Benefits & Compensation University

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Developments & Key Issues for Qualified Plans in 2020

October 14, 2020

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Agenda

- Issues and updates regarding distributions
- Reducing or suspending matching and nonelective contributions under 401(k) Safe Harbor plans in 2020 and beyond
- ERISA Title I round-up for plan sponsors
  - Recent Department of Labor updates
  - Litigation developments

Issues and Updates Regarding Distributions

- Hardship withdrawal issues
- Overview of other recent distribution changes and guidance
- CARES Act
  - Coronavirus-related distributions (CRDs)
  - Plan loan relief
- SECURE Act and CARES Act changes to Required Minimum Distribution (RMD) rules

Hardship Withdrawals

- Final IRS regulations §1.401(k)-1 (84 Fed. Reg. 49651; September 23, 2019)
- Key Changes - optional changes allowed as early as 2019; mandatory changes required for 2020
  - Reflect Bipartisan Budget Act of 2018 prohibition on suspension of deferrals following withdrawal (required) and expansion of available sources for withdrawal (optional)
  - Allow other conditions to be imposed, such as requirement to first take available plan loan (optional)
  - Incorporate Pension Protection Act's expansion of safe harbor events to allow withdrawal for medical, educational and funeral expenses of primary beneficiary under the plan (optional)

Hardship Withdrawals

  - Add safe harbor distribution event for losses due to disaster area declared by FEMA (optional)
  - Clarify that temporary safe harbor event for casualty loss not impacted by temporary change enacted by Jobs Act to Code Section 165 limiting casualty loss deduction (optional)
  - Specified procedures for substantiating withdrawal is necessary to satisfy immediate and heavy financial need (required – see later slide)

- Amendment Deadline
  - Amendments that relate to final regulations must be adopted no later than December 31, 2021

Hardship Withdrawals

- Immediate and heavy financial need
  - Safe harbor events set forth in regulations
- Internal Revenue Manual Section 4.72.2.7.5.1 (08-26-20)
  - Source documents at time of withdrawal request (e.g., funeral home bill, contractor invoice)
  - "Summary method"
    - Notification to employee (see Internal Revenue Manual Exhibit 4.72.2-1)
    - Source documents may need to be produced upon IRS request on audit
      - Information incomplete/inconsistent on its face
      - More than two hardship withdrawals in a single plan year

Hardship Withdrawals

- Withdrawal necessary to satisfy need
  - Amount of withdrawal may not exceed amount of need (including tax/penalties)
  - All other currently available distributions taken (not required to take plan loan)
    - Including nonqualified deferred compensation plans and ESOP dividends under 404(k)
  - Employee representation regarding insufficient cash or other liquid assets reasonably available to satisfy the need
    - May be in writing (including electronic means) or by recorded phone line
  - Plan administrator does not have actual knowledge that is contrary to employee's representation
    - No obligation to inquire

Other Recent Changes/Guidance

- Disaster Relief (other than Coronavirus relief)
  - FEMA safe harbor event for hardship withdrawals
  - Further Consolidated Appropriations Act, 2020 (Qualified Disaster Distributions)
    - Similar to legislative and other IRS relief we have seen in the past (e.g., hurricanes, wildfires)
    - Participants affected by major disasters declared between January 1, 2018, and February 18, 2020
    - Up to $100,000 in distributions not subject to 10% early withdrawal penalty (reduced by disaster distributions received in prior tax years)
    - Income inclusion ratably over 3 years
    - Re-contribution rights
    - Be aware of amendment deadline (December 31, 2020, for calendar year plans)

Other Recent Changes/Guidance

- Qualified birth or adoption distribution (QBOAD)
  - See IRS Notice 2020-68 for guidance
  - Optional (eligible participant may characterize as QBOAD even if plan does not)
  - Up to $5,000 per eligible child
  - Repayment Rights (questions remain about administering)
  - No Special Tax (402(f)) Notice or mandatory 20% withholding
- Optional in-service distribution from defined benefit plans beginning at age 59-1/2 (Bipartisan American Miners Act of 2019)
  - Separate from in-service distribution allowed at Normal Retirement Age

Other Recent Changes/Guidance

- Qualified plan loan offset (QPLO) amounts
  - Reduction in account balance to offset unpaid plan loan
  - Plan administrator determines whether plan loan offset is qualified in order to properly report on Form 1099-R, based on whether offset:
    - Relates to failure to meet plan loan repayment terms
    - Occurs within one year following severance form employment
  - May be rolled over through due date, including extensions, for filing federal income tax return for taxable year in which offset occurs (rather than standard 60-day rollover period)
    - Offsets in 2020 may be treated as Coronavirus-related distribution (allows for longer, 3-year rollover period)
  - IRS issued proposed regulations August 20, 2020 (85 Fed. Reg. 51369)

Other Recent Changes/Guidance

- IRS temporary relief relating to physical presence requirement for spousal consent rules; see Notice 2020-42
- SECURE Act protections for plan sponsors who want to offer lifetime income options in 401(k) plan
  - Safe harbor for selecting provider of in-plan group annuity
  - New Code Section 401(a)(38) allows optional in-service distribution in connection with elimination of lifetime income option
- Generally, deadline for amending to reflect SECURE Act changes is December 31, 2022, for calendar year plan

Other Recent Changes/Guidance

- Prohibition on plan loans through credit cards
  - SECURE Act change effective January 1, 2020
  - Do not expect many plans will have provided for this but beware if they do
- Final regulations under Section 3405 updating rules for withholding on certain periodic pension and annuity payments
  - Published October 1, 2020 (85 Fed. Reg. 61813)
  - Jobs Act modified rules – rather than specify default, withholding assumptions to be provided by IRS guidance
  - Final regulations simply align with this more flexible approach but for now, prior defaults continue to apply

CARES Act

- See IRS Notice 2020-50 for guidance relating to Coronavirus-related Distributions (CRDs) and special provisions regarding plan loans
  - For Qualified Individuals, CRD of up to $100,000 allowed for distributions taken January 1 - December 30, 2020
  - Expanded availability for new plan loans (ended September 22, 2020)
    - $100,000 (less outstanding loans) or 100% of vested account balance
  - Optional suspension of loan repayments due between March 27 - December 31, 2020, for up to one year
- Amend to reflect CRDs and loan relief by December 31, 2022, for calendar year plan

