NWCM FIDUCIARY FOCUS

EDITION 1 - 2021

RETIREMENT FIDUCIARY AND REGULATORY COMPLIANCE

REPORT BY NWCM PLAN DEPARTMENT
FEBRUARY 2021

A summary of key fiduciary takeaways for Plan Sponsors

FOR PLAN SPONSORS

Rowena Crest Viewpoint:
Columbia River Gorge

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A NOTE FROM THE NWCM TEAM

Welcome to the inaugural edition of NWCM's Fiduciary Focus. We are pleased to share important fiduciary* topics with our clients and friends throughout the retirement plan community. There are many important considerations facing anyone who sponsors a retirement program. The information provided in this update is intended to help you remain informed.

We look forward to providing updates on timely topics concerning retirement management and administration, and, where appropriate, adding references for those seeking additional information. Our staff would also be happy to provide more context around these topics for those interested.

Each edition will contain the following sections:

- **Fiduciary Tip**: This section highlights a recent regulatory development, such as a new rule or administrative guideline and some practical steps for implementation. In this edition, we focus on the new electronic delivery rules for required retirement plan disclosures.

- **Fiduciary Focus**: This section contains our featured article. In this edition, we focus on Environmental, Social, and Governance (ESG) factors. The Department of Labor recently took a position on ESG factors, and in this article we review the fiduciary considerations relating to ESG regulations.

- **Recent Litigation**: This is a roundup of relevant cases that have recently been decided or are working their way through the legal system. We intend to bring you updates on these cases in each edition as decisions are made and issues settled.

We hope you enjoy this inaugural edition and look forward to your feedback and comments about what you would like to see in future publications.

A plan fiduciary is anyone who assumes control over the maintenance and operation of a plan. As a plan fiduciary it is your duty to act solely in the best interest of the participants and beneficiaries of the plan.

FIDUCIARY TIP: E-DISCLOSURES

Last Spring, plan sponsors received remarkably good news from the Department of Labor. New rules allow employers to use electronic distribution (e-delivery) of required disclosures for retirement plans as the default form of communicating these important messages. E-delivery ensures a far more efficient and effective means of getting important information distributed consistently and verifiably.

Please review the following required steps:

- An **initial notice** must be distributed on paper advising participants that e-delivery will be the new default method for distributing required disclosures.

- The notice must also provide participants the option to **opt-out** from receiving documents electronically.

- The electronic delivery system must be designed to provide an **alert** when an email address is invalid or inoperable, and reasonable steps must be taken to cure the problem. If the problem is not cured promptly, the recipient must be treated as having elected to opt out of e-delivery and must be provided a paper copy of the document.

- Lists of those employees who lack verified e-mail addresses or who have opted out of e-delivery must be **maintained**. Paper copies of covered documents must continue to be sent to this group.

Talk with your plan's recordkeeper for additional details.

WHAT YOU NEED TO KNOW ABOUT: ESG

On November 13th, the Department of Labor (DOL) published the final version of its rule on Environmental, Social, and Governance (ESG) investing, titled “Financial Factors in Selecting Plan Investments.” The final rule provides updated regulatory guidance on selecting investments for retirement plans.

The DOL’s recent focus on ESG investing may come as a surprise to some, considering few 401(k) plans currently offer an ESG-themed option.[1] However, the recent guidance arrives amidst a growing interest in sustainable investing, as well as ongoing regulatory uncertainty regarding the inclusion of ESG options within retirement plans.

For additional information on the history of ESG, please see NWCM’s latest paper, “*An Introduction to Environmental, Social, and Governance (ESG) Considerations in Investing*”, which is available on our **website**.

What is the Final ESG Rule?

Although often referred to as the “ESG rule”, the DOL’s final rule removed any specific references to ESG and instead focused on an updated definition of the “pecuniary” and “non-pecuniary" factors which may or may not be considered when making investment selections.

According to the final rule, a pecuniary factor is defined as “a factor that a fiduciary prudently determines is expected to have a material effect on the risk and/or return of an investment."[2] Put simply, the primary factor to consider when selecting an investment is the benefit to the plan in terms of financial performance.

Following public comment on the proposed rule, the DOL acknowledged that considering ESG factors in certain situations may in fact be appropriate, if not imperative. For example, it would be improper for an investment professional to fail to take into consideration a company’s “improper disposal of hazardous waste” or “dysfunctional corporate governance” when making investment selections, as these factors represent material economic considerations that may impact financial performance. Even a company’s cybersecurity protocols potentially fall under the ESG spectrum.[3] No definitive list of ESG related factors currently exists, and the space is continuously evolving. It is ultimately up to the fiduciary to determine which factors may have a material effect on the return and risk of an investment and to make considerations on a fact-specific basis.

Given the breadth of factors that could potentially fall under the ESG label, it is unsurprising that an increasing number of companies are adjusting their practices to incorporate some ESG standards, and that more investment managers are integrating ESG criteria into their evaluation process in order to make more informed investment decisions.[4]

WHAT YOU NEED TO KNOW ABOUT: ESG

Although the new DOL rule does not apply to governmental plans, government plan sponsors may still be interested in following ERISA guidance as a fiduciary best practice.

Are Participants Requesting ESG Options?

Depending on the demographics of your plan, the inclusion of an ESG investment option may lead to increased participation. According to a recent survey, 85% of individual investors and 95% of millennials are interested in sustainable investing.[5] Although such a strategy is not right for all plans, as interest grows you may have participants who inquire about the availability of ESG investment options.

