VOL. 34, NO. 4 WINTER 2021

Benefits Law Journal

From the Editor—
Naked and Afraid (to Retire) — David E. Morse

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Benefits Law Journal (ISSN 0897-7992) (USPS 002-655) is published quarterly by Wolters Kluwer, 28 Liberty Street, New York, NY 10005. A one-year subscription is $789; single issue—$296. To subscribe, call 1-800-638-8437. For customer service, call 1-800-234-1660. Address editorial comments to **Benefits Law Journal**, 201 Ocean Avenue, New London, CT 06320. POSTMASTER: Send address changes to **Benefits Law Journal**, Wolters Kluwer, 7201 McKinney Circle, Frederick, MD 21704.

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Naked and Afraid (to Retire)

A bipartisan effort to create a no-cost national savings program was sacrificed to political expediency. Again. Championed by Ways and Means Chairman Richard Neal (D-MA), the proposal would have given the 55 million Americans without a workplace retirement program an effective way to save without burdening their employers. Specifically, employers would have been required to either offer their employees a 401(k) or 403(b) with automatic enrollment or facilitate automatic contributions to an Individual Retirement Account ("IRA"). The latest proposal, part of the decidedly partisan Build Back Better Act, also would have made the existing low-earner $1,000 savers credit refundable (if the participant does not earn enough to pay taxes, he or she receives the credit via cash or an IRA contribution) and extended the $500 credit for small employers for facilitating an auto-IRA.

Rep. Neal's savings program was ripped out in November, ostensibly to avoid the cost of the enhanced credits. I think the real reason this urgently needed legislation has not passed is that it does not provide the quick return to IRA providers and money managers and workers themselves that typically pushes legislation over the goal line.

Fifteen years after the auto-IRA was "invented" by Mark Ivry and David John, working respectively at Democratic and Republican-leaning think tanks, there is ample proof of concept: auto-IRA programs run by Oregon, California and Illinois have been facilitated by some 40,000 businesses on behalf of 400,000 participants who have accumulated $357 million in savings is just a few years. Despite some initial, and understandable, pushback from employers concerned that it would add to costs and burden overworked staff to comply with the state mandates, studies show that the costs were nonexistent and, thanks to smart program design and payroll software, compliance is easy. And, beyond auto-IRAs, decades of data on 401(k) plans unequivocally prove that people save way more with automatic payroll savings than any other approach.

Yet, 55 million people, mostly employed by smaller employers, or as part-time, temporary or gig workers, are not covered by any workplace program and have shockingly low savings. Under the Neal proposal, these folks would have automatically begun contributing six percent of their own pay to an IRA (usually a Roth), increasing one percent a year until reaching 10-15 percent, and invested in a target date, balanced or safety of principal fund. Of course, employers could always go one better and either add these workers to an existing or newly adopted 401(k) or a PEP or "pooled employer plan."

Robust disclosure to employees, simple contribution opt-out, election and "do-over" procedures would have been in place. Importantly,

employer contributions would not be required, employers only obligation would be to deliver the withheld wages to the IRA. Employers would not be fiduciaries. The employers could choose the IRA provider, using any Internal Revenue Service-approved financial institution or an existing state auto-IRA program. (Note: there is room for improvement in the Neal proposal, including imposing fiduciary standards on the IRA providers and relying more on state programs.)

So, with proof of concept, bipartisan support and no cost (without the savers and employer tax credits), what's the problem?

Savings take time. Fifty-five million is a lot people, but uncovered workers are largely lower-paid. Based on the experience of the three active state-auto-IRA programs – Oregon, Illinois and California, about 70 percent of eligible employees would contribute some $110 plus a month. Even though the aggregate numbers would be huge, it will take some years for these IRAs to reach critical (profitable) mass. No instant profits for IRA providers. From the workers perspective, user-friendly savings vehicles are not very sexy, because, again savings takes time to build compared with the immediacy of concerns like COVID-19, health care, education and student loans. Plus, voters are more blasé to not getting a new program verses the takeaway of something that exists.

Rumor has it that the Neal proposal will be added to the Secure 2.0 bill. But, like Lucy holding the football for Charlie Brown to kick, I do not have much faith in passage through a large reform legislation, especially with the approaching midterm elections. Instead, Congress needs to focus on this single and simple good idea and pass a national savings law. Although it will take years to have a meaningful impact and probably will not further anyone's political career, their children and grandchildren will thank them. Take the Neal language, add some basic fiduciary protections and just say yes.

The views set forth herein are the personal views of the author and do not necessarily reflect those of the law firm with which he is associated.

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Brokerage Windows in 401(k) Plans: The Total Abdication of Fiduciary Responsibility

Paul Blankenstein, Leigh Anne St. Charles and Rob Van Someren Greve

This article addresses the fiduciary issues raised by the current practice of plan fiduciaries of not only disclaiming any fiduciary responsibility for brokerage window investments, but also abdicating any role (fiduciary or otherwise) in assessing even the general suitability of those investments for a retirement plan, and concludes that the practice is in plain and notorious violation of what ERISA requires of fiduciaries.