CARES Act

- CRD Right to repay (or rollover into IRA) within three years
  - Only if distribution is otherwise eligible for tax-free rollover
    - Participant files amended tax return to reverse income inclusion for earlier years (Form 8915-E)
  - Rollover contributions allowed under plan terms?
  - Able to rely on certification of participant regarding eligibility
  - What if plan accepts invalid rollover contribution?
    - No qualification issue if –
      - Reasonable belief that contribution is valid rollover contribution (participant certification)
      - Upon later determination otherwise, distribute any amount attributable to invalid rollover contribution (including earnings) within reasonable period of time

CARES Act

- Plan Loans – Optional Repayment relief for Qualified Individuals
  - Notice 2020-50 safe harbor for administering suspension
    - Resume repayments in January, 2021
    - Extend term of loan by up to one year from original date (even if beyond 5 years)
    - Other ways to administer may be reasonable (but probably more complex)
    - Must add interest that accrued during suspension
  - Differentiate loan relief provided by IRS Notice 2020-23
    - No extension of loan term

Required Minimum Distribution Rules
Changes Under SECURE Act and CARES Act

- Overview: Required Minimum Distribution (RMD) Rules under Section 401(a)(9) of the Internal Revenue Code of 1986, as amended ("the Code") set deadlines for when payments must be paid, or begin to be paid, to plan participants during their lifetime and after death
- Setting Every Community Up for Retirement Enhancement Act of 2019 (SECURE Act), enacted December 20, 2019, made significant changes to timing rules applicable to RMDs
- Coronavirus Aid, Relief, and Economic Security Act (CARES Act) permitted waiver of 2020 RMDs to participants and beneficiaries from defined contribution plans

Required Minimum Distribution Rules
Changes Under SECURE Act and CARES Act

- General Overview of Code section 401(a)(9) RMD Rules
  - Payment dates are deadlines; plans may require earlier payment
  - Consequences of failure to comply with RMD rules:
    - Excise tax on participant, and
    - Potential plan disqualification

Required Minimum Distribution Rules
Changes Under SECURE Act and CARES Act

- **RMDs during participant's lifetime:** Plan must distribute entire account balance or begin periodic payments no later than participant's Required Beginning Date
  - Before SECURE Act: Required Beginning Date is April 1 following the later of the calendar year the participant attains age 70-1/2 or terminates employment (for 5% or more owner, after attainment of age 70-1/2, regardless of employment status)
  - After SECURE Act, age trigger changes to 72 for participants attaining age 70-1/2 after December 31, 2019

Required Minimum Distribution Rules
Changes Under SECURE Act and CARES Act

- RMDs for subsequent years must be made by December 31 of year to which they relate
  - Calendar year in which participant attains age 70-1/2 (age 72 after SECURE Act) is year one, and ability to defer until April 1 of following year creates a 3-month grace period
  - Year two and subsequent year payments due December 31, so participant may receive two RMDs in year two (same year in which Required Beginning Date occurs)
  - **Spoiler alert:** possibility of two RMDs in year two may be relevant to some participant with respect to CARES Act 2020 waiver

Required Minimum Distribution Rules
Changes Under SECURE Act and CARES Act

- Payment at Required Beginning Date
  - Plan must distribute entire account or begin periodic payments
  - A defined contribution plan may require participant to receive a single lump sum
  - Periodic payments must be distributed over period no longer than life or life expectancies of participant and designated beneficiary (subject to SECURE Act changes)
  - Designated beneficiaries are individuals designated by participant as beneficiaries, determined as of participant's death

Required Minimum Distribution Rules
Changes Under SECURE Act and CARES Act

- Payments after participant's death, if death is prior to 2020 (prior to effective date of SECURE Act)
  - Death on or after Required Beginning Date and after RMDs have begun:
    - Basic Rule: Remaining accounts must be paid to beneficiary as rapidly as under method being used prior to participant's death
    - If not being paid as an annuity, remaining accounts may be paid over longer of remaining life expectancy of designated beneficiary or deceased participant
  - Death prior to Required Beginning Date and before RMDs have begun
    - If beneficiary is not surviving spouse, distributions must be completed no later than end of year following year of participant's death or by December 31 of year containing 5th anniversary of death
    - If sole beneficiary is surviving spouse, may delay payment until year participant would have reached age 70-1/2

Required Minimum Distribution Rules
Changes Under SECURE Act and CARES Act

- Payments after participant's death, if death is in 2020 or later (after effective date of SECURE Act) - Overview
  - SECURE Act changes to post-death RMDs apply only to defined contribution plans
  - Whether or not payments have begun prior to death no longer determinative of RMD timing requirements
  - Creates a new category of "eligible designated beneficiaries," who are designated beneficiaries who are one of the following:
    - Surviving spouse
    - Child under age of majority
    - Disabled or chronically ill individual
    - Any other person no more than 10 years younger than participant

Required Minimum Distribution Rules
Changes Under SECURE Act and CARES Act

- Payments after participant's death, if death is in 2020 or later (after effective date of SECURE Act) – New Timing Rules
  - Basic Rule: Designated beneficiaries who are not eligible designated beneficiaries must receive full distribution within 10 years of participant's death (no more stretching over life expectancy)
  - Distributions to eligible designated beneficiaries must begin within one year of participant's death and be paid over period no longer than beneficiary's life expectancy (if child, no more than 10 years after child reaches majority)
  - If sole beneficiary is the surviving spouse, may defer distribution until participant would have attained age 72
  - Other beneficiaries (such as estates and trusts) must receive full distributions within 5 years of participant's death

Required Minimum Distribution Rules
Changes Under SECURE Act and CARES Act

- 2020 RMD Waivers under Section 2203 of the CARES Act – Overview
  - Added new Code Section 401(a)(9)(I)
  - IRS Guidance in Notice 2020-51 (includes model amendment that provides protection against Code section 411(d)(6) anti-cutback rules)
  - Applies to defined contribution plans (including 401(k), 403(b), and 457(b)), but not to defined benefit plans
  - Applies whether RMD payable to participant or beneficiary
  - Plans are not required to allow waiver of 2020 RMDs, but most probably will

