Quick Takes:

Q1 2025 Review of Defined Contribution Regulation, Legislation, & Litigation

endeavor retirement

In the waning days of the Biden Administration, there was a flurry of regulations and proposed regulations from the Department of Labor (DOL), Treasury Department and the Internal Revenue Service (IRS). Topics include various provisions of SECURE 2.0 as well as missing participants and updates to the Voluntary Fiduciary Correction Program (VFCP).

Regulatory Updates

New Secretary of Labor Confirmed, EBSA Head Nominated

In February, former Oregon Rep. Lori Chavez-DeRemer testified at a hearing hosted by the Senate Committee on Health, Education, Labor, and Pensions (HELP) as part of the process to confirm her as Secretary of Labor. Chavez-DeRemer was approved by 14 members of the Senate HELP Committee, with 9 members voting against her, and was subsequently approved by the full U.S. Senate on March 10.

The White House has officially nominated Daniel Aronowitz to become the next Assistant Secretary of Labor for the Employee Benefits Security Administration (EBSA). Aronowitz is the President of Euclid Fiduciary (now Encore Fiduciary), a fiduciary liability insurance underwriting company for employee benefit plans. His experience in the professional liability industry includes expertise as a coverage lawyer and underwriter. He's been a prolific writer criticizing the trends in ERISA litigation, notably, arguments made in excessive fee suits. A hearing to consider his nomination for the post has not yet been scheduled, but his nomination suggests a shift in focus for the DOL, alongside the pause in litigation involving the fiduciary rule.

IRS Issues SECURE 2.0 Auto-Enrollment, Roth Catch-Up Proposed Regulations

The Treasury Department and the IRS released a flurry of news on Jan. 10 in the form of proposed regulations relating to SECURE 2.0 provisions for retirement plan catch-up contributions and automatic enrollment requirements. These proposed regulations would amend the regulations under IRC Section 414(v) to reflect changes to the catch-up contribution requirements for certain catch-up eligible participants, including proposed rules related to a provision requiring that catch-up contributions made by certain higher-income participants (greater than $145,000 in prior year annual compensation) be designated as Roth contributions.

The proposed regulations also provide guidance for plan administrators to implement and comply with the new Roth catch-up rule and reflect comments received in response to Notice 2023-62, issued in August 2023. The IRS decided that they will not permit retirement plan sponsors to require that all participants make catch-up contributions on a Roth basis to simplify plan administration. More specifically, plan participants earning $145,000 or less must still have the option of making pre-tax catch-up contributions.

As a reminder, plan sponsors should be ready to comply with this provision of SECURE 2.0 by Jan. 1, 2026, regardless of whether the proposed regulations are finalized.

In a separate proposed regulation, the IRS clarified how the automatic enrollment mandate will work in specific instances. The automatic enrollment mandate took effect on Jan. 1, 2025 for plans created after SECURE 2.0 was passed on Dec. 29, 2022. The proposal says that plans that were created before SECURE 2.0 was passed can keep their grandfathered status if they later join a multiple employer plan (MEP).

Note that at present these are merely proposals – with a public hearing scheduled for early April 2025. However, depending on the final regulations, this could have a significant impact on participant communications and plan administration.

DOL Issues Final Rule on Voluntary Fiduciary Correction Program

On Jan. 14, the DOL issued a final rule regarding changes to its VFCP, which allows fiduciaries to send certain administrative errors to DOL and receive a no-action letter. These include prohibited purchases and sales, improper loans, and late contributions.

There are two new self-correction features added to the final rule under VFCP; the first is notably the failure to timely remit participant contributions and loan repayments, as the most frequently used correction under VFCP. The second new self-correction feature under VFCP involves certain eligible inadvertent failures related to participant loans. The expanded VFCP program should make it easier and less painful for plan sponsors to correct some of the most common administrative errors.

DOL Offers Fiduciaries Missing Participant Enforcement Relief

The DOL has announced an enforcement relief policy to provide retirement plan fiduciaries with an option to help manage small benefit amounts owed to individuals who cannot be located. Under the policy announced Jan. 14 in Field Assistance Bulletin No. 2025-01, the DOL says it will not take action under ERISA Section 404(a) against fiduciaries that transfer entire benefit payments owed to missing participants of $1,000 or less to state unclaimed property funds, if certain conditions are met.

