NWCM FIDUCIARY FOCUS

EDITION 4 - 2023

RETIREMENT FIDUCIARY AND REGULATORY COMPLIANCE

REPORT BY NWCM PLAN DEPARTMENT
JANUARY 2023

A summary of key fiduciary takeaways for Plan Sponsors

FOR PLAN SPONSORS

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Tumalo Falls in the Cascade Range west of Bend Oregon

The information summarized may vary based on plan type and may be subject to adjustment due to changes in applicable state and federal laws. The information is offered as general guidance only and is not to be relied on as specific legal advice. For legal advice on a specific matter, please consult with an attorney.

A NOTE FROM THE NWCM TEAM

Welcome to the fourth edition of NWCM's Fiduciary Focus. In each edition, we offer employers tools and insights to be more effective stewards for the retirement programs in their care.

With the recent passing of the SECURE ACT 2.0, we are pleased to provide an overview of creative and forward-looking solutions being deployed to address both the burden of student loans and the lack of household emergency savings. These two areas are seen, at best, as major competitors, or at worst, serious impediments, for retirement savings among employees. The burden of student debt is both alarming and growing and the lack of emergency savings places many households in the position of foregoing long-term retirement planning.

Regulators have responded to the retirement industry's innovations with both specific guidance and broad legislation. Our main article offers a review of some of the solutions being deployed and the legal framework being developed to accommodate them. It also offers paths for further research and our summary of the recent legislation impacting these areas.

In our **inaugural edition of Fiduciary Focus**, we focused our attention on environmental, social, and governance ("ESG") factors in retirement plans and the 2020 ESG rule published by the

Department of Labor ("DOL"), which was thought by some to have a “chilling effect” on investors.

This edition’s Fiduciary Tip provides an update on the current DOL stance on ESG investments. In November, the DOL released a new ruling on the matter, which was viewed as a major reversal from their previous position. We provide pertinent action items focusing on what plan sponsors’ next steps should be in response.

We invite you to take advantage of this overview and welcome you to reach out with any questions or comments. Enjoy!

FIDUCIARY TIP: DOL FINALIZES ESG RULE

In our **inaugural** Fiduciary Focus we told you we'd continue to monitor any developments on environmental, social, and governance ("ESG") investments in retirement plans and keep you updated.

On November 22nd, 2022, the U.S. Department of Labor ("DOL") issued a **Final Rule** on ESG in workplace retirement plans. In the ruling, the DOL specifies that retirement plan fiduciaries may, but are not required to, consider climate change and other environmental, social, and governance ("ESG") factors when choosing investment options for their participants in a retirement plan.[1,2]

This ruling reversed the Trump-era rule which forced fiduciaries to consider strictly pecuniary* factors when adding ESG options. The core investment duties remain under Employee Retirement Income Security Act ("ERISA") Section 404, which requires that fiduciaries must follow a prudent process and owe a duty of loyalty to participants and beneficiaries.

This is the Final Rule, and it applies to all investment decisions – not those solely perceived as ESG decisions. The DOL is not taking additional comments or waiting for additional steps.

**A financial factor that a fiduciary prudently determines will have a material effect on the risk or return of an investment based on appropriate investment horizons consistent with the plan's investment objectives and funding policies.*

FIDUCIARY TIP: ESG
ACTION ITEMS FOR PLAN SPONSORS

As you think about ESG investing and what it means for the retirement plan(s) with which you work, consider these steps:

1. Review the Final Rule and understand how it applies to your plan(s). Work with qualified retirement professionals, such as your NWCM consultant team, to help alleviate some of the burden and provide ongoing support.

2. Get educated about where you might have gaps in your understanding of the Final Rule and related ESG terminology. In the preamble to the Final Rule, the DOL lays out the most common types of ESG investing, which may be a surprise to some, including integration, negative screening and positive screening. If these terms are unfamiliar to you, click **here** for a glossary of ESG terms.

