

In 2018, the 5th Circuit Court of Appeals vacated the 2016 Fiduciary Rule.[2]

- It found that that discarding the "regular basis" provision of the 5-part test was inconsistent with ERISA's "fiduciary" definition, and improperly sought to define as fiduciaries "virtually all financial and insurance professionals who do business with ERISA plans and IRA holders."
- The 5th Circuit's action reinstated the 1975 5-part test.

In December 2020, the DOL adopted "Prohibited Transaction Exemption 2020-02," a class exemption covering fiduciary investment advice to retirement investors, including in the context of rollovers ("PTE").[3]

- The PTE permits financial institutions and investment professionals who provide "fiduciary investment advice" and who meet certain qualifications to "receive otherwise prohibited compensation."
- The PTE applies to recommendations made to retirement plans, participants and IRA owners, including to IRA rollover recommendations, and was termed the Fiduciary Rule.

In April 2021, the DOL issued a set of "Frequently Asked Questions" to provide "guidance" on the five-part test and the Exemption ("FAQ").[4]

Sources:
1. See, DOL, *Conflict of Interest Rule—Retirement Investment Advice*, 81 Fed. Reg. 20946 (Apr. 8, 2016).
2. See, *Chamber of Commerce v. U.S. Dep't of Labor*, 885 F.3d 360, 364 (5th Cir. 2018).
3. See, DOL, Prohibited Transaction Exemption 2020-02, *Improving Investment Advice for Workers & Retirees*, 85 Fed. Reg. 82798, 82862-66 (Dec. 18, 2020).
4. See, DOL, *New Fiduciary Advice Exemption: PTE 2020-02 Improving Investment Advice for Workers & Retirees Frequently Asked Questions* (Apr. 2021).

Retirement fiduciary advice (cont'd)

With the release of PTE 2020-02 and accompanying FAQ, the DOL choose to improve investor protections through tougher guidance regarding conflicts of interest for retirement fiduciaries.

But there have been two suits filed against the Rule.

FAQ Suit

One suit focused on the FAQ and alleges that the DOL attempted to impose new fiduciary obligations with the FAQ as opposed to providing mere guidance.[1]

- The suit alleges that the DOL's FAQ established that a financial professional's first instance of advice to roll over assets from one retirement plan to another can be the act of a fiduciary, "even though the Department's regulations state that a person is not a fiduciary unless he provides advice on a regular basis to the plan."
- The suit claims that the DOL's position wrongly eliminates the "regular basis" prong of the five-part test, and that "…by eliminating this prong, the Fiduciary Rule had improperly sought to define as fiduciaries virtually all financial and insurance professionals who do business with ERISA plans and IRA holders."
- The suit maintains that the DOL is prohibited "from regulating in this manner. If the Department wanted to change its rules, it needed to do so through the required notice-and-comment process – not through guidance documents."

Sources:
1. See, *Am. Sec. Ass'n v. U.S. Dep't of Labor*, M.D. Fla., No. 8:22-cv-00330 (2/9/22).

Retirement fiduciary advice (cont'd)

With the release of PTE 2020-02 and accompanying FAQ, the DOL choose to improve investor protections through tougher guidance regarding conflicts of interest for retirement fiduciaries.

But there have been two suits filed against the Rule.

Preamble Suit

The second suit was brought by a consumer group representing advisory firms that sell annuities and make rollover recommendations filed a suit in Texas alleging that the DOL's new interpretation makes them investment advice fiduciaries under ERISA.[1]

- The suit claims that DOL attempted to "resurrect and repackage the substance of its vacated Fiduciary Rule through adoption of a new Prohibited Transaction Exemption, No. 2020-02" despite having its original fiduciary rue vacated by the 5th Circuit.
- The suit notes that while the DOL claims to have left the 1975 five-part test for investment advice in place; however, "the text of the Revised Exemption…carries forward the core problem the Fifth Circuit identified in vacating the Fiduciary Rule the first time: DOL's impermissible effort to rewrite and expand the definition of a fiduciary under ERISA and the Code."

Conclusion

Both lawsuits allege that the DOL exceeded its authority under the Administrative Procedure Act ("APA").

- It shows the difficulty of expanding the definition of fiduciary without legislation, particularly to new groups of people.
- Such difficulties even exist at the state level. For example, Massachusetts's fiduciary rule, which imposed a heightened fiduciary conduct standard on broker dealers and agents, was recently invalidated.[2]

We await the decisions and their impact on the DOL's position.

Sources:
1. See, *Federation of Americans for Consumer Choice, Inc. v. U.S. Dep't of Labor,* N.D. Tex., No. 3:22-cv-00243 (2/2/22).
2. See, *Robinhood Financial v. Galvin*, MA, No. 2184CV00884 (March 30, 2022).