Over the last decade, fiduciaries of 401(k) plans have with increasing frequency opened their plans to investments offered through a "brokerage window," which allows participants to invest their pre-tax assets in the numerous and varied investment options offered by a securities broker retained by the plan, but whose investment offerings are unreviewed by plan fiduciaries. Almost one-half of the largest 401(k) plans offer brokerage windows, and many major financial institutions offer participants in their plans investments through such windows, often with their affiliates serving as the broker.

The "core" investment options offered by plans subject to the Employee Retirement Income Security Act of 1974 ("ERISA") must be initially selected by the plan fiduciaries through a prudent process and are required to be reviewed periodically for their continued prudence. That is, however, not the practice with plan investments made through brokerage windows. Indeed, fiduciaries of plans offering a brokerage window expressly disclaim any responsibility regarding the prudence

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of any investments made by participants through the brokerage window. These fiduciaries have explicitly abdicated their responsibility over brokerage window investments, as they have rejected any role in selecting or monitoring the continued prudence of such investments, leaving that to the securities brokers who are not themselves fiduciaries.[1]

As this article discusses, this failure is plainly contrary to the express fiduciary requirements of ERISA. However, plan fiduciaries that offer brokerage windows in their 401(k) plans have not yet been called to account for abandoning their responsibility to offer participants only prudently selected and monitored investment options. No court has so far spoken directly to the propriety of this prevailing fiduciary practice – or more precisely, the absence of a fiduciary practice – in the brokerage window space. And the guidance that the U.S. Department of Labor ("DOL") has provided has been widely viewed as giving license to plan sponsors and fiduciaries to ignore completely ERISA's fiduciary standards with regard to the investments of plan assets made through brokerage windows. Under this regime, investments that would be plainly imprudent if offered as a so-called "core" investment, or, in ERISA language, a "designated investment alternative," would not subject plan fiduciaries to any liability if offered through a brokerage window.

This article addresses the fiduciary issues raised by the current practice of plan fiduciaries of not only disclaiming any fiduciary responsibility for brokerage window investments, but also abdicating any role (fiduciary or otherwise) in assessing even the general suitability of those investments for a retirement plan, and concludes that the practice is in plain and notorious violation of what ERISA requires of fiduciaries.

BACKGROUND

What Is a Brokerage Window?

A typical 401(k) plan will offer participants a limited number (usually about 20 to 25, but sometimes up to 30) of "core" investment options into which plan participants can direct their tax-deferred retirement savings.[2] A brokerage window – sometimes referred to as a "self-directed account" or "self-directed brokerage account" – is an arrangement offered by a growing number of 401(k) plans that gives plan participants the ability to invest retirement assets in investments other than the plan's so-called "core" investments.[3] Through a brokerage window, participants get access to a considerably greater number of investments than those that comprise the plan's "core" portfolio.

While some brokerage window platforms limit the type of investment available, e.g., to mutual and/or exchange-traded funds, most impose no such limit and permit participants to invest their savings in any publicly traded investment instrument – i.e., not just the sort of mutual funds and exchange-traded funds that populate the “core” investments of a typical 401(k) plan, but also individual equities, options, and other more exotic and speculative investments, such as “puts” and “calls.”[4]

For present purposes, the critical difference between the “core” investment options of a 401(k) plan and the investments available through a brokerage window is that whereas “core” investment options are – or at least, are supposed to be – carefully selected and monitored by fiduciaries tasked with overseeing the plan so that plan participants can take some comfort that their retirement savings will at least be invested in prudently selected options, no such care is exercised with respect to the investments that are available through brokerage windows. Indeed, fiduciaries of 401(k) plans that allow participants to invest through brokerage windows expressly disclaim that they have undertaken any review of such investments.[5]

Brokerage Windows Give Plan Participants Access to Inappropriate Investments

The (perhaps unsurprising) result of the lack of fiduciary oversight of brokerage-window investments is that participants in 401(k) plans are given access to investments that may well be plainly inappropriate vehicles for a retirement savings plan. That is contrary to ERISA’s stated purpose of safeguarding the assets of retirement plan participants against loss to the extent reasonably possible.[6]

401(k) plans were introduced as a substitute for traditional defined-benefit retirement plans in the Revenue Act of 1978.[7] Since then, those plans have become the primary way in which Americans save for their retirement.[8] Like other retirement plans, 401(k) plans are not designed to be vehicles for speculative investments. Instead, the investment options offered by 401(k) plans are intended to allow participants to make investments that, to the extent reasonably possible, will ultimately provide an adequate source of income during their retirement.[9] To that end, plan assets are held in trust, thereby making investments of those assets subject to ERISA’s fiduciary standards.[10] And persons exercising “any discretionary authority” regarding the administration or “disposition” of plan assets are ERISA fiduciaries.[11]