3. Understand how the Final Rule interacts with actions by other agencies including the Securities and Exchange Commission ("SEC"), which currently has proposed rules pending that impact investment managers and registered investment advisors.

4. Review your existing framework for selecting investments, which is typically included in an investment policy statement ("IPS"), and determine if you are operating within that policy today. (Hint: you don't need a separate IPS for ESG, nor do you necessarily need to add additional language to your IPS. Just make sure your IPS aligns with what you are actually doing to review investments.)

5. Review your investment line-up, including your Qualified Default Investment Alternative ("QDIA"), and seek the help of a qualified retirement plan advisor or consultant with this evaluation.

If you are considering adding ESG options to your plan, ***contact*** *your NWCM advisor to ensure you are following the proper fiduciary process.*

Student Loan Debt, Emergency Funds, and Retirement Savings

You may soon be receiving questions from your employees on what your retirement plan offers with regards to student loan and emergency savings benefits, especially with the recent passing of the SECURE Act 2.0. In this article, we attempt to give plan sponsors an overview of the current landscape.

As a retirement plan sponsor, employers take on a series of responsibilities with respect to their plans. The rule that requires plan sponsors manage the plan strictly in the best interests of plan participants and their beneficiaries, known as the exclusive benefit rule, can be seen as more than a set of proscribed practices to maintain plan compliance. Viewed in a more positive sense, it opens the door to considering various ways to help plan participants make the best use of the retirement plan they are provided. This naturally leads to interest in providing education, but more than that, it brings a focus onto issues that may be preventing employees from saving for retirement.

This is the impetus behind programs that involve assistance with student loans and the need for emergency savings. Each of these areas represent forms of financial need that compete with saving for retirement and have generated interest in ways employers can assist in alleviating them. This article will discuss the challenges of student debt and lack of emergency savings and highlight the considerations involved in the ways they are being addressed.

Retirement and Student Loans

As of October 2022, more than 1 in 5 households held student debt and the total amount of student debt in the US exceeded $1.7 trillion. The burden is spread across age groups and the total amount exceeds the GDP of most countries.[3] Considering these statistics, there is little wonder why many analysts have begun labeling this the ‘Student Loan Debt Crisis.’ [4]

This ‘crisis’ affects people of color and lower-income students disproportionately. Black students on average owe $25,000 more than White graduates, and 48% of Black students owe an average of 12.5% more than they borrowed, higher than their peers. Families with lower incomes are also more likely to hold student debt and have more of it. [5]

Although discussions around student loan debt often revolve around millennials and Gen Z, student debt is also a growing issue for older Americans. In 2020, 22% of student loan debt was held by Americans aged 50 and older. [6]

Recognizing the need for relief, the federal government suspended student loan payments as part of the CARES Act in 2020. In August 2022, the Biden Administration presented a new plan for up to $20,000 in student loan forgiveness per borrower, and the proposal of a new income-driven repayment option.[7]

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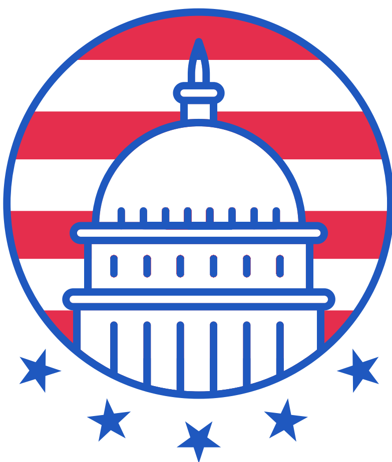
However, the Biden plan is currently being challenged by a number of lawsuits and the processing of student loan relief applications has been put on hold until the legal disputes are settled. Amidst the whirlwind of legislation, executive orders and legal challenges, the retirement plan industry has also been working to provide solutions to the problem of student loan debt.