Required Minimum Distribution Rules
Changes Under SECURE Act and CARES Act

- Basic Rule for CARES Act waiver: RMDs otherwise required for 2020 may be waived, including:
  - 2019 RMDs for which Required Beginning Date is April 1, 2020;
  - 2020 RMDs otherwise payable by December 31, 2020; and
  - 2020 RMDS payable with Required Beginning Date of April 1, 2021
- Waiver does not change Required Beginning Date; only affects whether payment must be made
- Does not affect rules for calculating amount or otherwise-applicable rules for timing, except payments subject to 5-year rule are payable over 6 years

Required Minimum Distribution Rules
Changes Under SECURE Act and CARES Act

- CARES Act 2020 RMD Waivers – effect on rollovers
  – Distributions that would have been RMDS but for CARES Act waiver may rolled to other plans or IRAs
  – Special Rules
    - Plan is not required to permit a direct rollover
    - If not directly rolled, distribution not subject to usual 20% mandatory withholding
    - Usual Code section 402(f) rollover notice to participant not required
    - "Extended 2020 RMDs" (an RMD included within a periodic payment) also eligible for rollover and subject to special exemptions for mandatory withholding and 402(f) notice
    - Extended rollover period (more than 60 days after distribution) allowed through August 31, 2020, and applied to distributions that would otherwise been RMDs

Required Minimum Distribution Rules
Changes Under SECURE Act and CARES Act

- Plan Amendments reflecting 2020 CARES Act Waiver
  - Plans not required to permit waiver of RMD amounts
  - Plans that do permit waiver and require conforming amendment must be amended retroactively no later than end of first plan year beginning on or after January 1, 2022
  - IRS provides model amendment providing for RMD waiver in Notice 2020-51
    - Under model amendment, the employer must choose one of following two defaults for payment of RMD in absence of participant election:
      - Participant or beneficiary *will* receive distribution unless participant/beneficiary elects otherwise, or
      - Participant or beneficiary *will not* receive distribution unless participant/beneficiary elects otherwise

Required Minimum Distribution Rules
Changes Under SECURE Act and CARES Act

- Plan Amendments reflecting 2020 CARES Act Waiver (cont'd)
  - Employer must also choose direct rollover treatment:
    - Default: plan offers direct rollover only for distributions that would be eligible rollover distributions in the absence of the CARES Act 2020 RMD waiver (meaning plan will not allow distributions that would have been RMDs but for the waiver to be directly rolled to another plan or IRA)
    - Plan may alternatively choose to treat one of the following as eligible for direct rollover (in addition to amounts that would normally be eligible rollover distributions):
      - 2020 RMDs;
      - 2020 RMDs and Extended 2020 RMDs (i.e., RMD part of periodic payment); or
      - 2020 RMDs but only if paid with an amount otherwise an eligible rollover distribution
  - Using IRS Model Amendment is not required, but protects against application of Code Section 411(d)(6) anti-cutback rules

Reducing or Suspending Matching and Nonelective Contributions under 401(k) Safe Harbor Plans in 2020 and Beyond

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Safe Harbor 401(k) Plans

- What is a safe harbor 401(k) Plan?
  - A plan described in sections 401(k)(12) or 401(m)(11) of the Internal Revenue Code of 1986 as amended (the "Code") or a qualified automatic contribution safe harbor plan described in sections 401(k)(13) or 401(m)(12) of the Code
- Advantage of Being a Safe Harbor 401(k) Plan:
  - Plan is treated as satisfying the actual deferral percentage (ADP) and, with respect to matching contributions, the actual contribution percentage (ACP) nondiscrimination tests that normally apply to 401(k) plans
  - Eases administration of plan, including administrative burdens resulting from failures to pass ADP and ACP testing (e.g., returning excess amounts to highly-compensated employees (HCEs))

Safe Harbor 401(k) Plans

- A safe harbor 401(k) plan must fulfill the following requirements:
  - The employer must make a specified level of matching contributions, or alternatively, a specified level of nonelective contributions, to the plan
  - The plan must satisfy certain vesting requirements
  - The employer must provide a “safe harbor notice” to participants prior to beginning of plan year, describing safe harbor features, including information about the matching contributions or nonelective contributions (optional for nonelective contribution plans in 2020 and later under SECURE Act)
  - **Note:** providing safe harbor notice allows employer to preserve ability to reduce or suspend matching or nonelective contributions mid-year

Safe Harbor 401(k) Plans

- Safe harbor 401(k) plan requirements (cont'd)
  - Plan terms generally must be set prior to beginning of the plan year, with few mid-year changes permitted
    - Strict limits on ability to reduce or suspend employer matching or nonelective contributions
    - Exception: a non-safe harbor plan may be amended before year-end to become a safe harbor plan by adding nonelective contributions
  - Violation of safe harbor rules can cause loss of safe harbor status and risk plan disqualification

Safe Harbor 401(k) Plans

- IRS Notice 2020-52 provided temporary relief by waiving for a limited period in 2020 some of the requirements that normally apply to suspension or reduction of safe harbor contributions under IRS regulations
  - Temporary relief provided in IRS Notice 2020-52 is realistically no longer available for reduction or suspension of safe harbor contributions on behalf of all eligible employees, because plan amendment had to be adopted and supplemental notice provided no later than August 31, 2020
  - May be possible to reduce or suspend matching or nonelective contributions on behalf of HCEs if requirements regarding supplemental notice and ability to change elections are satisfied under special rules for HCEs in Notice 2020-52

Safe Harbor 401(k) Plans

- IRS regulations provide limited ability to suspend or reduce matching or nonelective contributions to safe harbor 401(k) plan – apply any year, not just 2020
- Principal Requirement is that either:
  a) the plan sponsor must be operating at an economic loss for the plan year, OR
  b) the safe harbor notice provided prior to the beginning of the plan year to employees eligible to participate in the plan must have included a statement:
     i. that the plan may be amended during the plan year to reduce or suspend the safe harbor contributions, and
     ii. that the reduction or suspension will not apply until at least 30 days after all eligible employees receive a supplemental notice of the reduction or suspension

Safe Harbor 401(k) Plans

- Additional rules for suspending or reducing matching and nonelective contributions:
  - Adoption of plan amendment prior to effective date of change
  - The plan must satisfy the safe harbor requirements prior to effective date
  - Plan amendment must provide that the plan will satisfy ADP and ACP nondiscrimination tests for entire year in which change occurs
  - All eligible employees must receive supplemental notice about the change at least 30 days prior to amendment effective date
  - All eligible employees must be given a reasonable amount of time in advance of effective date to change elections