Contributions to ERISA-covered plans are made on a pre-tax basis, and participants pay income taxes only when they take a withdrawal.[12] The tax deferral status provided to participant contributions to 401(k) plans operates to “facilitate[] faster growth of the account balance,”[13]

which works to meet the statutes' implied promise that the assets in a participant's account will be an adequate source of income upon retirement. And, crucially, it is with an eye towards this goal that ERISA directs plan fiduciaries to review a retirement plan's investment options for prudence.[14] The protective regulatory framework of ERISA similarly works to incentivize investment in sound options curated by prudent fiduciaries who operate for the exclusive benefit of participants. Highly risky investments are generally viewed as improper vehicles for individuals saving for retirement – especially when the participants are approaching retirement age, and therefore will start taking distributions in the near future.[15]

While modern portfolio theory teaches that a range of investment risks facilitates a better return, ERISA requires that each investment offered by the plan must be prudent on its own.[16] Many, if not most, brokerage windows, however, impose no restrictions on the type of investments that are made available to participants, and thereby permit participants to direct their retirement assets into highly risky investments. For example, some plans allow participants to invest their savings into cryptocurrencies, a notoriously speculative type of investment.[17] Such investments may generate large returns when the market is up, but in a sudden downturn, such as the burst of the "tech bubble" in 2001 or the financial industry meltdown in 2008, retirement savings invested in speculative endeavors can be wiped out quickly. While younger participants may well be able to make up for those losses before they reach retirement age, older participants who are nearing retirement may not have time to recover those losses. Unfortunately, recent data shows that the rate of usage by plan participants of brokerage windows increases with age – older participants generally make more use of brokerage windows than younger participants.[18] Whereas only 0.4 percent of participants in the 20-29 age range and 1.6 percent of participants in the 30-39 age range make use of a brokerage window, participants over age 40 make investments through brokerage windows at about twice that rate.[19] This means that older participants, who are closer to retirement than their younger counterparts, invest more of their retirement savings in riskier investments – arguably the opposite of what prudence dictates. Yet, due to the lack of fiduciary oversight of brokerage-window investments, those tasked with managing the plan for the exclusive benefit of participants[20] do nothing to address this development, let alone limit its use by participants nearing retirement age.

Brokerage Windows Are Popular, and Increasingly So

Countless Americans saving for their retirement through a tax-deferred 401(k) plan have access to brokerage windows, which have

become an increasingly popular feature of 401(k) plans in recent years. As one industry commentator observed recently, "[t]he number of plan sponsors that offer brokerage windows has steadily increased over time."[21]

According to one recent industry survey, nearly a quarter (23.2 percent) of all 401(k)-style plans currently offer a brokerage window, and nearly 40 percent of plans that have more than 5,000 participants do.[22] A different study found that "[i]n 2019, 46% of plans in the market offered a brokerage window,"[23] and yet another survey commissioned by the ERISA Industry Committee found that 61 percent of member companies surveyed offered a brokerage window as part of their plan's investment line-up.[24]

Admittedly, both the percentage of plan participants that use their plan's brokerage window, as well as the percentage of total plan assets invested through brokerage windows, is comparatively small – about 2.4 percent and 1.5 percent, respectively.[25] These small percentages, however, do not provide a basis for concluding that "any concerns based on the possible proliferation of [brokerage] window investments may not be well-founded."[26] While the relative percentages may be small, the absolute amount of dollars involved is hardly negligible. In 2019, the total assets held in 401(k) plans was $6.4 trillion, and the total assets held in brokerage windows was approximately $96 billion – a significant amount by anyone's financial calculus. As the late Senator Everett Dirksen once famously observed: "A billion here, a billion there, and pretty soon you're talking real money." Indeed, by the authors' count, in 2019, 10 of the 25 largest 401(k) plans (as measured by total assets) allowed participants to invest plan assets through brokerage windows, with at least $9.1 billion invested through brokerage windows wholly unsupervised by plan fiduciaries.[27]

Many Financial Institutions Offer Brokerage Windows, and Those Windows Are Often Managed by Affiliate Security Brokers

Many major financial institutions that sponsor 401(k) plans offer participants the opportunity to direct their retirement savings into unmonitored investments through brokerage windows.[28] The list of financial services companies that offer brokerage windows includes State Street, Charles Schwab, Blackrock, UBS, Capitol One, and Deutsche Bank.[29] The total amount of 401(k) plan assets invested through brokerage windows by the plans reviewed by the authors was approximately $3.9 billion in 2019, up from about $3.2 billion in 2018, approximately a 20 percent increase.[30] One institution – UBS – alone accounted for

$1.2 billion of brokerage-window investments in 2019, which contributed about 18 percent of that plan's total assets.[31]

While some of these financial institutions use outside brokers, others rely on an affiliate of the plan sponsor for brokerage services.[32] For example, State Street, Charles Schwab, and TD Ameritrade all make use of an affiliate as the broker for the brokerage window in the 401(k) plans that they sponsor.[33] And many, if not all, of those brokers charge participants fees for transactions made through the brokerage window on the same basis as retail investors. This type of arrangement, where an affiliate of the sponsor provides (potentially highly lucrative) services to the plan, creates a significant risk of conflicts and self-dealing, and may well fall prey to ERISA's prohibited transaction provisions.[34]