How the Crisis is Being Addressed

In August 2018, Abbott Labs secured a **Private Letter Ruling** from the Internal Revenue Service ("IRS") allowing employee repayments of student loans to be considered contributions to their retirement accounts for the purposes of qualifying for a match from the employer. In this case, the administration was handled by the plan recordkeeper and a third-party provider (Bright Horizons EdAssist Solutions). This allowed for both the tracking of the student loan repayments and the appropriate accounting for the associated matching contributions from the employer.

Some recordkeepers have launched their own programs to assist plan participants with their overwhelming student loans. Several recordkeepers have introduced programs leveraging section 2206 of the CARES Act, which allows employers to contribute up to $5,250 pre-tax dollars toward employees student debt balances up until January 1, 2026. Other recordkeepers are facilitating plan sponsors with contributing to their employees' retirement accounts if the employee is making payments to their student loan, such as in the Abbott Labs example above. Innovative programs like these are becoming more prevalent in the retirement plan industry, but they can be difficult to implement and administer and may fall into a gray area with respect to ERISA and the DOL. In the past, plan sponsors using these programs have faced administrative challenges, potential tax implications, and the risk that these novel approaches may fail to conform with the ever-evolving regulatory landscape.



Congress is attempting to alleviate some of this confusion by codifying into law a provision relating to the treatment of student loan payments in employee retirement accounts. The SECURE 2.0 Act, which passed on December 23rd, 2022, allows employers to treat student loan payments as elective deferrals for purposes of matching contributions effective for plan years beginning after December 31, 2023. In other words, plan sponsors can now elect to make matching contributions when an employee makes a qualified student loan payment. The student loan match feature is optional and only applies to SIMPLE IRAs, 403(b), 401(k) and 457(b) plans. As mentioned above, some employers have already initiated similar programs, but this bill settles the legality questions and open the door for more employers to adopt this provision.

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Emergency Savings

Aside from student loan debt, another issue preventing people from saving for retirement is a lack of emergency savings. According to a report in 2020 by the Federal Reserve, 37% of American households could not come up with $400 to meet an emergency without resorting to borrowing.[8] Similarly, according to the Pew Research Center, 52% of middle-income households say they do not have funds available to cover expenses for three months.[9] In most retirement plans, employees can make hardship withdrawals from their retirement account, but this comes with additional fees and a tax penalty. Historically, this has been the only retirement-related solution for employers to assist employees with emergency situations, but innovative solutions are emerging.

Just like with the student loan crisis, the federal government has recognized the need for relief by including emergency savings provisions in recent retirement legislation. On December 23, 2022, the final version of Secure Act 2.0 was passed by Congress.[10] Secure Act 2.0 contains several provisions addressing emergency savings. The new law allows employers to automatically enroll their employees in a pension-linked emergency savings account at 3% of pay, up to $2,500. A separate provision allows workers to withdraw up to $1,000 from their 401(k) or individual retirement account (IRA) to cover emergency expenses without paying the 10% early withdrawal penalty.

Although there is some progress coming from the federal government, the retirement industry has also taken up the issue of emergency savings. Some retirement plan recordkeepers are offering emergency savings solutions as ancillary services. These programs all differ slightly in their structure and implementation, but in general they allow employees to contribute after-tax dollars and to view their savings account balance on the retirement plan portal. Some even allow the employer to make matching contributions. Despite recent guidance provided with the passage of Secure Act 2.0, employers should still be aware of the additional responsibilities and increased operational risks involved when they make these ancillary services available for employees.

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Conclusion

The shortfall in retirement preparedness is prompting the development and deployment of innovative solutions to alleviate the difficulties working people face in saving for retirement. Two main competitors for retirement savings deferrals are student loan repayments and the need for emergency savings. The retirement industry sees solutions in these areas as both pressing needs and opportunities to demonstrate flexibility and client focus. Regulators and legislators are also responding to help develop guidelines that allow these solutions to be built and operated without undue cost or administrative burdens. This is crucial because the range of programs being offered threatens to confuse the situation more than it solves it. The success or failure of these programs may have broad implications on the retirement security of workers in the years to come.

