
ERISA Fiduciary Rules – An Update on Current Issues and Considerations and Best Practices for Investment Decisions

Presentation for:
Employee Benefits Academy
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Presentation by:
Scott Austin, Partner, Hunton Andrews Kurth
Heath Miller, Co-Founder, Access
Retirement Solutions

- 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

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Partner

Email: saustin@HuntonAK.com

Phone: 214-979-3002

1445 Ross Avenue, Suite 3700
Dallas, TX 75202

600 Peachtree Street, NE
Atlanta, GA 30308

Scott works on all legal aspects of executive compensation and employee benefits, as well as ERISA litigation matters. His practice includes working with businesses to put in place and maintain executive employment agreements and deferred compensation arrangements, qualified retirement plans and health and welfare plans.

He helps lead the firm's Health Care Reform initiative. Scott regularly advises clients on issues involving deferred compensation (including Internal Revenue Code Sections 409A, 162(m) and 280G). He has also worked with a number of companies in designing and implementing cash balance plans and other qualified retirement plans, including 401(k) plans.

Scott works closely with the fiduciary administrative committees of clients' benefit plans and helps them through the murky waters of ERISA's fiduciary requirements. He also advises on the employee benefit aspects of corporate transactions and financings.



Co-Founder

Email: hmillier@acessretirementsolutions.com

Phone: 888-388-8627

Cell: 214.552.5064



Heath is an employee benefits attorney with more than 24 years of experience with defined contribution 401(k) retirement plans.

After receiving his LL.M. in taxation and a certificate in employee benefits from Georgetown University Law Center, Heath joined the Dallas office of Haynes & Boone as an associate before transferring to Baker Botts. Ultimately, Heath ended his private practice career at Morgan Lewis where he was a partner when he joined Shepherd Kaplan, a registered investment advisory firm.

Following the passage of the SECURE Act in December 2019, and the creation of Pooled Employer Plans (PEPs), Heath and his long-time colleague, Michael Halloran, recognized the potential for transformation that PEPs offered and established Access Retirement Solutions (Access). Unlike other service providers, or even other PEPs, Access focuses solely on delivering affordable, best-in-class retirement plan solutions by eliminating high fees, hidden costs, legal risks, administrative headaches and most importantly, conflicts of interests.

Upcoming 2022 Webinars

- **Upcoming 2022 webinars:**
 - **July 28:** Phased Retirement and Similar Employment Considerations
 - **September 22:** Cafeteria Plan Non-Discrimination Testing
 - **November 17:** End of Year Benefits “To-Do” List
 - Sign up here: [Employee Benefits Academy Webinar Series - Subscribe](#)

- Current Issues
 - Brokerage Window Considerations and Cryptocurrencies
 - Investments in ESG Funds
 - Cybersecurity
 - Excessive Fee Litigation Update

ERISA Fiduciary Considerations

Brokerage Window Considerations

- Brokerage Window Considerations
 - Duty to Monitor Funds Offered Through a Brokerage Window
 - Recent litigation has raised the issue of whether a plan fiduciary has a fiduciary duty to oversee and monitor the funds and other investment options offered through a brokerage window
 - To date, the courts have not imposed such a duty, however, on March 10, 2022, the DOL issued Compliance Assistance Release No. 2022-01 (dealing with fiduciary considerations of offering "cryptocurrencies" as investment options), in which it indicated that there could be fiduciary implications of allowing such investments through brokerage windows. This is the first indication that the DOL may view ERISA's fiduciary duties as extending to brokerage windows
 - To minimize risk, plan communications should disclose the risks and costs of investing through the brokerage window, including the fact that the BPAC does not monitor the investment alternative available through the brokerage window

ERISA Fiduciary Considerations

Brokerage Window Considerations

- Brokerage Window Considerations
 - Benefit, Right or Feature
 - A brokerage window is a benefit, right or feature under the plan and must, therefore, be offered on a non-discriminatory basis
 - The fees associated with entering the brokerage window should not be so high as to, effectively, prohibit non-highly compensated employees from using the brokerage window

ERISA Fiduciary Considerations

Investments in ESG Funds

- In October, 2020, the Trump Administration DOL issued a final rule that required plan fiduciaries to focus on "pecuniary" factors in selecting investment alternatives, including ESG funds
 - The rule did not preclude the inclusion of ESG funds, but did require plan fiduciaries to select the funds based on economic (rather than social or other) considerations; non-financial considerations could be used as a "tie-breaker" for ESG funds, so long as the pecuniary/economic factors were satisfied
 - During the Fall of 2020, the DOL began aggressively enforcing the rule through audits of plans that include ESG funds

ERISA Fiduciary Considerations

Investments in ESG Funds

- Shortly after the Biden Administration took office, it announced that it would not enforce the Trump Administration rule on ESG funds, stating that there was no real rationale for the rule
- In October, 2021, the Biden Administration's DOL issued proposed rules, which, among other things require fiduciaries to consider the pecuniary impacts of ESG factors (e.g., the economic impact of climate change) in making investment decisions and voting proxies
- If adopted, the proposed regulation will put fiduciaries in a difficult situation
 - Fiduciaries may be accused of not properly reviewing and promoting pecuniary aspects of ESG factors in making investment decisions;
 - But, also may be accused of disguising non-pecuniary factors (e.g., climate control, diversity, governance, etc.) as pecuniary factors

ERISA Fiduciary Considerations

Cybersecurity Considerations

- Cybersecurity threats pose a relatively new and increasing risk to retirement plan administrators
- Although HIPAA regulates the treatment and protection of protected health information (PHI), ERISA does not specifically provide for fiduciary responsibilities relating to personally identifiable information (PII) that are maintained and used in the administration of retirement plans
- Recent DOL guidance clearly demonstrates the DOL's view that protecting retirement plan data from cybersecurity attacks is a fiduciary obligation

ERISA Fiduciary Considerations

Cybersecurity

- Two recent types of cyber security litigation have emerged:
 - Fraudulent Distribution – Claims alleging breach of the duty of prudence (failure to maintain appropriate systems and processes) when a hacker successfully causes a 401(k) plan participant’s account to be distributed to a fraudulent account (*Leventhal v. MandMarblestone* (E.D. PA. 2019); *Bartnett v. Abbott Labs* (N.D. Ill. 2020))
 - Improper use of PII – Claims alleging that PII is a plan asset under ERISA and improper use (e.g., a third party administrator using PII to add additional services to participants) constitutes a fiduciary breach and a prohibited transaction
 - Whether PII constitutes a plan asset has not been settled
 - *Cassell v. Vanderbilt Univ.* (M.D. Tenn. 2018); *Kelly v. Johns Hopkins Univ.* (D.Md. 2019); *Harman v. Shell Oil Co.*, (S.D. Tex. 2020)

ERISA Fiduciary Considerations

Cybersecurity

- In April 2021, the DOL issued guidance for plan sponsors, fiduciaries, recordkeepers and plan participants on best practices for cybersecurity relating to 401(k) plans
 - Tips for sponsors and fiduciaries in selecting and monitoring plan service providers
 - Best practices for plan fiduciaries and recordkeepers
 - Tips for plan participants in accessing their online accounts

