Quick Takes:

Q2 2024 Review of Defined Contribution Regulation, Legislation, & Litigation

The second quarter of the year proved to be a busy one given the Labor Department's issuance of its new Retirement Security Rule that greatly expanded the definition of an ERISA fiduciary and litigation challenging the legality (and even the constitutionality) of that effort. Three of the suits challenging the use of plan forfeitures to offset employer contributions have now been reviewed by a federal judge – with differing results. Meanwhile, a suit challenging the prudence of a managed account as being little more than an expensive target date fund (TDF) emerged.

Looking ahead, HSA contribution limits will get a modest cost-of-living adjustment next year, and a bill has been introduced in the U.S. Senate that would dramatically increase the tax credits for small businesses that set up a retirement plan. Details follow.

Regulatory Updates

Final Investment Advice Fiduciary Rule Released

On April 23, the Labor Department (DOL) released its final Retirement Security Rule—also called the Fiduciary Rule—that the agency said will "protect the millions of workers who are saving for retirement diligently and rely on advice from trusted professionals on how to invest their savings." This Final Rule updates the definition of an investment advice fiduciary and sets aside the so-called five-part test that has defined ERISA fiduciary status for nearly fifty years in favor of a new standard that broadens that status to more people and more products, notably with regard to rollover advice, and most specifically with regard to closing a loophole for "one time" advice (the so-called "regular basis" prong of the five-part test).

The Final Rule and the amendments to prohibited transaction exemptions (PTE) 2020-02 and PTE 84-24 are effective September 23, 2024, and will apply to investment advice provided on or after that date. Both amended PTE 2020–02 and amended PTE 84–24 include a one-year transition period after their effective dates. Note, however, that litigation has (already) been filed challenging that implementation (discussed below).

HSA Contribution Limits Get a (Slight) Bump for 2025

While not quite the cost-of-living increase (7%) attributed to last year's record inflation, health savings account (HSA) limits will still receive an increase for 2025. Specifically, the annual limitation on deductions for an individual with self-only coverage under a high deductible health plan (HDHP) in 2025 will be $4,300, which is a 3.6% increase from the 2024 limit of $4,150. Similarly, the annual limitation on deductions for an individual with family coverage under a HDHP will be $8,550, a 3% increase from the 2024 limit of $8,300. The $1,000 catch-up limit for those aged 55 or older remains unchanged.

Legislative Updates

Bill Introduced to Boost Small Biz Retirement Plan Start-up Credit

Senator Maggie Hassan (D-N.H.), a member of the Senate Finance Committee, and Senator Ted Budd (R-N.C.), a member of the Senate Health, Education, Labor and Pensions (HELP) Committee, on May 23 introduced the Retirement Investment in Small Employers Act (RISE Act / S. 4398). The legislation would raise the minimum tax credit that small businesses with fewer than 10 employees can receive for retirement plan start-up costs from a minimum threshold of $500 to $2,500 to help them cover the costs of starting a retirement plan.

Litigation Updates

New Fiduciary Rule Immediately Challenged

Less than a month after it was rolled out, two lawsuits have already been filed challenging the new Fiduciary Rule; one by a consortium of nine national trade associations ("that represent life insurance companies, insurance agents, brokers, and distributors who issue, market, and sell insurance and securities products, including annuities, to retirement savers") and one by the Federation of Americans for Consumer Choice, Inc. (FACC), among others.

The former asserts that the Fiduciary Rule is "contrary to law, arbitrary and capricious, and unconstitutional," the latter seeks to vacate the Fiduciary Rule and amendment to PTE-84-24 under the Administrative Procedures Act (APA) on the grounds that they are "contrary to law and arbitrary and capricious." It also seeks "preliminary and permanent injunctive relief to prevent the DOL from attempting to enforce these unlawful rules and regulations." The US Chamber of Commerce, which successfully challenged the last attempt by the DOL to expand the scope of fiduciary, has already filed its support of the arguments made in the FACC suit. The suits seek not only to overturn the Fiduciary Rule but to forestall it going into effect.