ERISA'S FIDUCIARY STANDARDS APPLY TO BROKERAGE WINDOWS

ERISA's Broad Duty of Prudence

The fiduciary duties imposed by ERISA are "the highest known to the law."[35] As Justice (then Judge) Cardoza put the point almost 100 years ago, the fiduciary responsibility owed by fiduciaries to trust beneficiaries is "the punctilio of an honor the most sensitive."[36] ERISA embodies that trust concept, as it "describes the scope of the duty owed by an ERISA fiduciary in broad terms"[37] and refers to the responsibilities that fiduciaries have with respect to "the investments of the plan"[38] without singling out a particular type of investment option as lying outside the scope of fiduciaries' duty of prudence.

The specific fiduciary standards set out in ERISA § 404 mandate that fiduciaries act for the "exclusive purpose" of "providing benefits to participants," and do so "with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims," so as to "minimize the risk of large losses" to plan participants.[39] Courts use this "'prudent person' standard" to "measure fiduciaries' investment decisions and disposition of assets."[40]

This duty of prudence, as interpreted by the Supreme Court and the lower federal courts, in the context of 401(k) plans, comprises at least two more specific obligations: First, ERISA fiduciaries must select the investment options offered to plan participants through a prudent process.[41] Second, "the duty of prudence involves a continuing duty to monitor investments and remove imprudent ones."[42]

Enforcement of ERISA's fiduciary monitoring and oversight duties hold particular importance in the context of "defined contribution"

plans,[43] such as a 401(k) plan. In a "defined benefit" plan,[44] such as a traditional pension plan, participants are "entitled to a fixed periodic payment" from a pool of assets.[45] There, the plan sponsor has a built-in incentive to ensure that the pool of assets (consisting of employee contributions, employer contributions, or a mixture of both) is invested prudently, as "the [plan sponsor] typically bears the entire investment risk and . . . must cover any underfunding as the result of a shortfall that may occur from the plan's investments."[46]

In a 401(k) plan, on the other hand, the participant is entitled only to those funds contributed to his or her individual account, and any growth over time, and therefore bears the financial risk of loss or underperformance.[47] Accordingly, there is no plan sponsor backup for losses sustained in a participant's account, thus making fiduciary oversight of all investments even more crucial, so as to balance the twin goals of maximizing asset growth while minimizing risk.

Investments made through brokerage windows have the same essential characteristics of investments made by participants in the plan's core investments, as they are made in an ERISA-covered plan with tax-deferred assets. The sole material difference is that the plan fiduciaries disclaim any responsibility for the selection or continued prudence of these investments. But that artifice certainly cannot put those investments outside the scope of the duties ERISA imposes on fiduciaries. Indeed, ERISA § 410(a), which provides that any "instrument that purports to relieve a fiduciary from responsibility" is "void as against public policy,"[48] underscores that fiduciaries cannot avoid their fundamental responsibilities by simply disclaiming in a plan document or elsewhere that they have no such duty. Whatever may be the case in other contexts, that imperative is all the more important where, as here, the prudent management of retirement assets is a core ERISA purpose.[49]

In short, to the extent that the fiduciaries of a 401(k) plan allow participants to invest in any investment without separately vetting each one of those investments, whether made through a brokerage window or otherwise, the fiduciaries have violated ERISA's fiduciary requirements.[50] And fiduciaries compound that fiduciary breach by failing to periodically review even the prudence of the actual investments made by participants through the brokerage window.

The Current Practice of Plan Fiduciaries to Disclaim Any Duty over Brokerage-Window Investments Is Not Defensible

Nevertheless, a faulty proposition has taken root, which has infected many plans that employ brokerage windows: That fiduciaries have no

responsibility for the selection or monitoring of investment options offered to participants through brokerage windows. This absence of fiduciary responsibility regarding brokerage window investments appears to be based upon: (1) § 404(c) of ERISA, which absolves fiduciaries of financial responsibility for losses sustained in individual account plans (like 401(k) plans) where the participants exercise control over the assets in their accounts, and (2) DOL regulations that distinguish between so-called "designated investment alternatives" – i.e., the core investment options specifically selected by plan fiduciaries – and "non-designated investment alternatives," such as investments made through brokerage windows, and which excuse the latter from the far more robust disclosure regime required of the former.

No court has, however, directly ruled on whether brokerage windows fall outside the scope of ERISA's fiduciary duty of prudence,[51] and the DOL has provided guidance, accepted by all but one federal appellate court, that § 404(c) is inapplicable to the selection and monitoring of investments offered by 401(k) plans. Although the same should be true regarding investments made through brokerage windows, for the last decade at least, the DOL has inexplicably tolerated the widespread practice by fiduciaries of 401(k) plans of disclaiming responsibility for brokerage window investments. It appears, however, that the DOL may be reconsidering its acceptance of that practice, and for good reason.