ERISA Fiduciary Considerations

Cybersecurity

- Risk mitigation actions include:
 - Develop policies (similar to HIPAA privacy and security policies) to deal with and protect PII
 - Include “best practice” recommendations for participants to safeguard their plan accounts (SPD; special participant communications)
 - Vet vendors’ cybersecurity programs to ensure that best practices are being followed; require third party administrators and other service providers to periodically report on their cybersecurity practices and protocols
 - Include representatives of IT in RFPs and negotiations with vendors
 - Have IT representatives attend Committee meetings from time to time
 - Contractually require service providers to maintain cybersecurity insurance
 - Review and, if necessary, amend service provider agreements to ensure that they deal with cybersecurity issues and provide for safeguards to protect data, and do not contain language limiting the service provider's liability for cybersecurity incidents it causes (some companies have developed a cybersecurity "addendum" to include in service provider agreements)
 - Ensure that cyber liability insurance is in place for the Company

- In the typical excessive fee case, plaintiffs make various standard claims, including claims that the plan fiduciary:
 - Failed to use the least expensive share class available
 - Failed to offer index funds in place of more expensive actively-managed funds
 - Offered too few or too many investment options
 - Offered investment options that underperformed compared to others
 - Paid excessive recordkeeping or other administrative fees compared to alleged “market” fees
 - Paid recordkeeping fees based on a percentage of plan assets rather than a per participant basis
 - Failed to follow an investment advisor’s guidance
 - Improperly used plan assets to pay for plan sponsor or other plan expenses
 - Failed to regularly issue RFPs for recordkeeping and other administrative services

Excessive Fee Litigation Update

- The extent to which these types of allegations are sufficient to allege a viable cause of action and overcome a motion to dismiss, has been the subject of inconsistent and confusing decisions by Federal district and appellate courts

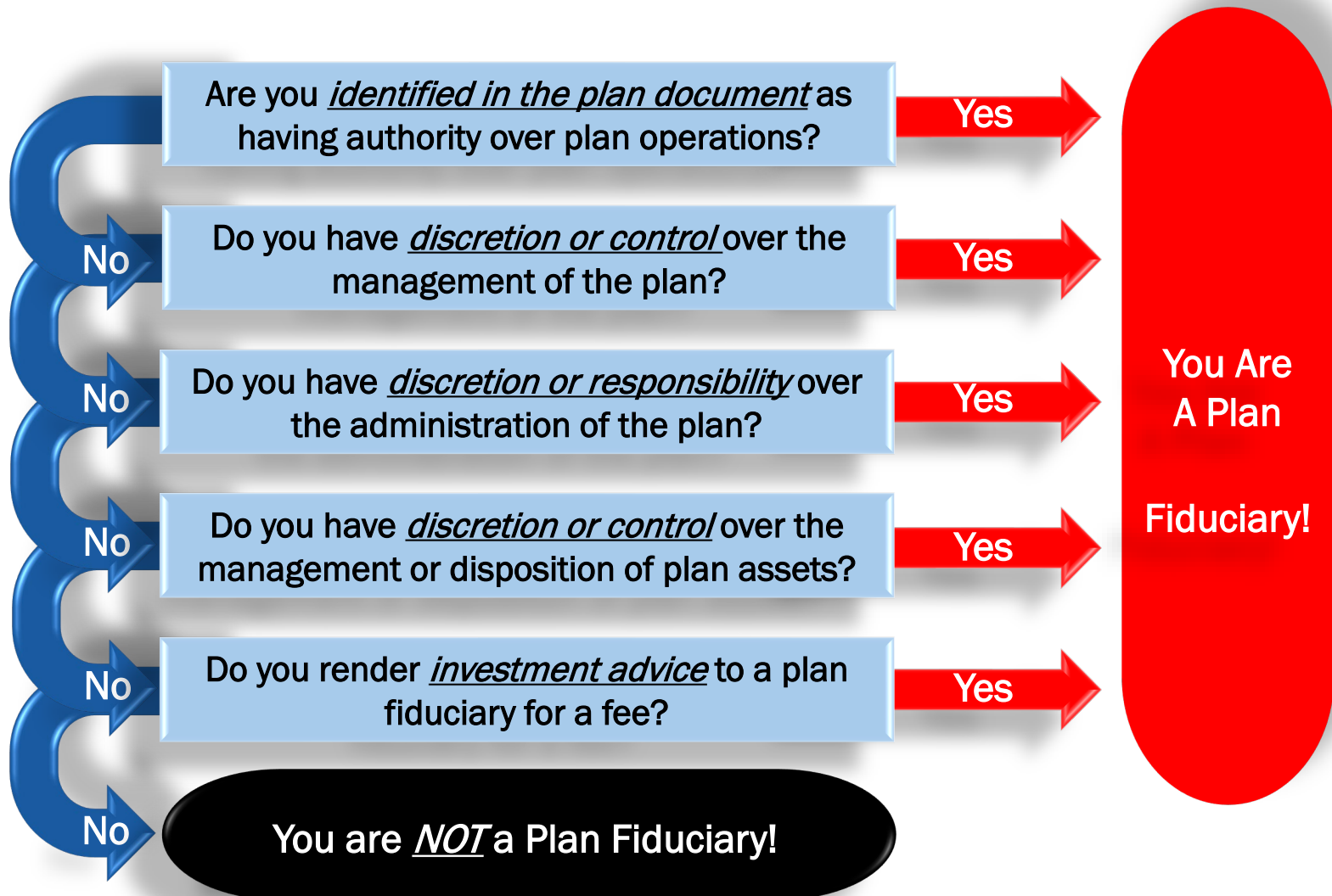
- *Sweda v. University of Pennsylvania*
 - Classic excessive fee allegations
 - District court dismissed
 - Offering a broad mix and range of investment options satisfied fiduciary duty
 - Adopted high standard for plaintiffs to overcome – requiring dismissal of plaintiffs claims if the alleged “actions are at least just as much in line with a wide swath of rationale competitive business strategy in the market as they are with a fiduciary breach”
 - Essentially plaintiffs had to rule out every possible lawful explanation of the fiduciary’s conduct
 - 3rd Circuit reversed the dismissal
 - Found that many allegations of fiduciary breach claims are inherently factual at the pleadings stage
 - It was sufficient that plaintiffs pleaded specific alternative investments that could have been used, and described the conduct of “similarly situated fiduciaries” to show what the fiduciaries should have done
 - Allegations include excessive administrative fees, failure to “comprehensively review” plan management, failure to use the plan’s size to negotiate lower fees, and retaining high-cost investment options when lower-cost, better-performing options were available
 - Supreme Court declined to hear the case
 - University of Pennsylvania settled for \$13 million and agreed to a number of ongoing actions relating to the administration of the plan

- *Hughes v. Northwestern University*
 - Classic excessive fee allegations
 - District court dismissed and 7th Circuit upheld dismissal
 - Offering a variety of investment funds was sufficient (essentially, the types of funds plaintiffs wanted were in the plan, and plaintiffs were not forced to invest in funds with higher internal costs)
 - Allegations that the plan offered too many options was not sufficient to state a viable cause of action
 - Supreme Court reversed:
 - 7th Circuit erred in relying on the plaintiff's ultimate choice among available investment options as excusing *allegedly* imprudent decisions by the fiduciary
 - A fiduciary is required to conduct a regular review of the plan's investments and remove imprudent investments within a reasonable period of time

