

Fiduciary Hot Topics

Q2 2021



Federal District Court Rules Record Keepers May Use Participant Data to Cross-Sell Retail Products - Harman et al vs. Shell Oil Company et al

- This class action suit, filed in January of 2020, was brought on behalf of participants in the Shell Provident Fund 401(k) Plan. The case was filed in the Federal District Court for the Southern District of Texas. The allegations are typical of such suits and include contentions such as the plan fiduciaries allowed the Plan to bear unreasonable administrative costs and failed to adequately monitor the investment lineup.
- Fidelity is the recordkeeper. It was named as a defendant on the grounds that it allegedly engaged in prohibited transactions under ERISA by using participant data to cross-sell. The cross-selling practices Fidelity is alleged to have engaged in are typical of many large record keepers. The complaint alleges that participant data was used to cross-sell brokerage and advisory services, insurance, credit cards

and other banking services. Recent settlements of some class action lawsuits have included a provision prohibiting the plan record keeper from using participant data to cross-sell retail products.

- Fidelity argued that it is not a plan fiduciary and did not engage in prohibited transactions through its use of participant data because, contrary to the allegations of the plaintiffs, such data is not a plan asset. The judge examined the Department of Labor regulations defining what constitutes a plan asset and agreed with Fidelity, granted their motion to dismiss them as a defendant.

As Expected, the Biden Administration Plans to Walk Back the New Regulation Restricting the Use of ESG Funds in 401(k) Plans

- ESG investing looks at environmental, socially responsible and corporate governance criteria in evaluating investments. The belief is that, over the long term, these factors can positively impact financial performance.
- The popularity of ESG investing has increased in recent years. Many defined contribution plans now include an ESG option in their lineup. Net flows into these funds reached \$51 billion 2020, which represents a tenfold increase over 2018.
- The Department of Labor's new rule for ESG investments took effect January 12th of this year. The rule manifests significant skepticism of ESG investing and created additional requirements for plan fiduciaries to add ESG funds to investment line ups. The Biden Administration announcement of a non-enforcement policy, and review, of the new rule is not surprising as the Democrat platform has historically tended to look more favorably upon ESG investing than has the Republican platform.
- The proposed rule, issued early last year, generated a fair amount of negative response from the financial services sector. In response to the many negative comments, the final rule goes so far as to completely remove reference to the term "ESG" altogether. Rather, it employs the terms pecuniary and nonpecuniary factors and permits the use of nonpecuniary factors, such as ESG criteria, only as a tie breaker.
- Two things that are of note. First, promulgating a regulation that contains specific criteria for evaluating investments was unprecedented. While the Securities & Exchange Commission and FINRA have promulgated many rules over the years, there are none that establish specific criteria that must be applied to evaluate a particular type of investment. Second, the manner in which the rule is drafted manifests a fundamental misunderstanding of modern portfolio theory and the manner in which investments are evaluated
- If the Biden administration is so inclined, promulgating a new rule will likely take a minimum of 18 months. In the meantime, it is expected that the Department of Labor will issue guidance to the effect that pecuniary factors may include ESG criteria. The result should be a roadmap provided to fiduciaries for the prudent selection and ongoing monitoring of ESG investments in ERISA plans.
- It is important for plan fiduciaries to understand that ESG funds can be complex. They do not represent a separate and distinct asset class (like large cap value or international equity), but rather are typically managed to an existing asset class. Thus, it is not a necessity for plan sponsors to add an ESG fund for diversification purposes. However, for plans that already offer an ESG option the Biden administration's nonenforcement announcement is welcome relief that they need not undertake the additional requirements outlined in the new rule at present. For plan sponsors that are considering adding an ESG

option, it may be advisable to take a wait and see approach until new guidance is published to better understand the prudent process that we hope the DOL will provide.

Under the American Rescue Plan Act of 2021, Tax Payers will Pick up the Tab for Underfunded Multiemployer Pension Plans for the Next 30 Years