Safe Harbor 401(k) Plans

- Looking ahead to 2021
  - Preserve ability to reduce or suspend matching or nonelective contributions mid-year in 2021 by including in the pre-plan year notice a statement saying:
    - That the plan may be amended during the plan year to reduce or suspend the safe harbor contributions, and
    - That the reduction or suspension will not apply until at least 30 days after all eligible employees receive a supplemental notice of the reduction or suspension
  - Provide to eligible employees the pre-plan year safe harbor notice that includes foregoing statement, even though the SECURE Act eliminated the requirement that pre-plan year notices be provided to nonelective contribution safe harbor 401(k) plans

ERISA Title I Round-Up for Plan Sponsors

- Recent Department of Labor updates
  - Electronic Disclosure Rule
  - ESG Proposed Rule
  - Proxy Voting Proposed Rule
  - Lifetime Income Disclosures Interim Final Rule
  - Registration of Pooled Plan Providers of Pooled Employer Plans Proposed Rule
- Litigation developments

Electronic Disclosure Rule

- DOL & EBSA issued regulations on May 21, 2020, effective July 27, 2020, regarding electronic disclosure of retirement plan notices
- Two main features:
  - Opt-out structure (vs. opt-in structure)
  - Two safe harbors:
    - Notice and access
    - Direct email delivery

Electronic Disclosure Rule

- Covered documents
  - Almost all documents required under Title I of ERISA
  - Not documents required by the IRC
- Covered individuals
  - Participant, beneficiary, or other individual who provides an electronic address
    - Can include smartphone number for notice and access safe harbor
  - Employee with employer-assigned email address

Electronic Disclosure Rule

- Requirements:
  - Initial notice on paper
    - Must include electronic address that will be used
    - Must include instructions on opting out entirely
  - Each subsequent e-disclosure must include instructions on how to opt-out entirely or obtain a paper version of an individual disclosure
    - No “à la carte” opt-outs
  - Monitor for invalid electronic addresses and promptly correct
  - Verify electronic address on termination of employment

Electronic Disclosure Rule

- Notice and access safe harbor
  - E-disclosure is a “notice of internet availability” (NOIA)
  - E-disclosure directs covered individual to website with ERISA notice
- Direct email safe harbor
  - Notice can be in body of email or attachment
  - No website or NOIA required

Electronic Disclosure Rule

- Key considerations
  - Limited application (retirement plans, **not** welfare plans)
  - Fiduciary obligations in selecting and monitoring third-party website provider
  - Notice and access vs. direct email
  - Use of apps
  - Whether to continue with 2002 safe harbor for some or all participants
    - 2002 safe harbor applies to retirement and welfare plans
    - Covers employees who are “wired at work” or who opt-in to e-disclosures

ESG Proposed Rule

- DOL published a proposed rule regarding the use of environmental, social and governance ("ESG") factors in selecting investments for ERISA plans in the Federal Register on June 30, 2020
- Main features:
  - Amendment of the "investment duties" regulation (29 C.F.R. § 2550.404a-1)
  - ERISA's duties of loyalty and prudence are met where a fiduciary evaluates investments "based solely on pecuniary factors"
  - Documentation obligations when choosing ESG-themed investment
  - ESG-themed funds may not be used as QDIAs

ESG Proposed Rule

- Broad usage of term "ESG-themed investments" as those "that include one or more environmental, social, corporate governance, or similarly oriented assessments or judgments in their investment mandates, or that include these parameters in the fund name"
- Purpose of proposed rule:
  - Growing emphasis on ESG investing may cause investment decisions based on factors other than providing benefits and defraying reasonable expenses
  - Potentially higher fees associated with ESG funds
  - Clarify that fiduciaries may not invest in ESG vehicles if they subordinate return or increase risk for the purpose of non-pecuniary objectives

ESG Proposed Rule

- Fiduciaries must evaluate investments solely based on pecuniary factors and not sacrifice investment returns to promote unrelated goals
- Fiduciaries may only consider ESG factors as pecuniary factors if they also examine the diversification, liquidity, and potential risk-return of ESG-themed investments to alternatives
- If two alternatives are "economically indistinguishable" and fiduciaries choose one based on non-pecuniary/ESG factors (the "all things being equal" test), the fiduciaries must document rationale for choice
- If fiduciaries add ESG-themed investment to individual account plan, decision must be based on "objective risk-return criteria" and documented
- ESG-themed investments cannot be added as, or as a component of, a QDIA

ESG Proposed Rule

- Key considerations
  - Documentation obligations: level of documentation required and potential associated costs
  - Pecuniary benefits of ESG-themed investments vs. potential risks
  - Potential changes to proposed rule based on negative feedback during comment process

Proxy Voting Proposed Rule

- DOL published a proposed rule regarding proxy voting and exercise of shareholder rights in the Federal Register on September 4, 2020
- Main features:
  - Amendment of the "investment duties" regulation to add a new subsection (29 C.F.R. § 2550.404a-1)
  - Fiduciaries must vote proxies if they prudently determine the matter being voted upon has an economic impact on the plan; otherwise, they may not vote proxies
  - Fiduciaries could adopt three "permitted practices" (**not** safe harbors) in their proxy voting policies

Proxy Voting Proposed Rule

- Purpose of the Proposed Rule:
  - Clear up historical confusion on whether voting proxies is required
  - Rescind IB 2016-01, which instructed fiduciaries to consider whether the vote (alone or together with other shareholders) would affect the value of the plan's investment, versus cost of voting, and also permitted consideration of ESG factors
  - Clarify that fiduciaries *must not* vote unless the matter being voted upon would have an economic impact on the plan

"Accordingly, the use of plan assets for purposes other than enhancing the value of the plan's investments—through proxy voting or otherwise—violates the fiduciary duties of loyalty and care under ERISA."