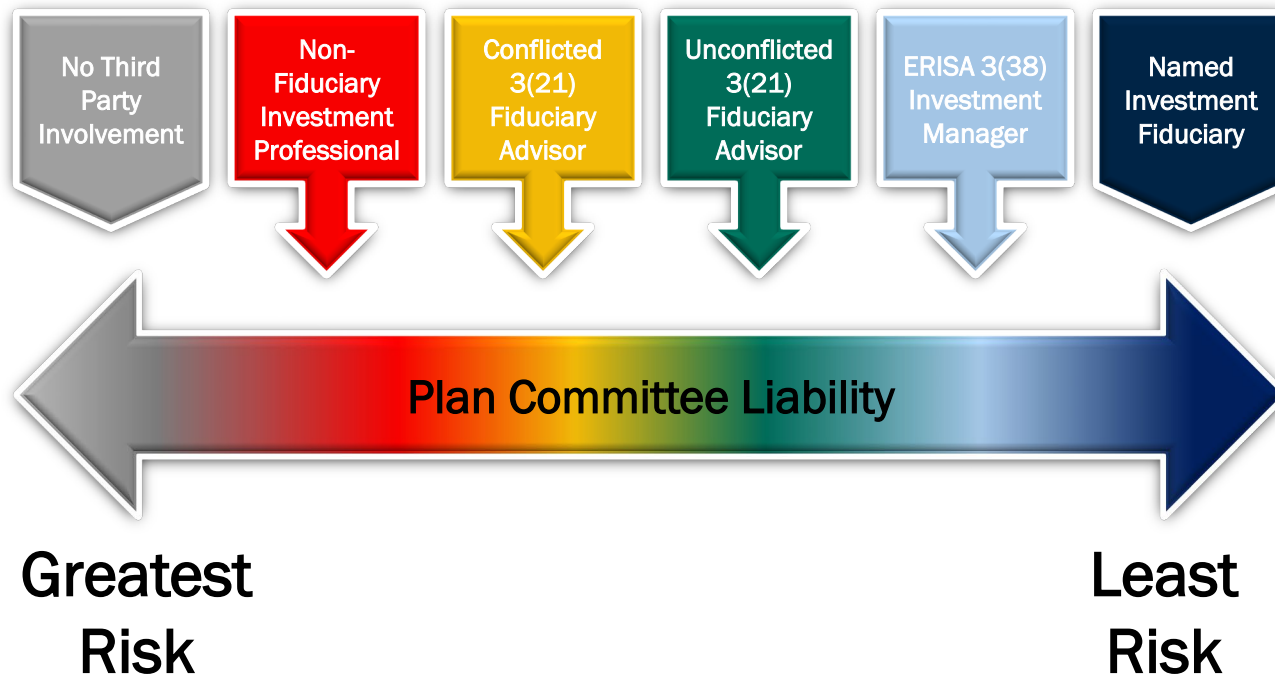
- *Hughes v. Northwestern University* (cont.)
 - The fiduciary's assembly of a diverse lineup of investment funds does not excuse imprudent decisions of maintaining funds which were not prudent
 - The duty of prudence turns on the circumstances prevailing at the time of the fiduciary act and is necessarily "context specific"
 - At times, the circumstances facing an ERISA fiduciary will implicate difficult tradeoffs, and courts must give due regard to the range of reasonable judgments a fiduciary may make based on his or her experience and expertise

- Alternatives for Delegation of Investment Responsibilities and Risk Mitigation Considerations

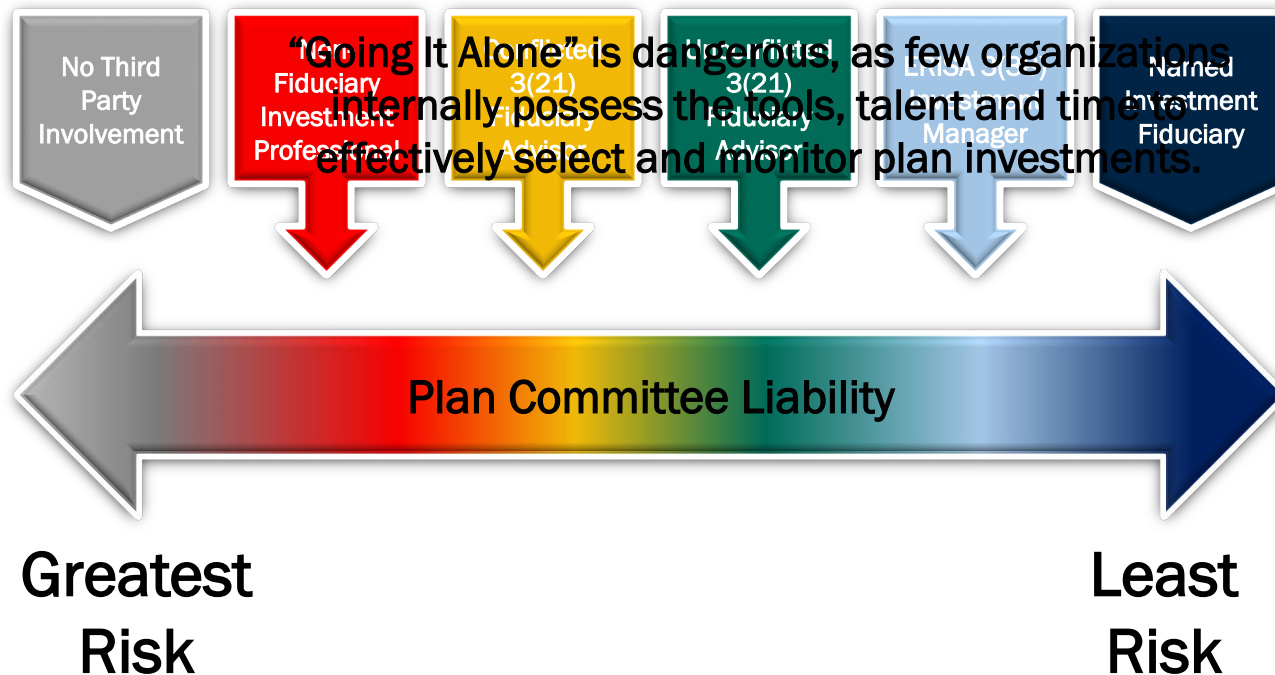
When are You Acting as a Fiduciary?