ERISA Section 404(c) Does Not Provide a Defense for a Fiduciary Failure to Monitor Brokerage-Window Investments

Fiduciaries often cite to ERISA § 404(c), which protects them against liability for losses due to participants' exercise of control over assets in their accounts, as implicitly relieving them of any fiduciary duties with regard to brokerage-window investments. Whatever § 404(c) may do, it does not relieve fiduciaries of their duties regarding the investment options offered to participants in a 401(k) plan, whether as core or brokerage-window investments.

ERISA § 404(c) offers a financial safe harbor for fiduciaries of plans that "provide[] for individual accounts and permit[] a participant or beneficiary to exercise control over the assets in his account."[52] When a plan meets the requirements for the safe harbor, "no person who is otherwise a fiduciary shall be liable . . . for any loss, or by reason of any breach, which results from such participant's or beneficiary's exercise of control."[53] On its face, § 404(c) seemingly provides the defense that the fiduciaries maintain exists – as selecting individual investments through a brokerage window would appear to be an instance of a participant's exercise of control over the assets in their account. That interpretation of § 404(c)'s scope would, of course, equally apply

to the so-called "designated investment alternatives" of 401(k) plans that are specifically named by plan fiduciaries, as those core investments are similarly subject to participant control.

The DOL, however, has long held the view that § 404(c) does not apply to the selection of investment options by plan fiduciaries, because "the act of limiting or designating investment options which are intended to constitute all or part of the investment universe of an ERISA 404(c) plan is a fiduciary function which . . . is not a direct or necessary result of any participant direction."[54] With the sole exception of the U.S. Court of Appeals for the Fifth Circuit, every federal court of appeals that has so far addressed the issue has agreed that § 404(c) cannot shield fiduciaries from financial liability for imprudence in the selection of investments.[55] In that regard, the courts emphasize that "the selection of the particular funds to include and retain as investment options in a retirement plan . . . logically precedes [] and thus cannot result from[] a participant's decision to invest in any particular option."[56]

This reasoning plainly extends to the fiduciary decision to allow plan assets to be invested in securities made available to plan participants through a brokerage window, as that decision similarly precedes any decision by a participant to make a specific investment through that window. That was DOL's view in 1992, when it opined that relief from fiduciary liability for loss under § 404(c) did not apply both to specifically designated investment options and to all other investments offered to plan participants. The 1992 DOL guidance explained that the act of "limiting or designating investment options" that "constitute all or part of the investment universe" is a fiduciary function, and therefore triggers the fiduciary obligation to evaluate and determine whether they should be "available as participant investment options."[57] Accordingly, fiduciaries should not be able to hide behind § 404(c) and shift the blame for any losses resulting from imprudent brokerage-window investments back to participants.[58]

Moreover, even if § 404(c) applied to the decision to offer brokerage window investments, it would merely offer fiduciaries a shield against financial liability for losses resulting from imprudent investments made through the window – which is not the same thing as relieving them from all responsibility for the decision to offer imprudent investments in the first place, and to periodically monitor those investments, and remove investment options that have over time became imprudent.[59] For example: A police officer may be able to escape financially compensating for harms due to their infringement of an individual's constitutional rights by invoking the doctrine of qualified immunity; but even where that doctrine provides the officer with a liability shield, the officer still had and has a duty to act in a manner that values those rights when making an arrest.

Similarly, fiduciaries bear responsibility for the selection of investment options made available to participants in a 401(k) plan, even if they can invoke the liability shield provided by § 404(c) to escape responsibility for any financial loss. ERISA § 502(a)(3) expressly authorizes participants to bring suit "to enjoin any practice that violates any provision of the [Act]" or to "obtain appropriate equitable relief to (i) redress such violations or (ii) to enforce provisions of the [Act]."[60] Accordingly, § 502(a)(3) should suffice to provide participants with the ability to force fiduciaries to treat brokerage-window investments as other plan investments subject to fiduciary oversight.[61]

The Regulatory Distinction Between "Designated Investment Alternatives" and Other Investments Does Not Establish that Brokerage-Window Investments Are Not Subject to ERISA's Fiduciary Standards

The DOL's disclosure regulations implementing § 404(c) draw a distinction between "designated investment alternatives" ("DIA") and non-DIA investments and exempt brokerage windows and "similar plan arrangements," which by stipulation do not count as DIAs, from the disclosure obligations that govern a plan's "core" (DIA) investments. Whatever its merit for general disclosure purposes, that distinction between DIA and non-DIA investments does not establish that brokerage-window investments are outside the scope of the fiduciary duty to prudently select and monitor investment options offered in a 401(k) plan.