Proxy Voting Proposed Rule

- Fiduciaries must:
  - Act in accordance with the economic interest of the plan based on risk/return
  - Consider likely impact on investment performance based on size of plan's holding, plan's percentage ownership of issuer, and costs involved
  - Not subordinate economic interests to any "non-pecuniary objectives"
  - Investigate material facts forming the basis of any proxy vote
  - Maintain records on proxy voting to demonstrate basis for any decision
  - Prudently select and monitor proxy advisors (who must also maintain records on proxy voting)

Proxy Voting Proposed Rule

- "Permitted practices" to reduce the need for fiduciaries to expend resources on considering proxy votes unlikely to have a financial impact:
  - Voting proxies per management's recommendations (subject to fiduciary's determination an issue requires further analysis due to heightened conflict of interest or is likely to have a significant economic impact on plan investment)
  - Voting proxies only on specific proposals substantially related to business activities (e.g., proposals related to corporate events, corporate buy-backs, share dilution, contested director elections)
  - Refraining from voting proxies if the plan's investment in a single issuer is relatively small compared to overall plan assets

Proxy Voting Proposed Rule

- Key considerations
  - Establishing a proxy voting policy and reviewing the policy every 2 years
    - Guidelines must be made available to participants
  - Determining how much evidence a fiduciary has to amass to demonstrate that a proxy vote would have an economic impact on a plan's investment
  - Prudently selecting and monitoring any proxy voting firm, including requiring the firm to document any proxy voting decisions
  - Proposed rule would not cover plans that only hold assets through registered investment companies, such as mutual funds

Lifetime Income Disclosure

- *Headline*: On September 18, 2020, DOL issued an Interim Final Rule that sets forth the elements for meeting the new lifetime income disclosure requirement created by the SECURE Act
- *Background*. ERISA Section 105(a) requires plan administrators to provide benefit statements at least annually; provided that in the case of a plan with participant-directed investments, benefit statements must be provided at least quarterly
- The Secure Act created a new requirement that plan administrators of defined contribution plans include in benefit statements a lifetime income disclosure
  - Such disclosure must be provided at least annually and set forth the monthly amount of a QJSA and of a single life annuity that are each actuarially equivalent to the participant's total account balance
  - The life time streams are to be calculated based on assumptions to be issued by the DOL

Lifetime Income Disclosure

- The SECURE Act tasked the DOL with issuing:
  - An interim final rule
  - Assumptions for converting account balances to lifetime income streams
  - A model disclosure by December 20, 2020

The new disclosure requirement applies to benefit statements issued more than one year after the last of those three pieces of DOL guidance is issued.

The Interim Final Rule. According to the DOL, the new Interim Final Rule, published September 18, 2020, satisfies each of the foregoing three requirements and *is effective on September 18, 2021, and applies to pension benefit statements furnished after such date*

Lifetime Income Disclosure

- *Limitation of Liability*: Section 105(a)(2)(D)(iv) of ERISA provides a limitation on liability. In relevant part it states that "[n]o plan fiduciary, plan sponsor, or other person shall have any liability under this title solely by reason of the provision of lifetime income stream equivalents which are derived in accordance with the assumptions and rules [prescribed by the Secretary] and which include the explanations contained in the model lifetime income disclosure [prescribed by the Secretary]."

Pension Benefit Statements

Lifetime Income Illustrations

Account balance as of [DATE]	Monthly payment at 67 (single life annuity)	Monthly payment at 67 (qualified joint and 100% survivor annuity)
$125,000	$645/month for life of participant	$533/month for life of participant. $533/month for life of participant's surviving spouse.

- Statement must show amount of account balance as of last day of statement period

Lifetime Income Disclosure

- Per the statute, the IFR requires that the PA include two lifetime income streams (a single life annuity and a joint and survivor annuity) on a participant's benefit statement in addition to their account balance. The IFR stipulates that calculations be based on the following assumptions:
  - That payment commences on the last day of the period covered by the statement
  - That as of that date the participant is age 67 (or the participant's actual age if older on that date)
  - In the case of the QJSA illustration, that the participant is married and that the spouse is the same age as the participant and that the survivor percentage is 100%
  - An interest rate equal to the 10-year constant maturity Treasury (CMT) securities yield rate for the first business day of the last month of the period to which the benefit statement relates
  - The applicable mortality table under Code section 417(e)(3)(B)
  - That the participant is 100% vested and that the account balance includes any outstanding loan other than one in default
  - No insurance load
  - No inflation adjustment

Lifetime Income Disclosure

- The pension benefit statements must include brief understandable explanations of the assumptions underlying the illustrations; primary purpose of explanation to clarify to participants that projected monthly payments are not guarantees
- The IFR includes model language that may be used to satisfy the explanation requirement
- While the explanations are required, use of the model language is optional
  - *However,* plan fiduciaries who wish to benefit from the liability relief of ERISA section 105(a)(2)(D)(iv) must use the model language or language that is substantially similar in all respects
- Some flexibility in format permitted

Lifetime Income Disclosure

- **Annuities issued by insurance companies:**
- Some defined contribution plans provide for "distribution annuities" which provide participants with periodic payments over their lives rather than lump sums
- Plan administrators of plans that offer annuities through a contract with a licensed insurance company, *may* base the two mandatory lifetime income illustrations on the terms of the insurance contract, instead of the otherwise mandatory assumptions set forth in the IFR
- Must still show SLA and QJSA commencing on last day of statement period, and assume that participant is age 67 on that date, but may otherwise substitute contract terms

Lifetime Income Disclosure

- Deferred Income Annuities
  - Some plans offer participants the ability to purchase deferred income annuities (DIAs) during the accumulation phase (i.e. during the period that contributions are being made to the plan)
  - Payment under the annuity is deferred until retirement age or even later, such as age 85
  - As contributions are used to purchase units in the annuity contract, each purchase reflects the interest rate environment and the participant’s age at the time of purchase

Lifetime Income Disclosure

- DIAs (cont'd)
- The IFR contains special disclosure rules for DIAs; the information that must be disclosed includes:
  - The date payments are scheduled to commence and the participant's age on such date;
  - The frequency and amount of deferred income stream payments under the contract as of the commencement date, in current dollars;
  - A description of any survivor benefit, period certain commitment or similar feature;
  - A statement as to whether payments are fixed or adjust with inflation and an explanation of adjustment if applicable
- There is no model for this disclosure and, according to the DOL, the relief from liability rule does not apply

Pooled Employer Plans

- *Headline*: On September 1, 2020, the DOL issued proposed regulations describing its registration process for Pooled Plan Providers (PPPs) of Pooled Employer Plans (PEPs). Under the proposed regulations, the PPP would be required to electronically file a proposed registration before beginning operations.