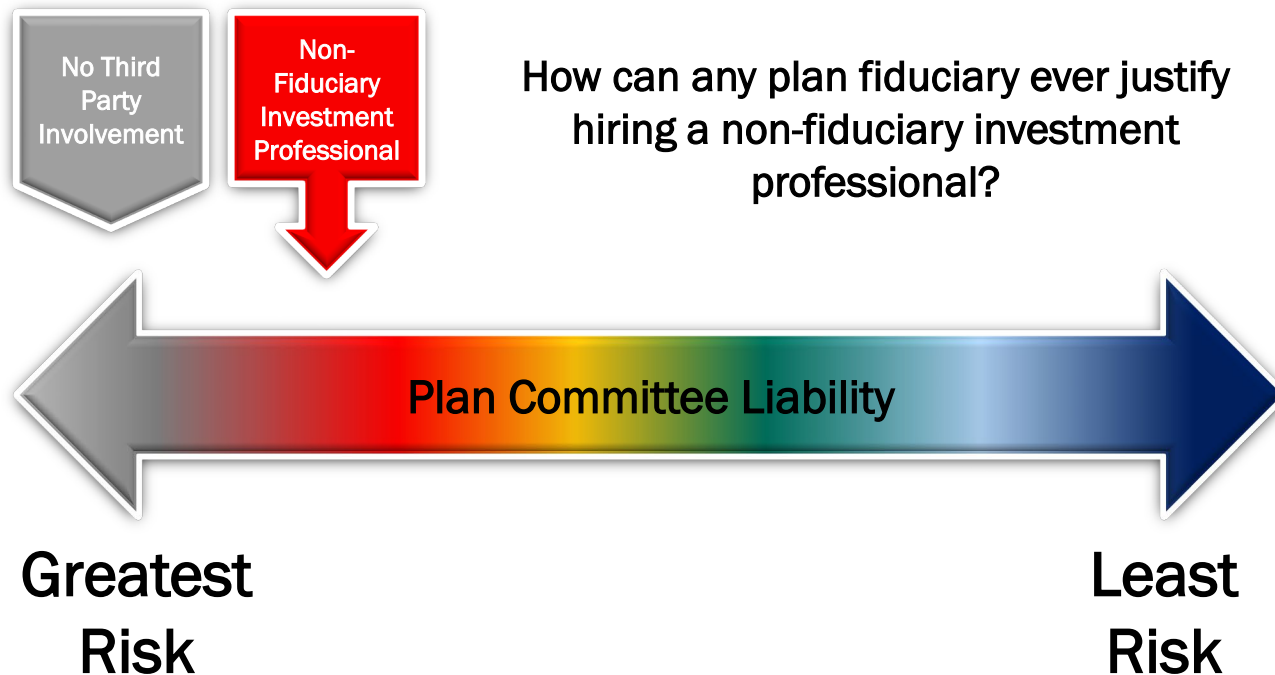
The Investment Advisory Continuum



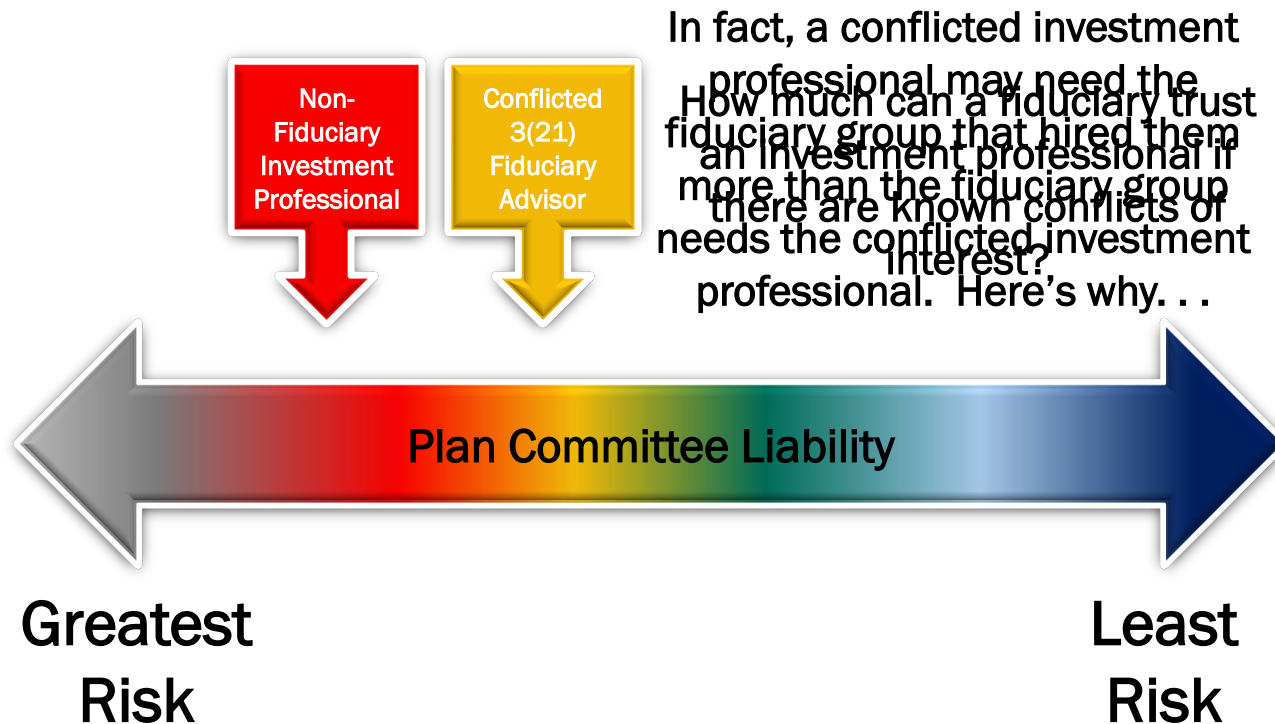
The Investment Advisory Continuum



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The Investment Advisory Continuum



Unless exempted, ERISA prohibits certain transactions



PTE 77-4

Permits the purchase or sale of shares of a mutual fund by a Plan, if the fiduciary recommending the purchase or sale (or an affiliate of the fiduciary) manages the mutual fund, *but only if* ~~an~~ *“independent fiduciary” approves the purchase or sale of the mutual fund.*