The disclosure regulations finalized by the DOL in 2010, which are codified at 29 C.F.R. Part 2520, first introduced the term "designated investment alternative," which refers to "any investment alternative designated by the plan into which participants and beneficiaries may direct the investment of assets held in, or contributed to, their individual accounts."[62] As there is no textual basis for the distinction, the definition of DIA arbitrarily excludes "'brokerage windows,' 'self-directed brokerage accounts,' or similar plan arrangements that enable participants and beneficiaries to select investments beyond those designated by the plan,"[63] even though such investments are made with plan assets and have been determined by the plan fiduciaries to be allowable plan investments. The regulations impose stringent disclosure obligations with respect to DIAs and are considerably more forgiving disclosure duties with respect to non-DIAs.[64] Significantly, the § 404(c) disclosure regulations do not discuss (and are in fact conspicuously silent on) whether the selection process for non-DIA investments somehow falls within § 404(c)'s scope.

Some commentators, along with many plan sponsors and fiduciaries, have, however, taken the DOL's grouping of plan investment

options into DIAs and non-DIA options for purposes of disclosure requirements as a basis for concluding that investments made through brokerage windows, being non-DIA options, are somehow not subject to ERISA's fiduciary standards regarding the investment of plan assets. For example, in a submission to the ERISA Advisory Council in 2021, one commentator stated that:

> [T]he current definition of brokerage window enables plan sponsors and participants to easily distinguish between a particular investment option that is one of the plan's DIAs . . . and one that is not a DIA but is simply made available through a brokerage window. This definition works just as it should. If the plan fiduciary designates specific investment options, those designations convey to participants that the plan fiduciary is standing behind those options, and fiduciary obligations . . . should and do apply. On the other hand, if the plan fiduciary allows participants to invest in options that are not designated by the plan fiduciary, such as the options available through a brokerage window, it is clear to the participants that the plan fiduciary has not screened such options, so no fiduciary or disclosure obligations should or do apply with respect to such options.[65]

This argument draws some apparent support from the fact that "[m]ultiple regulations explicitly tie the duty to monitor" to DIAs.[66] Specifically, both 29 C.F.R. § 2550.404a-5(f) and 29 C.F.R. § 2550.404c-1(d)(2)(iv) reference fiduciaries' "duty to prudently select and monitor providers of services to the plan or designated investment alternatives offered under the plan." The proponents of this line of argument maintain that this establishes that there is no comparable fiduciary duty to oversee a plan's non-DIA investment options.[67]

Yet, nothing in the disclosure regulations expressly limits the monitoring duty that ERISA imposes on fiduciaries to DIAs, and, in fact, there is ample reason to believe that no such limitation exists. Indeed, the regulations note that meeting the requirements for a § 404(c) plan "does not serve to relieve a fiduciary from its duty to prudently select and monitor any service provider,"[68] which would include the performance of brokers retained by the 401(k) plan, which would, in turn, include the prudence of investments allowed by the broker. As one court observed in that precise regard: "Just because these regulations apply to DIAs," that "does not preclude them from applying also to other forms of investments, such as self-directed brokerage accounts."[69] In the absence of an express statement that § 404(c) relieves fiduciaries of responsibility over brokerage-window investments, DOL's 1992 advice that any decisions regarding which investment options are offered to participants are not covered by § 404(c) should control.[70]

The "prudent man standard of care" imposed by § 404(a) applies "with respect to a plan," not just to the portion of the plan investments that have been identified as DIAs.[71] As the Supreme Court explained, "the [fiduciary] must systematically consider *all* the investments of the [plan] at regular intervals to ensure that they are appropriate."[72] Moreover, "by contrast to the rule at common law, trust documents cannot excuse trustees from their duties under ERISA."[73] In other words, "the duty of prudence trumps the instructions of a plan document."[74] That certainly extends to any attempt in a plan document to limit a fiduciary's monitoring duties through designation of certain investment as DIAs and others as non-DIA options. Indeed, ERISA § 410(c) explicitly renders any "instrument which purports to relieve a fiduciary from responsibility or liability" for the performance of his or her duties "null and void" as "against public policy."[75]

Fiduciaries Cannot Escape Liability for Failing to Review Brokerage-Window Investments by Attempting to Transfer Fiduciary Responsibility to the Broker Servicing the Window

Nor can fiduciaries escape being called to account for failing to oversee brokerage-window investments by seeking to transfer fiduciary responsibility for such investments to the broker who services the brokerage window. As noted, ERISA § 410(a) nullifies any such contractual or other arrangement.

Furthermore, seeking to transfer fiduciary responsibility for monitoring brokerage-window investments onto a broker presumes that plan fiduciaries had the responsibility for monitoring these investments in the first place, for they cannot transfer a responsibility they do not have themselves.[76] Accordingly, an attempt to abdicate the duty of prudence in this manner presupposes what many fiduciaries seek to deny, i.e., that they bear a fiduciary responsibility for the prudence of brokerage-window investments.

Some commentators argue that even if plan officials retain some fiduciary responsibility regarding brokerage-window investments, that duty is fully discharged if the fiduciaries prudently select the broker for the window.[77] But even the prudent selection of a provider to the plan does not relieve the fiduciary of the duty to oversee the performance of the provider.[78] In the brokerage-window context, that would require reviewing the investment options offered to plan participants and vetoing those that would be imprudent if offered directly in the plan as a core investment.