Pooled Employer Plans

- *Background on Pooled Employer Plans (PEPs)*
- *Historic DOL position*:
  - If multiple, unrelated employers shared a common nexus (such as industry or geography), the arrangement would be recognized as a single plan (often referred to as a "closed MEP") for purposes of satisfying many of ERISA's requirements, such as the annual Form 5500 filing
  - If a plan included unrelated participating employers that did not share a common interest (referred to as an "open MEP"), each participating employer treated as maintaining its own plan that was required to independently satisfy ERISA's requirements, including filing a separate Form 5500 and obtaining an independent audit, if applicable
  - Banks, insurance companies and other financial service firms precluded from acting as sponsors of MEPs that were intended to be treated as a single plan
- *Historic IRS Position*: the "one bad apple" rule; the IRS took the position that if one employer failed to meet the qualification requirements for its portion of the MEP, the entire MEP could be disqualified, even with respect to unrelated employers that had satisfied their obligations (IRS had proposed regulations in 2019 that would create limited exception to this rule)

Pooled Employer Plans

- *New PEPs*
- The SECURE Act essentially reversed these IRS and DOL positions by creating a new retirement vehicle called a "Pooled Employer Plan" or "PEP," a kind of open MEP:
  - In which unrelated employers may participate without a common nexus, and which is treated as a single plan for purposes of ERISA;
  - Which may be sponsored by a bank, insurance company or other financial services firm; and
  - Which will not be treated as failing the qualification requirements solely because a single employer fails to satisfy those requirements so long as the PEP provides for the transfer of the offending employer's plan assets to one of certain specified arrangements

Pooled Employer Plans

- A PEP May be either:
  - A qualified defined contribution plan under Section 401(a) of the Internal Revenue Code (the "Code") or
  - Individual retirement accounts described in Section 408 of the Code. The PPP responsible for maintaining a PEP may be one of the participating employers, or may be an unrelated entity, such as an insurer or financial institution, that meets certain requirements

PEPs are intended to enable the employees of small employers to enjoy the same economies of scale, efficiencies, and cost savings as those enjoyed by the employees of large employers.

Pooled Employer Plan

- *Some of the applicable requirements include:*
- PPPs will need to be registered with the IRS and the DOL before beginning their PEP operations. Per slide above, on September 1, 2020, DOL proposed regulations describing registration process for PPPs; PPP would be required to electronically file a proposed registration before beginning operations.
- The PPP must:
  - Be designated by the PEP as (a) a named fiduciary, (b) the plan administrator and (c) the person responsible to perform all administrative duties necessary to ensure that (i) the PEP meets the applicable requirements of ERISA and the Code, and (ii) each employer in the PEP takes such actions as necessary for the PEP to meet the such requirements
  - Acknowledge in writing that it is acting as a named fiduciary and plan administrator with respect to the PEP
  - Be responsible for ensuring that any person or entity who handles assets of, or who is a fiduciary to, the PEP is bonded in accordance with ERISA Section 412
- Employers may retain fiduciary responsibility for selection of investment options, but otherwise this falls to PPP
- **See Mayer Brown Article:** "Pooled Employer Plans – FAQs for US Employers"

Pooled Employer Plans

- *Benefits of PEPs*:
  - Because a PEP is treated as a single plan for purposes of satisfying the requirements of the Employee Retirement Income Security Act ("ERISA"), it affords streamlined administration and reporting
  - In addition, PEPs offer the possibility of lower costs than single employer plans on account of the pooling of assets and attendant economies of scale in connection with investment options (may enhance ability to obtain lower cost options)
  - Some commentators suggest that the greatest benefit may be that the PPP will be responsible for most fiduciary and administrative duties related to the PEP, freeing participating employers from the burden of those responsibilities and enabling them to limit their legal exposure for such matters (note: employers still have fiduciary duty to prudently select and monitor the PPP)

Actuarial Assumption Cases

- Since late 2018, eleven cases have been filed challenging the actuarial assumptions or conversion factors used in defined benefit plans
- The suits generally allege one or more of the following:
  - The assumptions (or tabular factors) used to convert the normal form of benefit (typically a single life annuity) to a joint and survivor annuity or other form of life annuity are unreasonable and result in a benefit that is not actuarially equivalent to the participant's normal form of benefit
  - The assumptions (or tabular factors used) to reduce plaintiffs benefit to reflect commencement prior to early retirement are unreasonable and result in a benefit that is not the actuarial equivalent of the participant's accrued benefit at normal retirement age

Actuarial Assumptions Cases

- Plaintiffs claims are typically brought under the following ERISA provisions:
  - *ERISA Section 203(a)* provides that "an employee's right to his normal retirement benefit is nonforfeitable upon attainment of normal retirement age"
  - *ERISA Section 204(c)(3)* provides that "in the case of any defined benefit plan, if any employee's accrued benefit is to be determined as an amount other than an annual benefit commencing at normal retirement age …the employee's accrued benefit …shall be the actuarial equivalent of such benefit or amount…"
  - *ERISA Section 205*. *ERISA Section 205(a)* provides that in the case of a married participant who does not die prior to his annuity starting date, the participant's benefit must be paid in the form of a QJSA. See also *Code Section 401(a)(11)*. *ERISA Section 205(d)* defines a QJSA as, *inter alia*, an annuity that is the actuarial equivalent of a single life annuity (generally the normal form).

Actuarial Assumption Cases

- While the definition of "actuarial equivalent" is the subject of litigation, a definition suggested by one court is as follows: "[t]wo modes of payment are actuarially equivalent when their present values are equal under a given set of assumptions." *Stephens v. US Airways Group, Inc.*, 644 F.3d 437, 440 (D.C. Cir. 2011)
- Calculating the present value of a stream of payments requires:
  i. The dollar amount of each payment,
  ii. The length of time over which payments will be made, and
  iii. A discount rate

Actuarial Assumptions Cases

- In the case of an annuity for a life (or lives) to calculate the value of an annuity payable over individual's life time need a to make an assumption regarding the individual's life expectancy (i.e. period over which payment will be made)
- Mortality tables predict how many people at any given age will die before reaching the next higher age; essentially, these predictions determining the number of years a plan expects to pay benefits to a retiree
- Newer mortality tables reflect longevity gains made after older tables were produced

Actuarial Assumption Cases

- In cases that allege that the assumptions for converting an SLA to another annuity form such as a J&SA, the challenge is generally aimed at the use of mortality tables that the plaintiffs claim are outdated; the use of an older mortality table will generally result in a lower J&SA conversion factor than the use of a newer table that reflects longer life expectancies. The tables challenged have ranged from tables issued in 1951 to 1984.
  - Interestingly, plans that use an older mortality table commonly use an interest rate assumption that is higher on average than what might be considered reasonable today. In general the use of a higher interest rate assumption will produce a larger J&SA conversion factor than a lower interest rate will. As a result in some cases an older table together with a higher interest rate may produce a J&SA that is very similar in amount to (and in some cases better than) that produced by a newer table and lower interest rate (e.g., the 417(e) assumptions).