- The American Rescue Plan Act of 2021 (“ARPA”) is the \$1.9 trillion stimulus package signed into law by President Biden on March 11th. The key provisions are a \$300 per week supplement to unemployment benefits, paid emergency leave for 100 million individuals and \$1,400 in direct payments to many Americans.
- Among many other provisions, this law includes an \$86 billion bailout of Taft Hartley multiemployer pension plans. In enacting this legislation a major concern of Congress was that the Pension Benefit Guaranty Corporation (the “PBGC”) is the back stop for these plans.
- The PBGC is a government agency that guarantees payment of benefits under private defined benefit pension plans. There is no comparable insurance for defined contribution plans. When the sponsor of a pension plan goes into bankruptcy, the PBGC assumes responsibility for the plan going forward.
- The PBGC now pays benefits to almost a million participants covered by 4,800 failed pension plans and is responsible for future payments to another half a million individuals. It is funded by premiums assessed against pension plans.
- The PBGC’s liabilities far exceed its assets. Its program for Taft Hartley multiemployer plans is in especially bad shape with liabilities for benefits exceeding assets by about \$65 billion. This program was on track to run out of cash in 2025 which meant that without legislative action many plan participants would no longer receive their pension payments.
- Several years ago, Senator Sherrod Brown of Ohio proposed a federal bailout for multiemployer plans known as the Butch Lewis Act. Until now this bill was viewed as having little chance of passage.
- A version of this bill is included in the ARPA. Underfunded multiemployer plans will receive a cash infusion of federal tax dollars sufficient to keep them solvent through 2051. There is no repayment obligation.
- The PBGC has 120 days from March 11 to issue guidance with details on the process to apply for assistance
- To pay for this bailout, the ARPA increases the PBGC fixed-rate premium to \$52 per participant in plan years beginning after December 31, 2030. To put this in historical perspective, in 1974 when ERISA was enacted, the premium was one dollar. This may not represent real increase because PBGC premiums are indexed to inflation, and if current trends continue, the premium will be around \$52 in 2031 even without this increase.

ARPA Provides Funding Relief for Underfunded Single Employer Pension Plans

- Sponsors of defined benefit plans are subject to minimum funding requirements that require these plans to fund benefit liabilities as they accrue. Two provisions in ARPA provide some relief with regard to minimum funding.
- This relief is only meaningful for pension plans with significant underfunding. It should be noted that this relief permits a postponement of a portion of required contributions but does not reduce the ultimate amount of required funding. Over the long term, postponing a portion of contributions will increase required contributions.

Longer Period to Amortize Funding Shortfalls

- Sponsors of pension plans that are underfunded because the liability for benefits exceeds plan assets must make additional contributions to cover this underfunding. Under current law, these payments may be amortized (i.e., spread out) over seven years. ARPA extends this amortization period to 15 years, thereby reducing required contributions in the short term.

Interest Rate Relief Extended and Increased

- The higher the interest rate assumption used to value pension plan liabilities, the lower the value of those liabilities resulting in a lower minimum required contribution.
- In 2012, 2014, and again in 2015, to address concerns that historically low interest rates were inflating pension obligations, Congress provided temporary interest rate relief known as “interest rate stabilization.” Interest rate stabilization allows for the use of slightly higher interest rate assumptions thereby lowering the required minimum contribution.
- The most recent relief provided by interest rate stabilization under 2015 legislation began phasing out this year. The ARPA extends and increases interest rate stabilization.

Senate Removes Freeze on 401(k) Inflation Adjustments from ARPA

- In a preview of things to come, the House version of the ARPA contained a provision eliminating the automatic inflation adjustments for the annual contribution limits to defined contribution plans.
- The rationale was to help fund the multiemployer plan bailout and to prevent high income tax payors from benefiting disproportionately from the favorable tax treatment afforded by retirement plans.
- The Senate removed this provision.

For any further questions, please do not hesitate to contact your financial professional at info@lawleyinsurance.com.

This material was created to provide accurate and reliable information on the subjects covered but should not be regarded as a complete analysis of these subjects. It is not intended to provide specific legal, tax or other professional advice. The services of an appropriate professional should be sought regarding your individual situation.

To remove yourself from this list, or to add a colleague, please email us at info@lawleyinsurance.com.

Lawley Retirement Advisors, LLC (LRA) is a registered investment advisor with the Securities and Exchange Commission. Such registration does not imply a certain level of skill or training. The information herein has been provided for informational purposes only, and is not intended to serve as investment advice or as a recommendation for the purchase or sale of any security. All investments involve risk, including loss of principal invested. Past performance does not guarantee future performance. LRA is not affiliated with The National Association of Plan Advisors. Securities and Advisory Services offered through Cadaret Grant & Co., Inc., member FINRA/SIPC and a SEC Registered Investment Adviser. Additional Advisory Services offered through Lawley Retirement Advisors, LLC, a SEC Registered Investment Adviser. Lawley Retirement Advisors, LLC and Cadaret Grant & Co., Inc. are separate entities. ACR# 3541041 04/21

A Proud Member of