Undertaking such a responsibility is, some commentators observe, an impossible task to impose on plan fiduciaries, as brokerage windows offers thousands of investment options to plan participants.[79] But rather than operating an as excuse for relieving fiduciaries of

responsibility for brokerage-window investments, the practical inability of fiduciaries to vet such investments serves as a powerful reason to find such brokerage-window arrangements to be altogether inappropriate for retirement plans. If an investment platform by its very structure makes it impossible for a fiduciary to discharge the duties prescribed by ERISA, the answer is not to relieve the fiduciary from those duties, but rather to hold that platform unavailable for investments by participants in an ERISA-covered retirement plan.

The DOL's Inconsistent Guidance on Whether Fiduciaries Have Oversight Responsibility with Respect to Brokerage Window Investments Is at Best a Rickety Three-Legged Stool on Which Fiduciaries Should Rely Upon to Abdicate Monitoring Duties at Their Peril

While DOL's 1992 guidance on the scope of § 404(c) held that the section was inapplicable to the selection and monitoring of all investments offered by an ERISA-covered retirement plan, the disclosure rules the agency issued in 2010 have caused many in the ERISA fiduciary community to hold fast to the belief that the liability shield of § 404(c) applies to non-DIAs, like brokerage-window investments. The DOL has only added more confusion to the matter by its 2012 flip-flop as to whether there might be fiduciary responsibility regarding brokerage-window investments in certain circumstances.

Some 401(k) plan fiduciaries expressly rely on the DOL's withdrawal in July 2012 of an earlier Field Assistance Bulletin suggesting that ERISA's fiduciary duties apply to brokerage-window investments. Indeed, some commentators have pointed to the DOL's 2012 about-face in its guidance on whether brokerage-window investments fall within the scope of ERISA's fiduciary duty standards as providing a sound basis for concluding that brokerage windows fall outside that scope. That reliance on DOL's flip-flopping should, however, provide fiduciaries with little comfort in the totality of circumstances.

In 2012, the DOL initially issued guidance suggesting that brokerage window investments might in certain circumstances be subject to ERISA's fiduciary standards. In Field Assistance Bulletin ("FAB") 2012-02, issued on May 7, 2012, the DOL explained that:

> If, through a brokerage window or similar arrangement, non-designated investment alternatives available under a plan are selected by significant numbers of participants and beneficiaries, an affirmative obligation arises on the part of the plan fiduciary to examine these alternatives and determine whether one or more such alternatives should be treated as designated for purposes of the regulation.[80]

At that time, it was the DOL's position that a non-DIA investment available through a brokerage window could merit DIA treatment under the disclosure regulations, if a large number of participants chose to invest in it.

The DOL failed, however, to explain why a brokerage-window investment would become subject to ERISA's fiduciary standards simply because a significant number of participants selected that investment. That failure is easily explainable as there is no logical basis to find that a non-DIA became a DIA merely because many participants found some non-DIA investment particularly attractive. One more likely, but unstated reason may have been that the DOL realized that investments in a non-fiduciary curated investment were increasing and could result in substantial losses to participants, especially for those participants who opt to invest in highly speculative securities. And while fiduciary responsibility operates to protect plan assets as a whole, it also operates as a safeguard against losses in an individual account as a result of fiduciary negligence.[81]

Two months later, however, the DOL flip-flopped. On July 30, 2012, in response to a strong pushback from plan sponsors, brokers, and fiduciaries, the DOL abandoned the approach to the issue set out in its May 2012 Field Assistance Bulletin. In its revised guidance, FAB 2012-02R, the DOL, returning to its original position on the matter, said that "[w]hether an investment alternative is a [DIA] for purposes of the regulation depends on whether it is specifically identified as available under the plan."[82] Apparently no longer concerned that investments in highly speculative brokerage-window offerings could well result in substantial losses to participants, the agency added that "nothing in this Bulletin prohibits the use of a platform or a brokerage window, self-directed brokerage account, or similar plan arrangement in an individual account plan."[83]

An exemplar of consistency on this issue the DOL plainly has not been. While withdrawing from its earlier guidance, DOL's July 30, 2012 guidance nevertheless kept at least one foot on the fiduciary duty side of the line, observing that:

> [F]iduciaries of such plans with platforms or brokerage windows, self-directed brokerage accounts, or similar plan arrangements that enable participants and beneficiaries to select investments beyond those designated by the plan are still bound by ERISA section 404(a)'s statutory duties of prudence and loyalty to participants and beneficiaries who use the platform or the brokerage window, self-directed brokerage account, or similar plan arrangement, including taking into account the nature and quality of services provided in connection with the platform or the

> brokerage window, self-directed brokerage account, or similar plan arrangement.[84]

This shifting of the DOL's view of whether brokerage windows should be treated under ERISA's fiduciary standards provides at most weak, if any, support for the current practice of many fiduciaries that treat brokerage windows investments as outside the purview of the fiduciary duty of prudence mandated by ERISA. Certainly, the language quoted in the preceding paragraph from DOL's July 2012 guidance that the duties of prudence set out in ERISA § 404(a) apply to plans with brokerage window arrangements undercuts substantially any contrary implications in previous DOL guidance.