Actuarial Assumption Cases

- In cases that allege that the assumptions for reducing a participant's benefit to reflect early commencement, the challenge is generally aimed at the use of mortality tables that the plaintiffs claim are outdated, as well as interest rate assumptions that the plaintiffs claim are too high (or where a plan uses tabular factors, that the factors are produced by such assumptions); this is because older tables and higher interest rates both tend to result in lower early retirement benefits

Actuarial Assumption Cases

- The results have been as follows:
  - In three cases motions to dismiss have been granted
    - *Brown v. UPS*, No. 1:20-cv-00460 (N.D. Ga): the court granted the motion to dismiss because plaintiffs had not exhausted their administrative remedies
    - In *DuBuske et al. v. PepsiCo, Inc. et al.*, No. 7:18-cv-11618 (S.D.N.Y), plaintiffs had alleged that the factors for converting an SLA to a non-SLA annuity violated ERISA Section 203 which provides that a participant's benefit is nonforfeitable upon attainment of normal retirement age. The *Pepsi* court granted the motion to dismiss on the ground that Section 203 did not apply as none of the plaintiffs had reached normal retirement age.
      - The court later granted a motion to reconsider filed by plaintiffs pointing out that they had actually also brought another count under a different section of ERISA. Ultimately, however, the parties settled and the case appears to have gone away.

Actuarial Assumption Cases

- In *Eliason v. ATT*: the court also granted a motion to dismiss because the plaintiffs were without standing. Plaintiffs had claimed that the application of the plan's ERFs unreasonably reduced their benefits, but it became apparent in early "jurisdictional discovery" that the ERFs in question were not applied in calculating the lump sums payable to the original named plaintiffs. Because the plaintiffs had not suffered any injury, the court dismissed for lack of standing.
  - Note that the plaintiffs had tried to cure the standing issue by adding plaintiffs who had elected annuities and whose benefits had in fact been subject to the contested ERFs, but the court held that their addition did not cure the defect; the new plaintiffs are, however, free to refile a new cause of action

Actuarial Assumption Cases

- In the following seven cases the courts have denied motions to dismiss:
  - Belknap v. Partners Healthcare System, Inc. No. 1:19-cv-11437 (D. Mass.)
  - Cruz v. Raytheon Company et al. No. 1:19-cv-11425 (D. Mass.)
  - Duffy v. Anheuser-Busch Companies, LLC No. 4:19-cv-01189 (E.D. Mo.)
  - Herndon v. Huntington Ingalls Industries, Inc. et al No. 4:19-cv-00052 (E.D. Va.)
  - Smith et al. v. U.S. Bancorp et al. No. 0:2018-cv-03405 (D. Minn.)
  - Smith v. Rockwell Automation Inc. et al. No. 2:19-cv-00505 (E.D. Wis.)
  - Torres et al. v. American Airlines, Inc. et al. No. 4:18-cv-00983 (N.D. Tex.) *(settled)*

Herndon Case: Battle of the Experts

- In addition in the *Herndon v. Huntington Ingalls Industries, Inc*. case listed above, the court recently denied defendant's motion for summary judgment
- The plan in Herndon used the 1971 GAM table and a 6% interest rate for purposes of converting an SLA to a J&SA; plaintiffs alleged that the use of the 1971 GAM table violated ERISA
- Defendant argued that the *conversion factor* produced by the table and the 6% interest rate is reasonable; plaintiffs and defendant retained experts who each submitted testimony

Herndon Case: Battle of the Experts

In brief summary, and oversimplifying somewhat:

- Plaintiff's expert focused on what he viewed as an unreasonable input – the 1971 GAM table and argued that the use of such an assumption violated ERISA's actuarial equivalent requirement;
- Defendant's expert focused on the fact that the conversion factor produced by the plan's assumptions fell within a range of results produced by various combinations of more "modern" mortality tables and interest rates; defendants' took the position that, as a consequence of this analysis, the conversion factors were themselves reasonable as a matter of law

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Herndon Case: Battle of the Experts

- The magistrate identified as a central issue of the case "whether actuarial equivalence is gauged by assessing the reasonableness of the actuarial assumptions underlying the conversion factor (i.e., the interest rate and mortality table) or the reasonableness of the conversion factor itself"
- In recommending against summary judgement, the Magistrate stated that there was a triable issue of fact, and that a factfinder could decide that the use of the 1971 GAM as an underlying actuarial assumption to determine ERISA mandated actuarial equivalence was unreasonable and deprived plaintiffs of their actuarial equivalent benefits
- The magistrate also noted that he found the defendants' expert's arguments compelling, and that a factfinder might find for the defendants, but at this stage he was required to view all disputes in the light most favorable to the plaintiffs

Actuarial Assumptions

- McCarthy vs. Dun & Bradstreet 482 F.3d 184 (2nd Cir. 2007): An oldie, but a goodie
  - Plan reduced early retirement benefits using an interest rate of 6.75% and a mortality table. The plaintiffs challenged the reasonableness of the 6.75% interest rate. The district court noted that the regulations do not specify a rate or range of rates that constitute reasonable actuarial reductions and stated that the question of whether rates are reasonable is a mixed question of law and fact.
  - The court stated that "a plan has met its ERISA obligations with respect to calculation of early benefit payments if it selects a discount rate that is reasonably calculated to be representative of participants' average discount rate," meaning, apparently, the rate of return desired by participants.
  - The court noted that a plan might assume that participants would prefer the return on a zero risk portfolio (like 30-year government securities) or something like the plan's actual rate of return (in this case about 8-10%). The court observed that 6.75% fell somewhere between those rates, and also noted that at the time the plan was amended and restated in 1994, 6.75% was less than the return on the zero risk portfolio. The court issued summary judgment in favor of the defendants on the ground that a reasonable trier of fact could not have found that 6.75% was unreasonable. The Second Circuit affirmed.