PTE 77-4

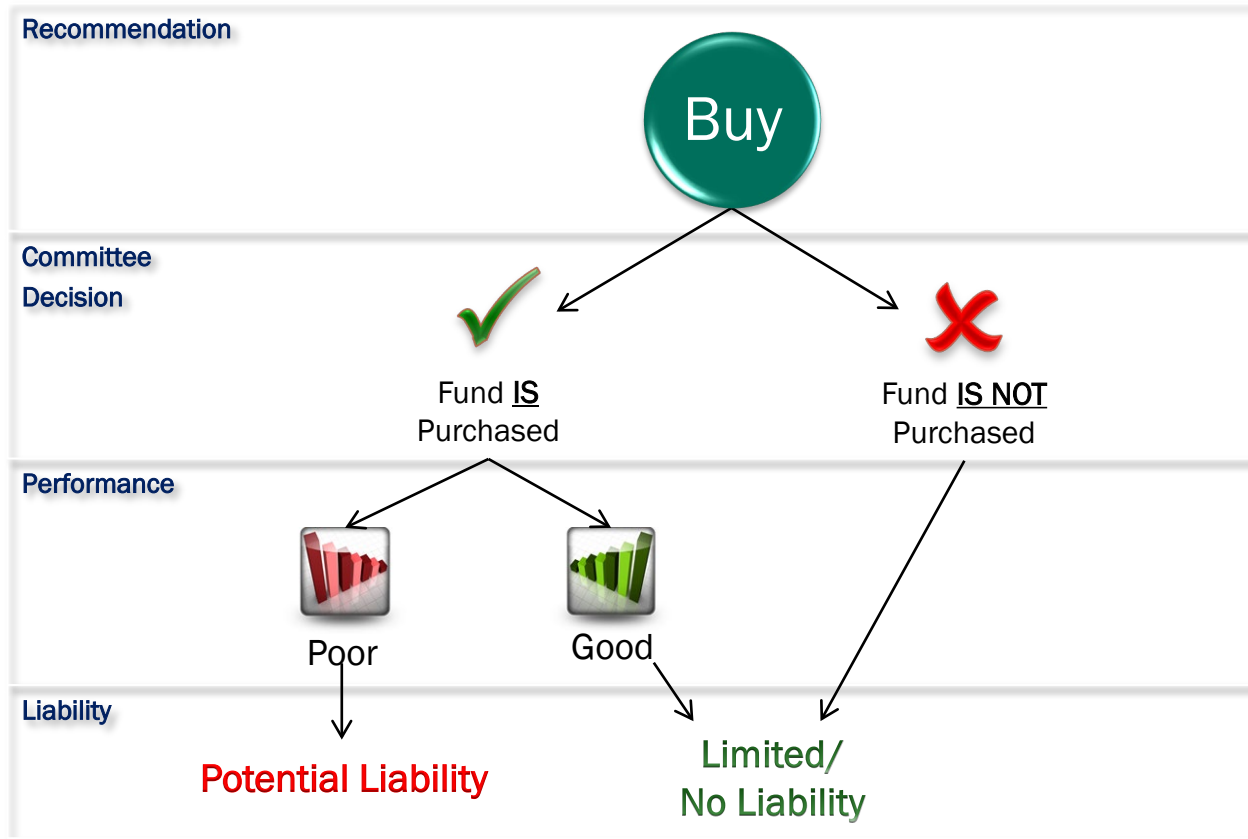
Question: Who do you think the “independent fiduciary” is that typically approves these transactions? This raises an important question . . .

Answer: “Who is providing a service to whom?” That’s right. It’s typically the Plan’s Committee.

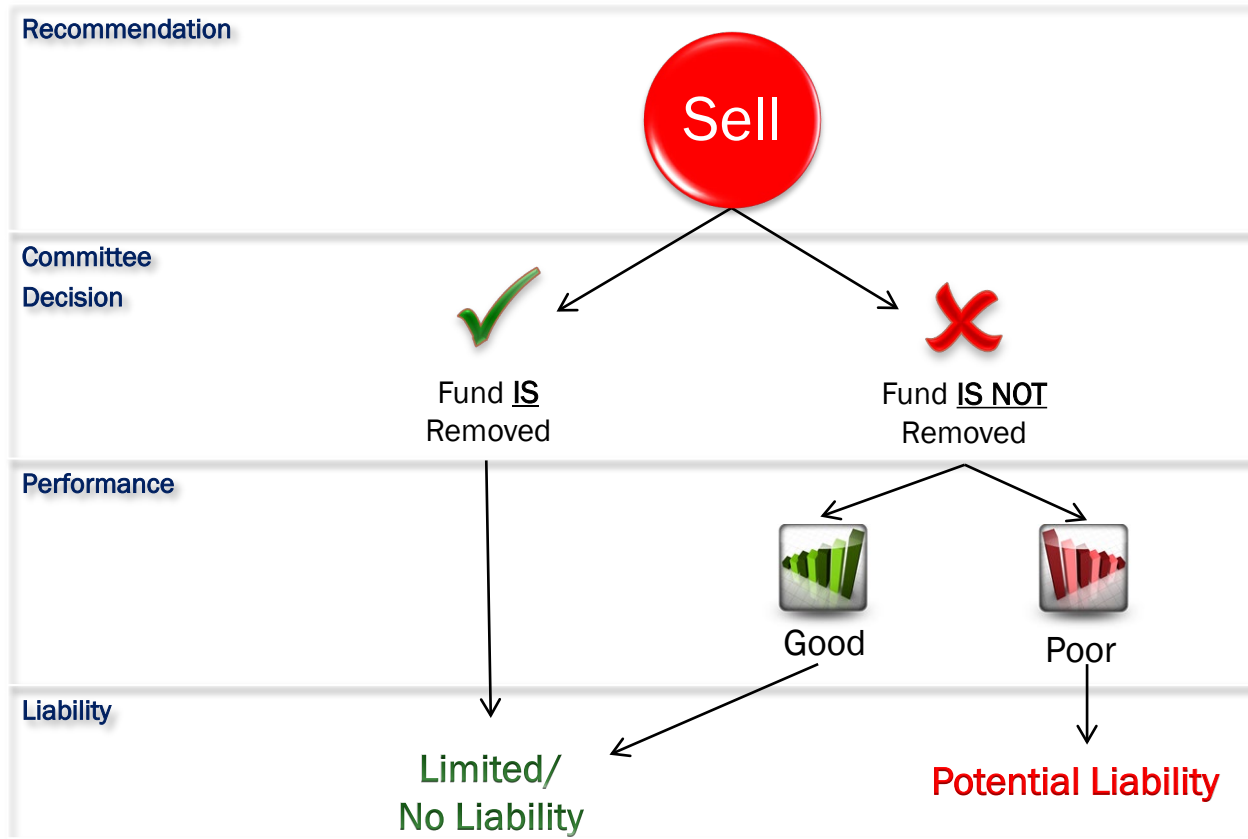
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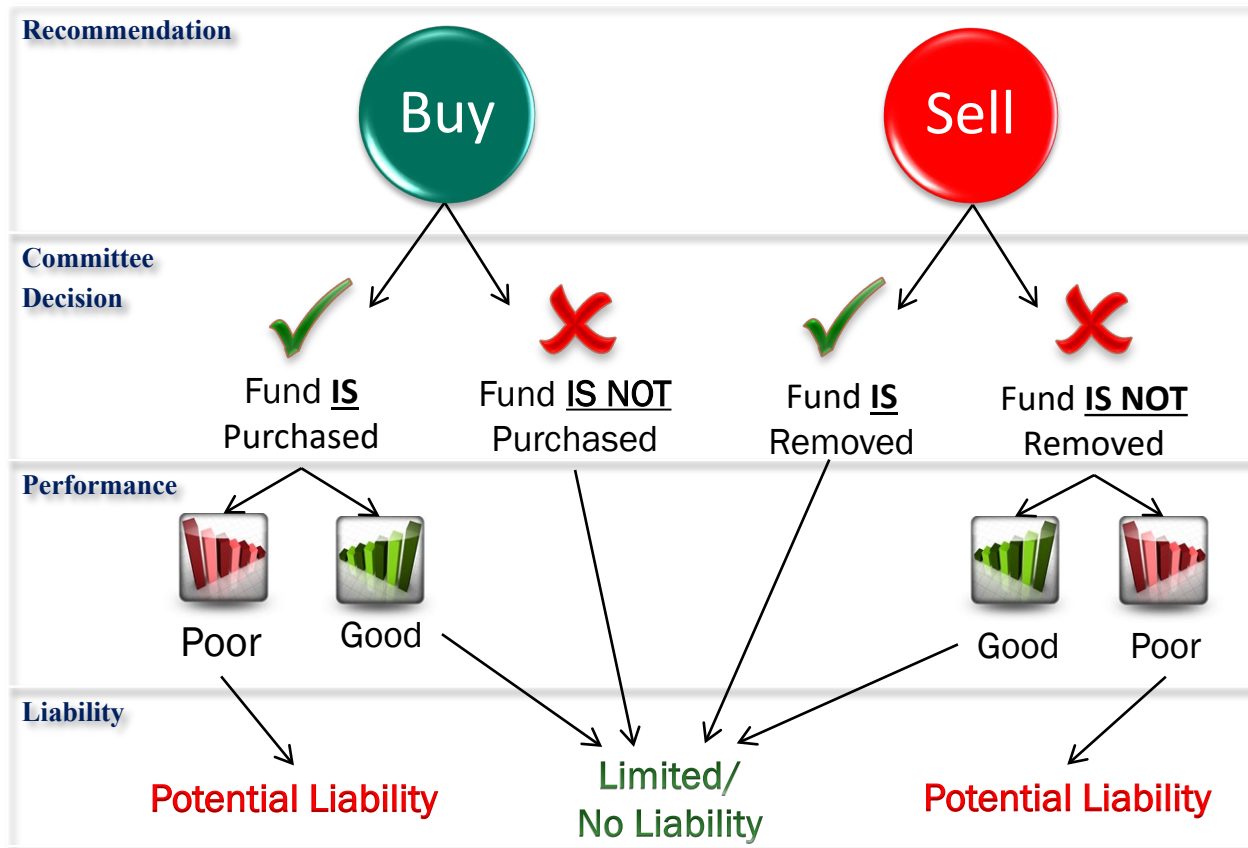
Investment Decisions – Buy or Sell