As of June 14, the DOL has not surprisingly already responded with an "opposition to plaintiffs' motion for preliminary injunction," commenting that "Because the [DOL's] amended test reasonably addresses the totality of the circumstances, Plaintiffs have failed to muster convincing arguments that the Retirement Security Rule is unlawful." They also argue that the "requested injunction would harm [the DOL] in executing their statutory responsibilities and disserve the public interest."

Plan Forfeiture Suit – One Moves Forward, Another Rebuffed

There have been a series of cases filed in federal court in California challenging as a fiduciary breach the use of forfeitures to offset employer contributions. While clearly permissible, and in at least several cases, specifically detailed in the plan document, the argument has been that doing so is not in the "best interests" of participants. A federal judge has now ruled in one of those cases (Perez-Cruet v. Qualcomm Inc.) and found a "plausible" case has been made sufficient to reject the motion to dismiss by the plan sponsor defendants, keeping the suit active.

On the other hand, another case involving the use of forfeitures by the HP defendants was recently dismissed by a federal judge, who found those allegations "implausible because it relies on a false premise that HP receives a windfall from forfeited amounts, and it would require that plan expenses are always paid before reducing employer contributions." However, the judge gave the plaintiffs 30 days to remedy the shortfalls in their arguments. Neither case represents a final judgement on the matter, but the suits remind that it is important to both know – and follow – the terms of the plan document.

Reminder About Beneficiary Designations

In a case that reminds of the importance of keeping beneficiary designations current, a 401(k) balance of some $754,006.54—accumulated by one Jeffrey Rolison in the Proctor & Gamble 401(k) from his date of enrollment (4/27/87) through his death (12/14/15) was recently awarded to his former girlfriend. They broke up in 1989, but Rolison never changed the beneficiary designation. While there are legal protections for spouses, non-spouses, which in this case was the deceased's family, can be left out in the cold.

Managed Account Default Draws Suit

A new suit alleges a fiduciary breach by plan fiduciaries of the Bechtel Trust and Thrift Plan that defaulted participants into a managed account option that they claim was nothing more than an expensive TDF. The suit alleges that "without additional personalization of information from Plan participants, managed accounts are essentially expensive TDFs, focused on the single demographic factor of age."

While this is only one side of the suit, it begs the question: if there is no difference between a TDF and a managed account, is it reasonable to charge a higher fee for the latter? This case is a good reminder to document the process and the rationale for the selection, as the rationale will highlight the value of a more expensive solution when selected.

Prudent Process Prevails

Evidence of a prudent process—and a lack of valid comparator plans—produced a win in federal court for the fiduciary defendants of a $6.5 billion plan in an excessive fee suit. In an order granting summary judgment (Moore et al. v. Humana Inc. et al.), the court found evidence of prudent process involving both request for proposals (or RFPs) and annual benchmarking. The court noted that the fiduciary defendants admitted that they did not "seek to continually negotiate the lowest possible recordkeeping fee with Schwab (the plan's recordkeeper); they merely assert that this was unnecessary, and they had no duty to do so". As courts have now found in several federal court districts, this court also found the attempted fee comparisons with plans of a similar size alone to be insufficient without detail as to the range of services provided for those fees.

TDF Underperformance Premise (Still) Unpersuasive

The fiduciary defendants in another of the BlackRock LifePath TDF suits have—again—successfully fended off litigation claiming they chased low fees and disregarded poor performance. This series of lawsuits - filed on behalf of participants in about a dozen 401(k) plans that had investments in the BlackRock Lifepath TDFs (including Citigroup Inc., Genworth, Capital One, Booz Hamilton Allen, Stanley Black & Decker Inc., Marsh & McLennan Cos., Advance Publications, and Wintrust Financial Corp.) have argued that the plan fiduciaries imprudently "chased low fees" and disregarded alleged poor performance.

Despite the second chance to improve their arguments, Judge Edward J. Davila found no issue with the Cisco System 401(k) plan's use of custom benchmarks (which was contemplated in the plan's investment policy statement), disagreed with the plaintiffs' arguments regarding appropriate comparator funds, and noted that "...federal courts have nonetheless widely and consistently rejected attempts to impose ERISA liability where the claims are based solely on a fund's underperformance," and dismissed the claims, but left an opportunity to address the shortfalls in their arguments.