Specifically, in order to qualify for relief, fiduciaries must meet certain conditions, including:

- The transfer to a state unclaimed property fund is a prudent destination for the participant's or beneficiary's retirement benefit payments
- The plan fiduciary has implemented a prudent program to find missing participants consistent with the DOL's best practices for pension plans, and nevertheless has been unable to locate the participant or beneficiary
- The plan fiduciary selects the state unclaimed property fund offered by the state of the last known address of the participant or beneficiary
- The plan's summary plan description (SPD) explains that retirement benefit payments of missing participants or beneficiaries may be transferred to an eligible state fund and identifies a plan contact for further information concerning the eligible state funds to which the benefit payments are transferred; and
- The state unclaimed property fund qualifies as an "eligible state fund" as defined in the guidance

In addition, for purposes of determining the present value of the benefit, the fiduciary must disregard the amount of any outstanding plan loans but must include rollover contributions described in Internal Revenue Code Section 411(a)(11)(D). The DOL's temporary relief comes as the issue of finding missing participants has created plan administration challenges, considering that there is not a set of prescribed rules to follow, though it is often the subject of DOL audits.

Legislative Updates

Legislation to Allow 403(b)s to Invest in Collective Investment Trusts (CITs)

In February, U.S. Senator Katie Britt (R-Ala.) reintroduced The Retirement Fairness for Charities and Educational Institutions Act (S. 424), which is another bill to allow 403(b) plans to include collective investment trusts (CITs) as part of their investment menu options. A version of the bill (H.R. 1013) was later introduced in the U.S. House of Representatives.

Beyond that, the House Financial Services Committee has announced that it welcomes comments on allowing 403(b)s to invest in CITs and on legislation that would help make that possible by amending the Securities Act of 1933 and the Investment Company Act of 1940.

More States Consider Auto-IRA Programs – and One Looks to Add Auto-Enrollment

Four state legislatures – Indiana, North Carolina, Alabama, and Mississippi – are currently considering bills that would create a state program to provide retirement plan coverage for their private-sector employees whose employers do not have access to a plan at work. Meanwhile, Hawaii is considering expanding its program to include automatic enrollment.

As of June 30, 2024, 20 states have enacted state retirement programs. Some are already active; some will take effect at a future date. Studies have indicated that these state mandates have led to increased adoption of traditional workplace retirement plans.

Litigation Updates

SCOTUS Hears Oral Arguments in ERISA Burden of Proof Case

In late January, the U.S. Supreme Court heard oral arguments of both parties in a case that could resolve the question of which party bears the burden of proof in ERISA litigation. Federal district courts have been split on the issue - the Eighth and Ninth Circuits have favored the defendants, while the Second, Third, Seventh, and Tenth Circuits have believed that plaintiffs are required to allege additional elements to state a claim. The DOL has weighed in suggesting that the fiduciary defendants should have the burden of proof.

A decision in favor of the fiduciary defendants is anticipated to slow the pace of ERISA fiduciary litigation, while a decision in favor of the plaintiffs suing is likely to encourage more litigation. A decision is expected by June 2025.

Mixed Results in Forfeiture Reallocation Suits

New suits continue to emerge, adding to the nearly two cases filed challenging the use of forfeitures to offset employer contributions, rather than reducing plan expenses or reallocating them to remaining participants. In Feb. 2025, a suit targeting the $7 billion Charter Communications 401(k) claimed the fiduciaries violated terms of the plan document in offsetting employer contributions with forfeitures. At the same time, a motion to dismiss a suit involving HP was granted, claiming the allegations were "impermissibly broad". A related motion to dismiss the suit involving the Clorox 401(k) that had been granted, was rejected on rehearing. Amazon and JP Morgan were also named in forfeiture reallocation suits during the quarter.

Suits involving the disposition of forfeited balances continue to be filed and adjudicated, with varying results. All, however, serve as a reminder that decisions left to the discretion of the plan committee will likely be deemed to be a fiduciary decision, but in any event should be done in accordance with the terms of the plan document.