Investment Decisions – Buy or Sell

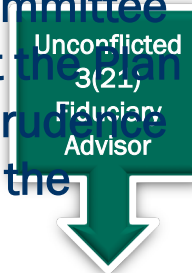


Investment Decisions – Buy or Sell



The Investment Advisory Continuum

Discretion and control over investments matters shifts from the Plan Committee to the Investment Manager, but the Plan Committee must still exercise prudence in selecting, and must monitor, the Investment Manager.



Greatest
Risk

Least
Risk

The Investment Advisory Continuum

Ideally, the plan should designate an unconflicted discretionary third-party investment professional directly and the plan sponsor directly compensates the investment professional outside of the plan.

ERISA 3(38)
Investment
Manager

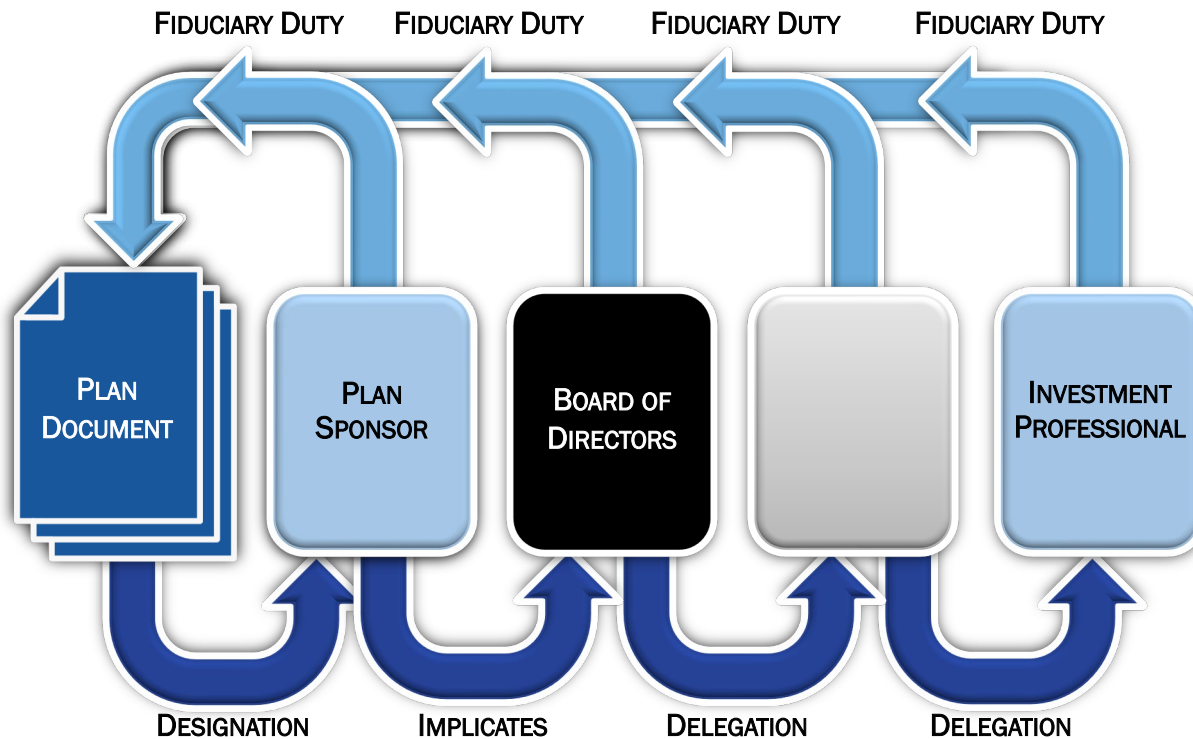
Named
Investment
Fiduciary



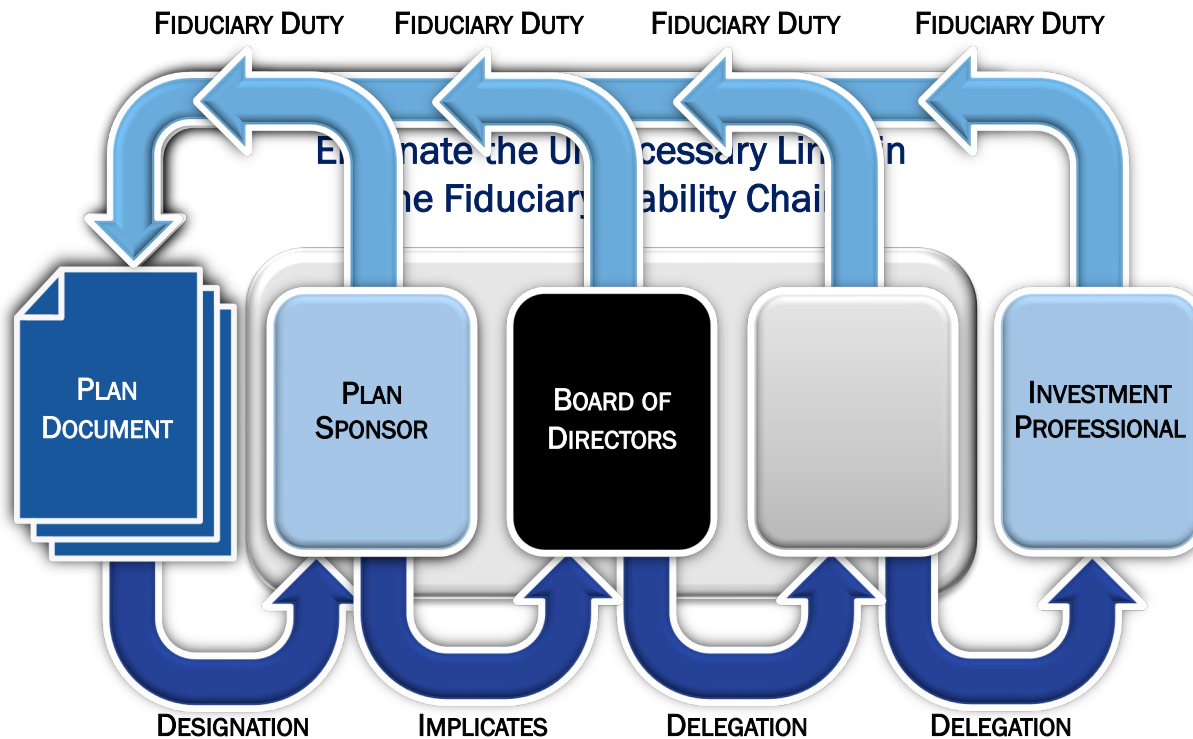
Greatest
Risk

Least
Risk

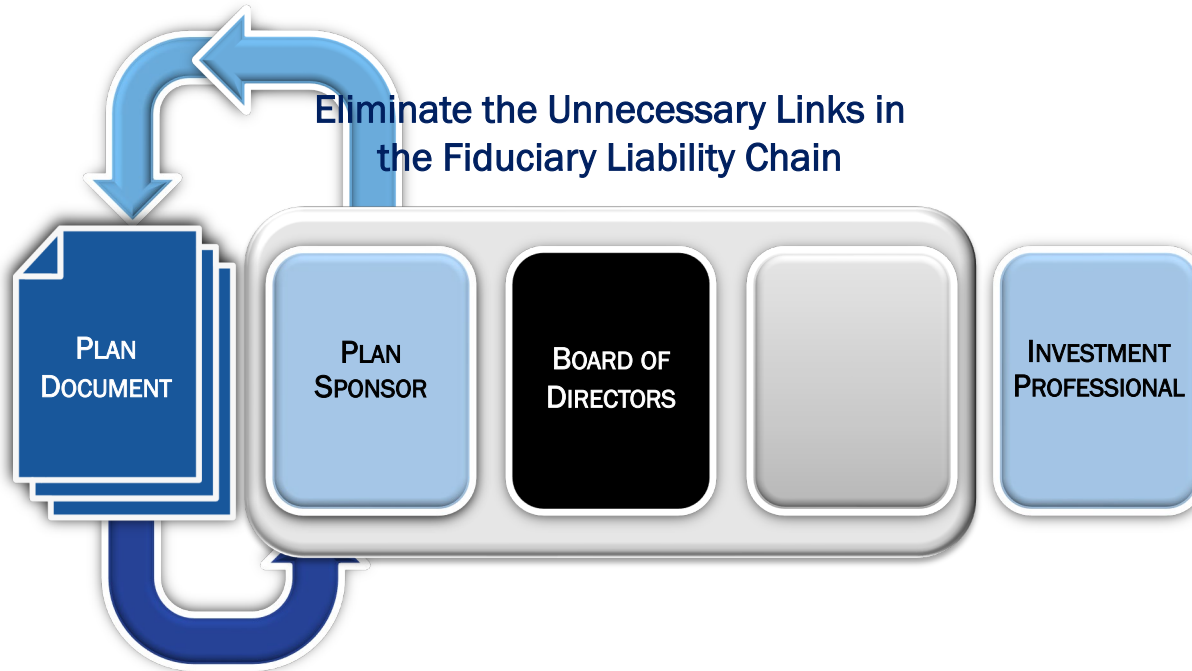
Unnecessary Links in the Liability Chain



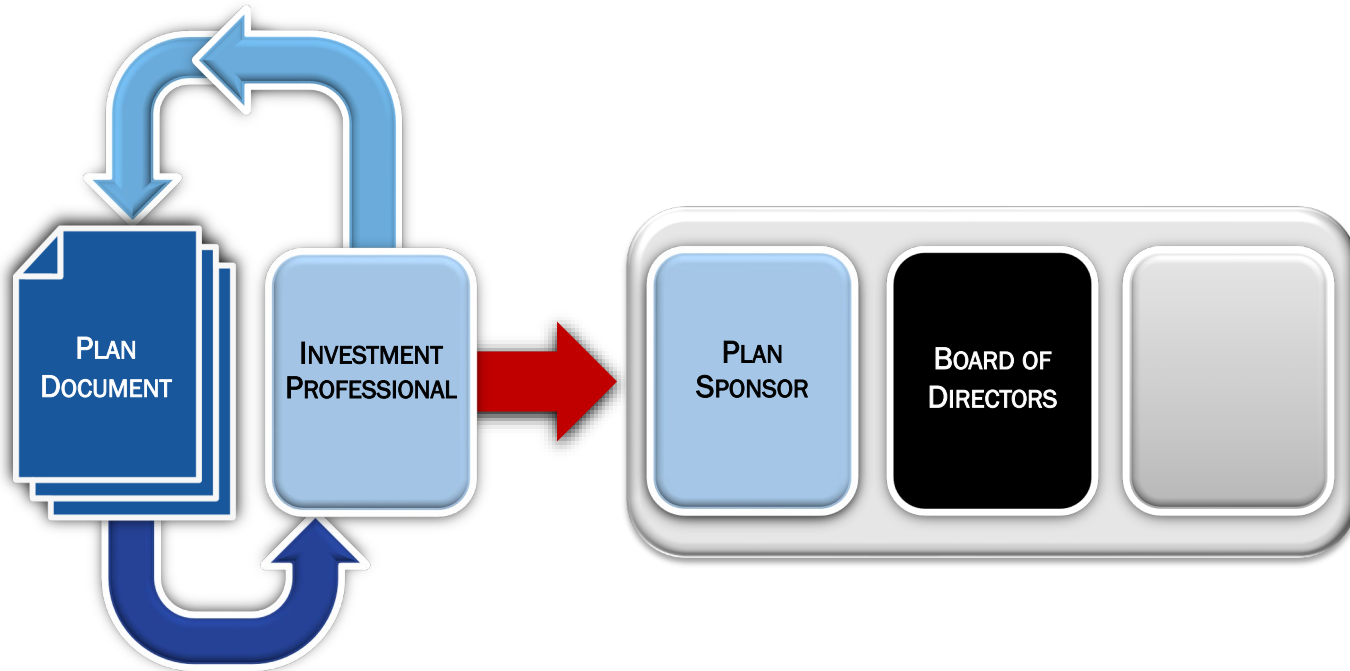
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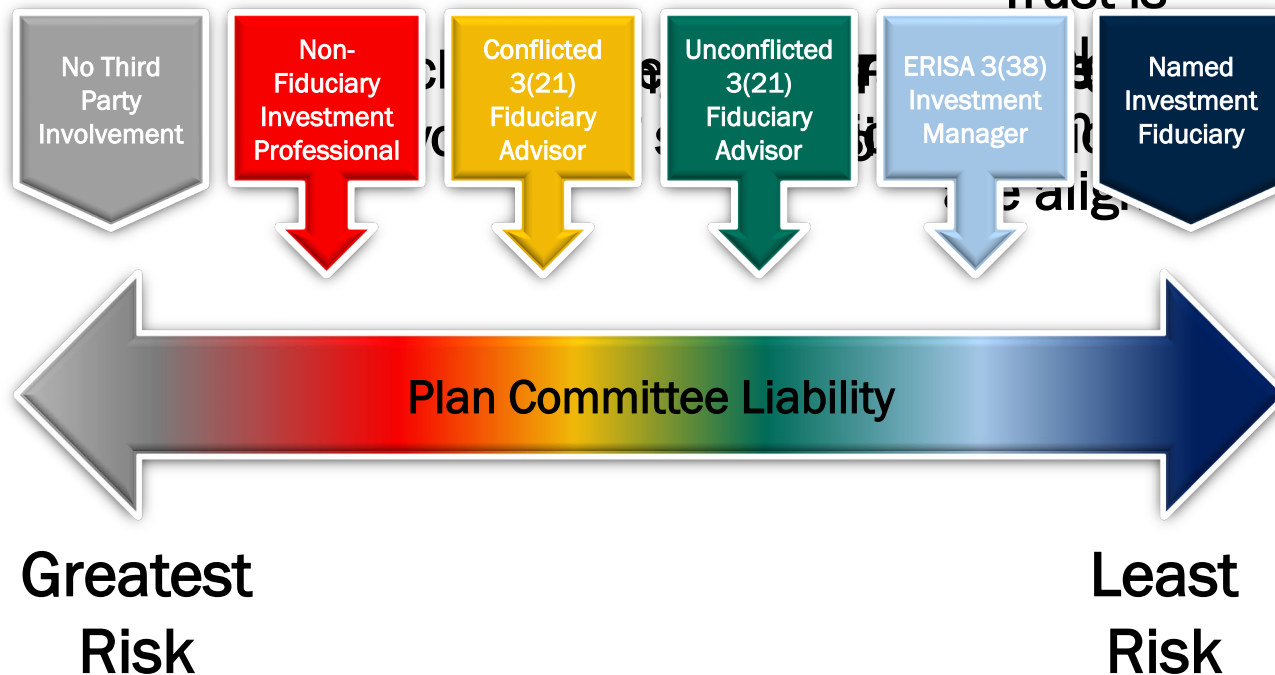