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Crypto in 401(k) plans

Crypto in 401(k) plans

Is there a place for cryptocurrencies (“crypto”) in 401(k) plans?

Crypto is a fast-growing asset class

- Crypto surpassed $3 trillion in market capitalization in 2021, which was up from just $14 billion five years earlier.[1]
- To date, approximately 16% of adult Americans (40 million people) have invested in, traded, or used crypto.[2]
- Interest has grown so fast that the White House recently issued an executive order directing the federal government to draft a national policy to regulate digital assets.[2]

The DOL’s view

The Department of Labor (“DOL”) has taken a negative view of crypto in 401(k) plans. It recently issued a compliance bulletin highlighting "serious concerns" over cryptocurrencies in retirement plans, including:

- Their "highly speculative" nature;
- The inherent difficulty of evaluating their return potential and risks;
- The unique risks associated with their custody and recordkeeping; and
- The still-evolving regulatory environment.[3]

While the DOL did not say that crypto investments are incompatible with ERISA, it stated that it “has serious concerns about the prudence of a fiduciary's decision to expose a 401(k) plan's participants to direct investments in cryptocurrencies, or other products whose value is tied to cryptocurrencies."

"These investments present significant risks and challenges to participants' retirement accounts, including significant risks of fraud, theft and loss."

Sources:

1. See, Fact Sheet, *President Biden to Sign Executive Order on Ensuring Responsible Development of Digital Assets*, www.whitehouse.gov (March 9, 2022).
2. See, Briefing Room, *Executive Order on Ensuring Responsible Development of Digital Assets*, www.whitehouse.gov (March 9, 2022).
3. See, *401(k) Plan Investments in "Cryptocurrencies"*, Compliance Assistance Release No. 2022-01, U.S. Department of Labor, Employee Benefits Security Administration (March 10, 2022).

Crypto in 401(k) plans (cont'd)

Is there a place for cryptocurrencies ("crypto") in 401(k) plans?

Industry response to DOL

The DOL's negative view of crypto does not seem to be stopping the interest.

Fidelity, the largest US provider of retirement plans, announced that it will allow participants to allocate up to 20% of their 401(k) account balances into Bitcoin.[1]

- Plan sponsors need to understand that if they provide crypto in their plans, they will open themselves and their plans to DOL scrutiny.
- As the Supreme Court recently explained, "even in a defined-contribution plan where participants choose their investments, plan fiduciaries are required to conduct their own independent evaluation to determine which investments may be prudently included in the plan's menu of options."[2]
- In a response to an inquiry on its guidance from Senator Tuberville, the DOL outlined its intention to conduct an investigative program aimed at plans that offer participant investments in cryptocurrencies and related products, and that plan fiduciaries who select such funds or allow them through brokerage windows "should expect to be questioned about how they squared their actions with their duties of prudence and loyalty."

Sources:
1. See, *Fidelity's New 401(k) Offering Will Invest in Bitcoin*, New York Times (4/26/22).
2. See, *Hughes v. Northwestern University*, 142 S.Ct. 737, 742 (2022).
3. See, EBSA, *Response to Senator to Tommy Tuberville,* DOL (April 20, 2022).

Crypto in 401(k) plans (cont'd)

Is there a place for cryptocurrencies ("crypto") in 401(k) plans?

Potential impact of DOL guidance

The DOL's guidance on crypto in retirement plans could impact a recent settlement that T. Rowe Price entered regarding allegations of 401(k) self-dealing.

- T. Rowe recently reached a tentative $13.6 million settlement in a class action suit alleging that the firm breached its fiduciary duties by putting only proprietary funds in its plan.[1]
- In addition to the payment, T. Rowe agreed to add a brokerage window to the plan, which plaintiffs viewed as "the most valuable feature of the settlement" as it would allow investments in funds other than T. Rowe funds.
- The DOL guidance "may bear on the court's assessment of the reasonableness" of the settlement terms because it could give T. Rowe grounds for denying plan participants access to a brokerage window, as the settlement agreement lets T. Rowe close the window in the event of any regulatory change that "makes such monitoring or reporting materially more burdensome or costly than it is today," which requiring oversight of individual investment options might do.[2]

Sources:
1. See, *Feinberg et al. v. T. Rowe Price Group, Inc. et al.*, D. Md., Case 1:17-cv-00427-JKB Document 234-1 (1/07/22.
2. See, *Feinberg et al. v. T. Rowe Price Group, Inc. et al.*, D. Md., Case 1:17-cv-00427-JKB Document 246 (Filed 04/25/22).

Crypto in 401(k) plans (cont'd)

Is there a place for cryptocurrencies ("crypto") in 401(k) plans?

Why invest in crypto

- Some proponents argue that crypto can raise expected returns with minimal risk.
- Others argue that crypto is an inflation hedge and a portfolio diversifier that has low correlation to traditional asset classes, including physical commodities.