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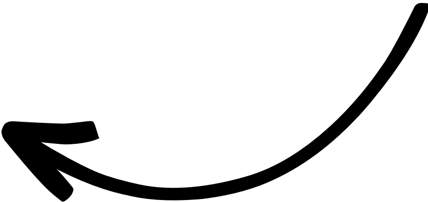
Special Edition: SECURE 2.0 Brings Expansive Changes to Retirement Programs

To see NWCM's full breakdown of the recent retirement legislation and the final SECURE Act 2.0 click here.



RECENT ERISA LITIGATION

Excessive Fee Case – Hughes v. Northwestern University

Case Summary: In December 2021, the Supreme Court reviewed a case involving allegations of excessive plan fees and imprudent plan investment options. The case had been dismissed by a lower court. However, in a unanimous opinion issued in January 2022, the Supreme Court reversed the lower court's decision, sending the case back to be re-evaluated. In the ruling, the Supreme Court stated that excessive fee claims should be reviewed on a context-specific, case-by-case basis. Please refer to our previous **edition** of Fiduciary Focus for additional details on this case.

Case Update: Prior to the Supreme Court's decision, several excessive fee cases were put on pause pending the Court's ruling. The decision was considered narrow, so it was not immediately clear how it would be applied or whom it would favor. We are now beginning to see how lower courts are applying the Hughes v. Northwestern decision.

In June 2022, the first appellate decision applying the new "context-specific" standard outlined by the Supreme Court was published in the case of Smith v. CommonSpirit Health. Plaintiffs in the case claimed that the plan's fiduciaries had breached ERISA by offering actively managed* investment options instead of lower-cost index options and allegedly allowing excessive recordkeeping fees. The court dismissed the case, noting that the plan fiduciaries had not acted imprudently by merely offering actively managed funds. The court stated that ERISA "*does not give the federal courts a broad license to second-guess the investment decisions of retirement plans*." With regard to the claim of excessive recordkeeping fees, the court noted that the plaintiffs had failed to provide context to support the claim that the fees were "*excessive relative to the services rendered*." The decision cited the Hughes decision directly, noting that fiduciaries face many difficult tradeoffs in their decision-making process and that "*courts must give due regard to the range of reasonable judgments a fiduciary may make based on her experience and expertise.*"

*Active and passive management are two different approaches to investing with different aims, risks, and potential performance outcomes. In exchange for typically higher fees, active management provides an opportunity to obtain market-beating returns, while lower-cost index funds track the performance of market indexes and go up or down based on market conditions. Either approach, or a mix of the two, may be used as long as there is a prudent selection and monitoring process in place.

Action Item: The decision in Smith v. CommonSpirit Health is considered a significant win for plan fiduciaries and will likely be relied upon to fight future excessive fee lawsuits. That said, excessive fee litigation is unlikely to go away anytime soon. These cases underline the importance of properly monitoring investments and ensuring the reasonableness of plan fees. Plan fiduciaries should have a process in place to document their fiduciary decisions.

Cybersecurity – Giannini v. TransAmerica Retirement Solutions, LLC., Disberry v. Employee Relations Committee of the Colgate-Palmolive Company

Case Summary: In a class action lawsuit filed in late 2021, plan participants alleged that their plan administrator, TransAmerica, failed to safeguard participant data which resulted in a data breach. Please refer to our previous editions of Fiduciary Focus for additional details on this case.

Case Update: A motion to dismiss the case was filed by TransAmerica in August 2022, but no ruling has been made on the motion as of the date of this publication.

As cybersecurity remains a key concern for plan fiduciaries, a new case, Disberry v. Colgate-Palmolive, has recently emerged. This case involves a former employee whose plan balance was stolen via an orchestrated cyberattack. A hacker gained access to the participant's online account by contacting the recordkeeper's customer support call center and falsely claiming to be the participant. Over the course of two months, the fraudster changed contact and login information and ultimately received a full distribution of the account balance, totaling over $750,000. After discovering the theft, the participant requested that her balance be restored but her claim was denied.