Federal Judge Again Backs ESG Rule

A suit brought by a coalition of 26 so-called “red state” Attorneys General in 2024 claimed that the DOL’s environment, social, and governance (ESG) final regulation that was effective as of Jan. 2023 “undermines key protections for retirement savings of 152 million workers. They argued that the rule prioritizes ESG factors in investing, including the Biden Administration’s stated desire to address climate change.”

A federal judge ruled that the regulation was within the purview of the DOL, but the Attorneys General appealed the decision following the U.S. Supreme Court ruling in the Loper Bright case, which overturned the Chevon doctrine that had previously required courts to defer to regulatory agencies interpretations of ambiguous statutes.

However, that same federal district court judge has again, after a thorough analysis, affirmed his previous conclusion that the regulation was within the DOL’s purview, and remains the law of the land. While the decision is likely to be appealed again, for now the standard of review remains that fiduciaries are to consider only the financial interests and benefit of participants in reviewing investments, though if all other considerations are equal, other factors may serve as a tiebreaker.

Judge Says American Airlines 401(k) Fiduciaries ‘Blinded’ by ESG Focus

ERISA litigation often equates the fiduciary duties of prudence and loyalty but a federal judge has drawn a distinction between the two in a controversial case involving ESG factors and proxy voting.

A Participant plaintiff filed suit in the U.S. District Court for the Northern District of Texas in June 2023 alleging that plan fiduciaries of the American Airlines 401(k) breached their fiduciary duties in violation of ERISA by investing millions of dollars of American Airlines employees’ retirement savings with investment managers and investment funds that pursue leftist political agendas through ESG strategies, proxy voting, and shareholder activism. These activities are claimed to fail to satisfy the fiduciary statutory duties to maximize financial benefits in the sole interest of the plan participants.

Following a four-day bench trial, the judge has now concluded that while the plan fiduciaries fulfilled their duty of prudence (though he expressed some skepticism about the objectivity of the approach) he said the fiduciaries violated their duty of loyalty to plan participants, essentially making decisions that put corporate interests ahead of participant interests. In doing so, he cited comments and emails made by plan committee members that were cognizant of the large debt and ownership interests of BlackRock – a major proponent of ESG goals – with both American Airlines and the plan advisor.

The judge has asked for additional information from the parties in assessing damages which have not yet been awarded.

J&J Dodges Healthcare Fiduciary Breach Suit — for Now

Nearly a year ago, Johnson & Johnson was sued by an employee who claimed that defendants breached their fiduciary duties and mismanaged Johnson and Johnson's prescription-drug benefits program, costing their ERISA plans and their employees millions of dollars in the form of higher payments for prescription drugs, higher premiums, higher deductibles, higher coinsurance, higher copays, and lower wages or limited wage growth.

The case had been widely viewed as the first in a potential wave of participant fiduciary breach suits involving healthcare plans, which now have the same 408(b)2 disclosure rules and fiduciary obligations that have been in place for retirement plans.

The judge in this case recently granted a motion to dismiss the suit with regard to the specific plaintiff here that didn't appear to have suffered personal injury and therefore lacked standing to bring suit. However, he left the door open for a different plaintiff to bring suit and considering the amount of social media trolling for potential plaintiffs, this isn't likely to be the last such suit filed.

Managed Account Suit Holds Off Target-Date Fund Comparison — Again

A suit involving fiduciaries of the $5.1 billion Bechtel Trust and Thrift Plan claimed that participants were being defaulted into a managed account as the qualified default investment alternative (QDIA) that involved no real personalization and thus was no more than an expensive target date fund (TDF).

The judge here noted that the asset allocation and management used by the managed account were sufficiently distinct from that of a TDF, such that the TDF was not a plausible comparison to a managed account.

While it is not the first time that a federal judge has found managed accounts and TDF comparisons to be apples and oranges, for fees to be considered reasonable, there should be a comparison to service differentials. A managed account that provides no more than a TDF would seem to be vulnerable to legal challenge.