Single Stock Fund Cases

Two Circuit Court decisions issued in 2020, *Quatrone v. Gannett Co., Inc.*, No. 19-1212 (4th Cir. Aug. 11, 2020) and *Schweitzer v. Inv. Comm. of Phillips 66 Sav. Plan*, No. 18-cv-20379, 2020 WL 2611542 (5th Cir. May 22, 2020), highlight the dilemma of retirement plan sponsors and fiduciaries, who, as a result of a corporate transaction, inherit a plan investment fund consisting of a single class of stock that does not constitute an employer security for purposes of ERISA (i.e., a "single stock fund").

Single Stock Fund Cases

- Background. A single stock fund within a retirement plan can arise in a number of ways, but often results from a corporate spin-off transaction
  - In the spin-off of a division, parent corporation contributes the assets and liabilities of the division to a new subsidiary, and then distribute shares in the subsidiary to the parent's shareholders. If parent's shareholders include a retirement plan with an employer stock fund that holds shares of the parent, the plan—like all other shareholders—will receive shares of the subsidiary in connection with the spin-off. As a result, the plan will hold *both* the parent stock and subsidiary stock.
    - Where the retirement plan is maintained by the subsidiary, the parent corporation's stock will no longer constitute an employer security for purposes of ERISA Section 407, if the parent and subsidiary are no longer ERISA affiliates
    - If the post spin-off retirement plan is maintained by the parent corporation, the subsidiary's stock will not constitute an employer security if the corporations are no longer ERISA affiliates

Single Stock Funds Cases

Background (cont'd)

- ERISA Section 404(a)(2) provides that acquiring or holding an employer security in an individual account plan does not violate a fiduciary's duties of diversification or prudence
- This exemption from the diversification requirements does not apply to stock that is no longer an employer security on account of a spin-off

Single Stock Fund Cases

- The Fourth Circuit decision in *Gannett* includes an analysis of what plaintiffs must assert in the Fourth Circuit to state a claim for breach of fiduciary duty in a single stock fund case and a discussion of the application of the ERISA duties of prudence and diversification to a single stock fund
- District court in *Gannett* granted the defendants' motion to dismiss for two primary reasons:
  i. The plaintiffs' duty-of-prudence claims were barred under *Fifth Third Bancorp v. Dudenhoeffer*, 134 S. Ct. 2459 (2014) because they had failed to allege "special circumstances" related to mistakes in market valuation, and
  ii. ERISA's duty to diversify merely requires diversity among the funds offered by a plan; it does not require that every individual fund be diversified

Single Stock Fund Cases

- The Fourth Circuit reversed the District Court
  - The court explained that the duty of prudence under ERISA Section 404(a)(1)(B) includes the sub-duties of investigation, monitoring/removal, and diversification; in addition, the court noted that ERISA separately specifies a duty of diversification under ERISA Section 404(a)(1)(C)
  - The court assumed (based on Fifth Circuit precedent and defendants' failure to assert otherwise) that post-spin-off, the parent stock no longer constituted employer stock with respect to the subsidiary's plan, and thus was not exempt from ERISA's diversification requirements

Single Stock Fund Cases

- The court rejected the defendants' argument that a fiduciary is not obligated to ensure individual funds within a defined contribution plan are diversified so long as the plan's investment menu allows participants to choose from a mix of options that allow them to create a diversified portfolio
- Relying on its earlier decision in *DiFelice v. U.S. Airways, Inc.*, 497 F.3d 410 (4th Cir. 2007), the court explained that each fund offered by a plan must be prudent and, because diversification is a sub-duty of the duty of prudence, the duty to diversify applies at *both* the fund level *and* the plan level
- The court also rejected the defendants' argument that, because the parent stock fund was frozen to new investments, and participants were able to withdraw their money from the fund, defendants were under no obligation to remove the fund from the plan's investment lineup. The court held that there was no per se rule under ERISA that a fiduciary is never required to remove a frozen investment fund and that prudence may compel the removal of such a fund.

Single Stock Fund Cases

- The court further held that it was not appropriate on a motion to dismiss to entertain the defense that participants could have divested the parent stock in their discretion, because argument that participant choice relieves a fiduciary of liability is an affirmative defense that is not appropriate to decide at the MTD stage

- The court held that *Dudenhoeffer* was inapposite, reasoning that *Dudenhoeffer* only forecloses claims that a fiduciary should be able to predict the performance of publicly traded stock absent pleading special circumstances. In this case, the court held that the plaintiffs' claims of imprudence were based on the defendants' failure to diversify, not on a failure to outsmart an efficient market.

Single Stock Fund Cases

- *Compare: Young v. Gen. Motors Inv. Mgmt. Corp.*, 325 F. App'x 31, 33 (2d Cir. 2009). In *Young*, the Second Circuit held that ERISA's duty of diversification under Section 404(a)(1)(C) applies only at the plan level, and does not extend to the fund level.

Single Stock Fund Cases

- Fifth Circuit decision in *Schweitzer* involved underlying facts and issues very similar to *Gannett*, but Fifth and Fourth Circuit panels reached very different conclusions
- In *Schweitzer*, plaintiffs challenged the continued maintenance of single stock funds resulting from a corporate spin-off. District Court granted defendant's motion to dismiss and the Fifth Circuit affirmed. In its decision the Fifth Circuit made the following points:
  - The court rejected the defendants' contention that the parent stock (held in former subsidiary's plan) continued to be an employer security post-spin-off
  - The duty of diversification applies differently to defined benefit and defined contribution plans; the fiduciaries of a participant-directed defined contribution plan "need only provide investment options that enable participants to diversify their portfolios; they need not ensure that participants actually diversify their portfolios"
  - *Dudenhoeffer* does not foreclose the argument that it was imprudent for the plan to offer a single stock fund on the ground that such an undiversified fund is inherently risky; the court agreed that it may be imprudent in some circumstances to offer such a fund as an investment option

Single Stock Fund Cases

- *However, the Fifth Circuit ultimately affirmed the grant of the motion to dismiss:*
  - The court reasoned that because the parent stock fund was frozen to new investments immediately following the spinoff, "the fiduciaries were not offering participants an imprudent investment option," and given that the plan's participants were able to divest their investment in the fund and the plan distributed warnings about diversification, the plaintiffs failed to state a plausible claim that the plan fiduciaries should have forced divestment

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