Both of those premises are proving to be false. Crypto is more correlated to traditional assets than originally believed and, as such, is not serving as an inflation hedge.[1]

- On the plus side, the volatility of crypto could generate a lot of unrealized capital gains and losses, so investing through a 401(k) could provide tax benefits.

Conclusion

Whether cryptocurrencies belong in a person's investment account depends on their risk tolerance, ability to absorb volatility and losses, and knowledge of the digital assets industry.

- Fiduciaries should consider that as well as the higher perceived risks of such investments when considering their inclusion in a plan.
- If a crypto investment is chosen, be prepared for enhanced DOL scrutiny.

Sources:

1. See, Iyer, *Cryptic Connections: Spillovers between Crypto and Equity Markets*, International Monetary Fund (January 11, 2022) (the correlation between crypto assets and major stock indices have been steadily rising).

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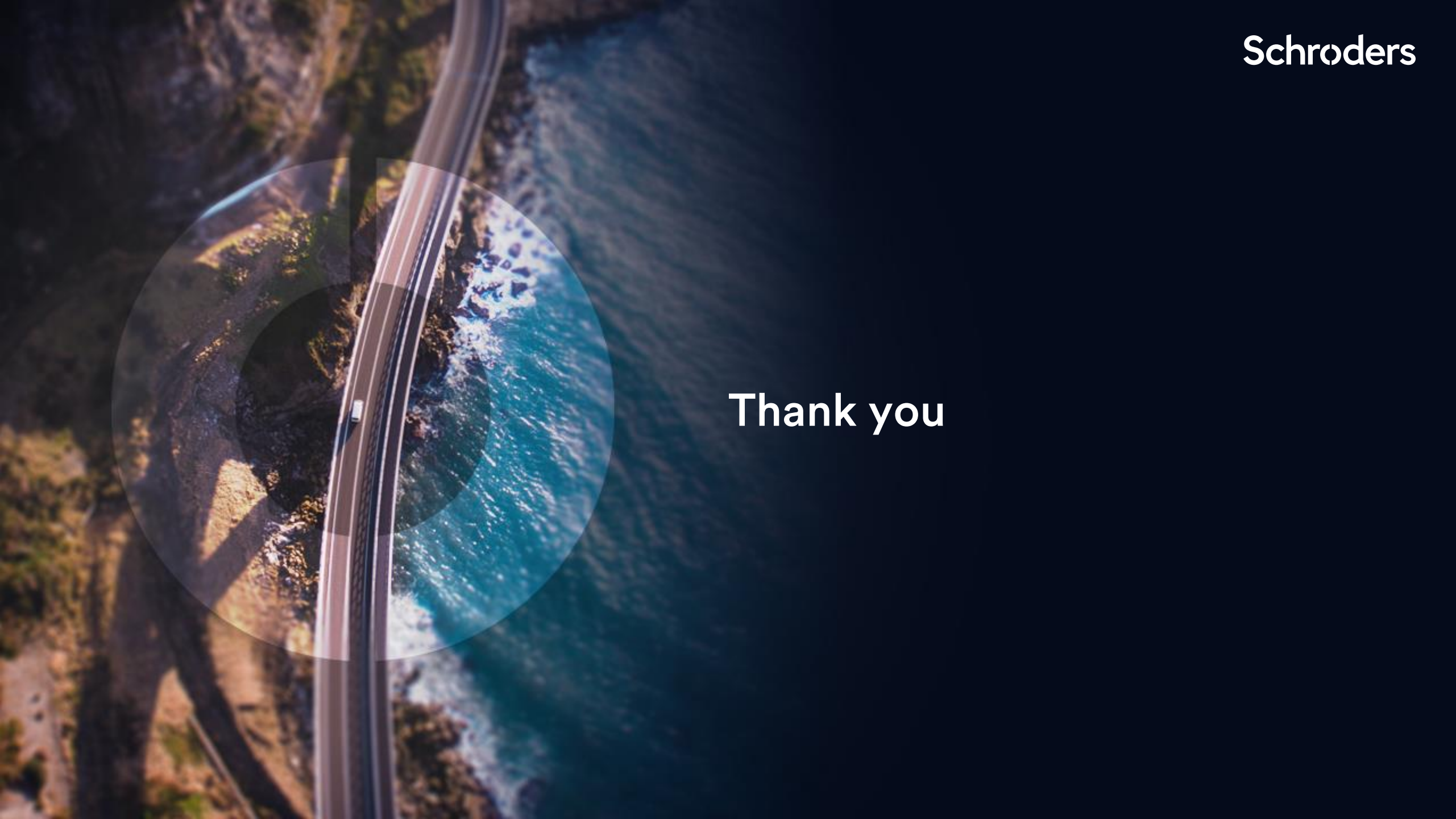

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