Consider the funds currently available in your plan's investment lineup. Although you may not have any options specifically labeled as ESG, many funds already take certain ESG factors, such as sustainability, into consideration as part of their overall evaluation framework. Moving forward, companies that currently do not focus on ESG factors may feel added pressure to adjust their practices to incorporate ESG standards.

Inform participants of their ability to make ESG selections through a self-directed brokerage window, if this is an option made available in your plan. Not all ESG funds are appropriate for a plan core menu, especially given the ongoing regulatory uncertainty; however, interested participants with a self-directed option have access to a broad array of alternative investments. This option can provide employees with added flexibility, without impacting the core investment choices offered.

How Should Plan Sponsors Approach ESG?

At NWCM, we ensure that all investment recommendations meet our quantitative and qualitative scoring criteria based on the investment objectives of our clients, and following all applicable laws, rules, and regulations.

When considering whether or not to implement ESG options into a plan investment menu, it is important to consider whether the option(s) would be offered in addition to, or in place of, the plan's existing investment options. Consult with your advisor for additional insights on how to manage the investment menu in your plan.

Whether you intend to offer an ESG-themed option or not, the incorporation of additional factors into the investment evaluation process provides added value and insight, even if only as a supplemental piece of information rather than as a specific focus. From a fiduciary perspective, the more information available the better.

What's Next?

It is widely assumed that the Biden Administration will be more favorably inclined to view ESG factors as legitimate considerations and therefore it is unclear how this might impact enforcement of this new DOL rule going forward. Additionally, because the final DOL rule removed specific references to ESG, it is possible the new Administration may issue additional guidance that specifically addresses ESG. NWCM will continue to monitor any developments in this area and keep you updated.

RECENT ERISA LITIGATION

1

Gannett Co. v. Quatrone – Single Fund Diversification

In early January, the Supreme Court signaled interest in a case involving whether a plan may offer an “undiversified” single-stock option on the menu as long as the overall menu is considered diversified.[6]

The suit filed against Gannett Co. centered around the stock of its former parent company, TEGNA Inc. Participants in the company’s 401(k) plan alleged that the company violated their ERISA duties because they failed to quickly reduce their holdings of TEGNA Inc. following the split of Gannett and TEGNA, and that due to the failure to divest the plan became undiversified. It is undisputed that the plan as a whole offered a diverse menu of options, the only question is the over-concentration of the TEGNA stock. The fiduciary duty provisions of ERISA state that a fiduciary is required to “diversify the investments of the plan so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so.”[7] If the Supreme Court takes up the case it will focus on whether the diversification requirement is imposed with respect to the plan as a whole or with respect to each individual investment option.

2

Smith v. GreatBanc Trust Co. – Mandatory Arbitration Provisions

Over the past few years there has been a great deal of litigation regarding the enforceability of mandatory arbitration provisions within plan documents. Arbitration provisions, as well as class action waivers, prohibit participants from filing lawsuits in court and instead require mandatory arbitration.

In 2019, the U.S. Court of Appeals for the 9th Circuit ruled that ERISA plans can enforce mandatory arbitration,[8] but ongoing litigation continues to challenge the validity of these provisions. In August 2020, it was ruled in Smith v. GreatBanc Trust Co. that a mandatory arbitration provision was not enforceable because the plaintiff had not received notice that the plan had been amended to include the arbitration provision.[9] The case is currently on appeal to the 7th Circuit and may result in a split with the previous decision held by the 9th Circuit. The question regarding arbitration provisions is a live issue that will continue to be tested in the courts in 2021.

RECENT ERISA LITIGATION

3

Bartnett v. Abbott Labs - Cybersecurity

Cases surrounding cybertheft of retirement plan assets are on the rise. The recent case of Bartnett v. Abbott Labs involved a plan participant whose account was attacked by a hacker who requested and received an account distribution of $245,000.

The case named the plan sponsor as a defendant in the case, alleging that the plan "has discretionary authority or discretionary responsibility in the administration of the Plan."[10] The case against the plan sponsor was recently dismissed, as it was ruled that the plan sponsor did not perform any fiduciary acts related to the theft, nor was the plan aware of the unauthorized attempts to access the plaintiff's account.[11] However, the court ruled that the claims brought against the recordkeeper in the case may move forward.

In light of recent cybersecurity related litigation, it is critical that plan fiduciaries continue to review their own cybersecurity procedures, as well as those of their service providers.

4

Harmon et al. v. Shell Oil Co. – Participant Data

Another emerging legal question involves whether or not there is a fiduciary duty to protect participant data privacy (e.g., investment history, account balances, social security numbers, age, income, marital status etc.) and whether such data should be considered a "plan asset". ERISA does not specifically define "plan asset," and therefore case law surrounding this novel subject may provide additional guidance.

In the case of Harmon et al. v. Shell Oil Co. et al. it is alleged that the plan failed to safeguard participant data because it permitted the plan's recordkeeper to use participant data for marketing purposes.[12] The case claims that participant data must be protected as a plan asset and that any use for non-retirement plan related purposes is a fiduciary breach. The defendants in the case dispute this claim, calling it an "unprecedented legal theory."[13] The case is ongoing, but the eventual determination could have a significant impact on ERISA plans.

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