The plaintiff in the case is now suing the plan's committee (Colgate-Palmolive), the recordkeeper (Alight), and the custodian (BNY Mellon), claiming that they failed to safeguard her plan assets from the cyberattack. The plaintiff also notes that the hacker attempted to gain access to her other benefits accounts but that those attempts were unsuccessful because of the security measures implemented by those plans and their recordkeepers.

Cybertheft cases are often resolved when the recordkeeper restores the participant's account balance before the case proceeds to court, but in this case, the defendants have elected to fight the participant's claims. Motions to dismiss have been filed, with the Colgate-Palmolive plan asserting that the fraud occurred "through no fault of the Committee" while Alight places the blame of the "unfortunate loss" on "bad actors", claiming that they hold no fiduciary responsibility.

The court must now decide whether the plan and/or the recordkeeper had account security processes that were prudent and followed an objectively reasonable process. As a matter of law, the defendants in the case likely do not bear legal responsibility for the theft, which further emphasizes the need to safeguard participant account safety.

Action Item: Plan fiduciaries should confirm whether their current or prospective providers offer security guarantees that will protect plan participants in the event of a cyberattack. Additionally, plan fiduciaries should keep the recent DOL cybersecurity **guidance** in mind when selecting and monitoring plan service providers, in order to ensure the security of participant data. As part of their guidance, the DOL published a list of **online security tips** that can be provided to employees. The action items outlined can help plan participants protect their retirement accounts from fraud and theft.

Additionally, NWCM recently released a Cybersecurity Training Lab for our clients, which is available in ShareFile or upon request. It is highly recommended that you complete the Training Lab and follow the action steps provided to ensure that your organization is following industry best practices.

Target Date Funds – Jones et al. v. DISH Network Corporation et al., Tullgren v. Booz Allen Hamilton Inc

Case Summary: In a class action lawsuit, plan participants alleged that Dish Network breached their fiduciary duty by selecting and retaining the Fidelity Freedom target date funds (TDFs). According to the plaintiffs, the actively managed target date suite was "riskier and more costly" than alternative target date options. Please refer to our previous **edition** of Fiduciary Focus for additional details on this case.

Case Update: DISH Network is currently attempting to have the case dismissed. In August, DISH Network brought forward a recent ruling by the 7th circuit in a similar case (Albert v. Oshkosh Corp). One of the claims made in that case was that certain actively managed funds should not have been offered because they were more expensive than passively managed funds. The 7th circuit ruled that the "*allegation that certain actively managed funds in the plan were imprudent because they were more expensive than passively managed funds was threadbare and failed to provide a comparison to a meaningful benchmark*."

Conversely, eleven lawsuits have recently been filed against plans that offered the passive BlackRock LifePath Index target-date series. The plaintiffs in these cases argue that the plan fiduciaries "chased low fees" by offering the passive BlackRock TDFs at the expense of performance. The plaintiffs argue that the plan sponsors should have removed the target date series because its performance trailed over certain time periods compared to other available TDFs.

In December 2022, a federal judge dismissed two of the lawsuits, rejecting the argument that the BlackRock funds could be compared to the performance of other target date suites without factoring in different strategies, glidepaths, and investments. It is likely that the remaining cases, which were virtually identical and filed by the same law firm, will also be dismissed.

Action Item: It is important to follow a prudent process and maintain adequate documentation when making investment decisions. Fiduciary prudence is assessed based on whether a prudent process was followed in arriving at a decision, not on its results.

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NWCM Resources

1. https://www.nwcm.com/
   NWCM website.

2. https://www.nwcm.com/insights/blog/category/defined-contribution-plan-resources/
   Defined Contribution plan resources.

3. **Fiduciary Focus Edition 1**
   Fiduciary Focus Edition 2
   Fiduciary Focus Edition 3
   Previous editions of Fiduciary Focus.