Unnecessary Links in the Liability Chain

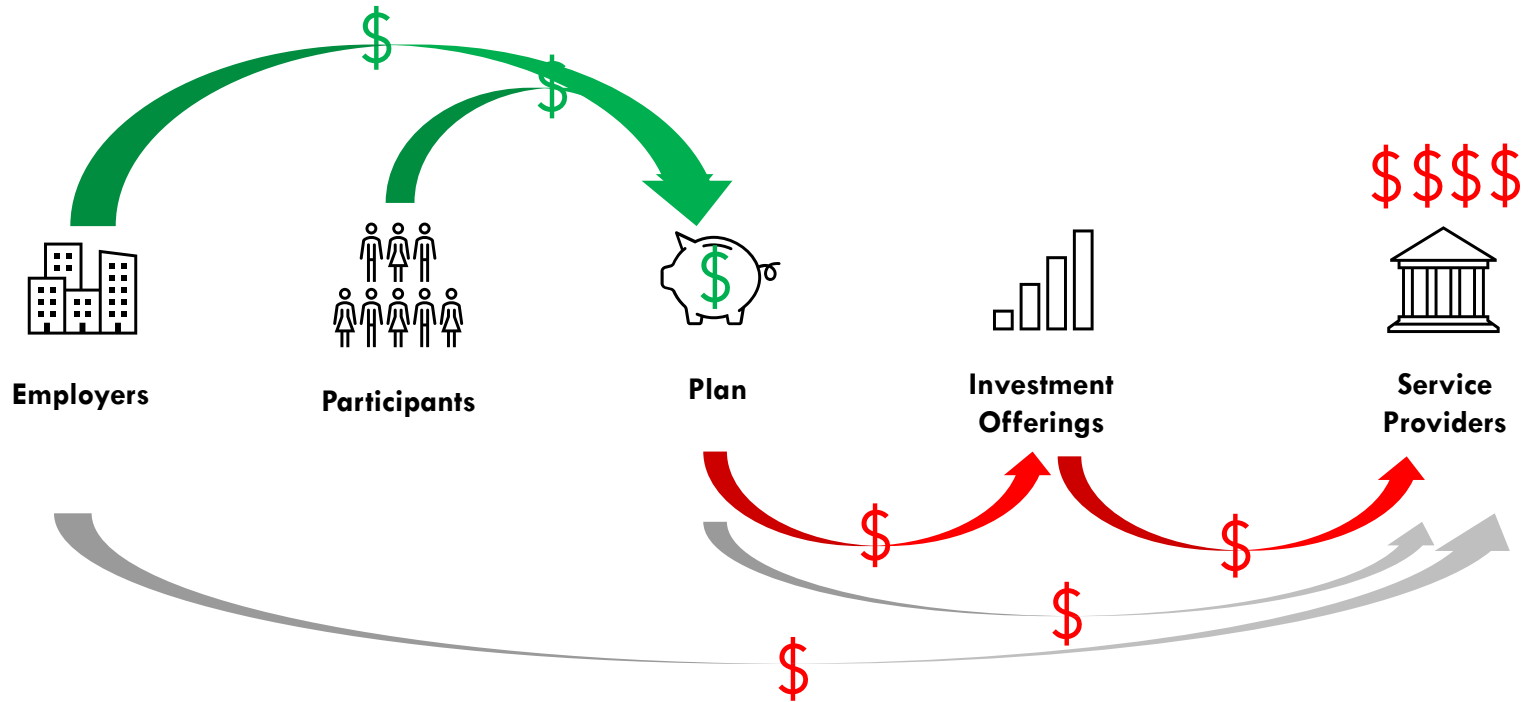


The Investment Advisory Continuum

The only difference is who has discretion and the Designation of the Directly Retained Trust is



How are Providers being Paid?



What is being “Shared” and with Whom?

Share Classes

SAMPLE TARGET DATE RETIREMENT FUND				
Class	Ticker	Revenue Sharing	Expense Ratio	Excess
R6	RFETX	0	0.35	0.00
R5	REETX	0.05	0.40	0.00
R5E	RHETX	0.15	0.50	0.00
A	AAETX	0.30	0.69	0.04
R4	RDET X	0.35	0.7	0.00
R3	RCETX	0.65	1.00	0.00
R2E	RBEE X	0.80	1.15	0.00
R2	RBETX	1.10	1.45	0.00
R1	RAETX	1.10	1.48	0.03

Confidential and proprietary information

Questions?

Executive Compensation Academy

- Title: How to Effectively Vet and Hire a Compensation Consultant
- When: July 14, 2022
- Time: 10:00 am – 11:00 am CT
11:00 am – 12:00 pm ET

Employee Benefits Academy

- Title: Phased Retirement and Similar Employment Contributions
- When: July 28, 2022
- Time: 10:00 am – 11:00 am CT
11:00 am – 12:00 pm ET