The DOL's next act on the brokerage window issue was its 2014 Request for Information, which suggested that the agency was restless as to where it had left the matter. The information sought indicated that the DOL was engaged in a comprehensive review of the entire brokerage window issue. Specifically, the DOL sought information on:

(1) The characteristics of brokerage-window arrangements offered;

(2) The participation rate in plans that offered them;

(3) The process for selecting and monitoring service providers for these arrangements;

(4) Their associated costs;

(5) The disclosures made regarding them; and

(6) The use of advisors in connection with brokerage-window usage by plan participants.[85]

The information sought, the DOL explained, was to assist "the Department in determining whether, and to what extent, regulatory standards or other guidance concerning the use of brokerage windows by plans are necessary to *protect* participants' retirement savings – a core ERISA purpose."[86]

In any event, whatever limited comfort the brokerage-window community should take from DOL's inconsistent and sometimes incoherent actions (or inactions) on the subject may not long endure. The DOL seemingly has had second, if not third, thoughts regarding its apparent past tolerance for brokerage-window investments wholly unsupervised by plan fiduciaries. In the spring of 2021, the ERISA Advisory Council of the DOL's Employee Benefits Security Administration held a

meeting on brokerage windows in 401(k)-type plans. In its announcement of the meeting, the Council stated that it "will examine brokerage windows in participant-directed individual account retirement plans that are covered by ERISA to gain a better understanding of their design, prevalence, and usage."[87] The announcement further referenced the 2014 Request for Information, and noted that in 2014, "[t]he Department was interested in whether guidance would be appropriate and necessary to ensure that plan participants and beneficiaries with access to a brokerage window are adequately informed and protected under ERISA," adding that "[t]he work of the Council is intended to assist in this effort."[88]

The protection of the assets of participants in any ERISA-covered retirement plan is, of course, a key purpose of the statute, which it seeks to accomplish by subjecting the investments of those assets to fiduciary oversight. Consistent with that understanding, the DOL in 1992 found that § 404(c) was inapplicable to all investments of plan assets, whether specifically designated or otherwise. It would appear that the DOL is reconsidering its later misadventures on the subject.

RELIEF

In the authors' view, the foregoing discussion demonstrates that ERISA mandates fiduciary oversight of brokerage-window investments on the same plane as other plan investment options. Given that the fiduciaries of numerous 401(k) plans freely admit that they do not oversee such investments, establishing a breach of the duty of prudence should follow for any plan participant seeking to address this failure through litigation.

Of course, to succeed in litigation, a participant seeking to bring suit will also need to establish an "injury-in-fact" in order to have Article III-standing.[89] One way to do so would be for the participant to allege and then demonstrate that he or she has suffered a loss in their personal account due to an investment in an imprudent investment option that was offered through the plan's brokerage window.[90] While even in an "up market" an individual participant may have suffered a financial loss as a result of imprudent investments made through the plan's brokerage window, the plan as a whole may not have, and it may therefore be difficult to proceed as a class action, because there may not be a sufficient number of participants who have suffered losses to justify class treatment.[91] It is often the case that, where class treatment is not available, the recovery of losses sustained by an individual participant may not make litigation financially viable. That circumstance should not, however, necessarily prevent fiduciaries from being called to account for their failure to discharge their duties.

As noted previously, ERISA § 502(a)(3) authorizes suit by a participant to "enjoin" any act or practice that violates the statute, and to "obtain other equitable relief," to "redress such violations," and to "enforce any provisions" of the Act.[92] ERISA by its very terms creates a right for participants to have all investments of plan assets be subject to fiduciary oversight, and § 502(a)(3) specifically authorizes courts to enjoin a failure by fiduciaries to provide such oversight.

Abdicating the duty of prudence with respect to brokerage-window investments is not just a "bare procedural violation" that is "divorced from any concrete harm," rather, it creates a "risk of real harm," which should provide the requisite standing.[93] Indeed, courts have taken action to enjoin imprudent fiduciary practices even where there had been as yet no monetary loss, recognizing that "[t]he likelihood that a fund's assets will be unnecessarily diminished is greatly increased when its trustees show a propensity to engage in imprudent conduct."[94]

A downturn in the stock market is bound to happen at some point, and participants who have directed their retirement savings towards high-risk investments through brokerage windows may well see those savings wiped out. As one federal court of appeals trenchantly explained:

> Requiring a showing of loss in such a case would be to say that the fiduciaries are free to ignore their duties so long as they do no tangible harm, and that the beneficiaries are powerless to rein in the fiduciaries' imprudent behavior until some actual damage has been done. This result is not supported by the language of ERISA, the common law, or common sense.[95]

Waiting for the monetary loss to occur, another appeals court similarly observed, would "undermine the purpose of ERISA which is to insure that the assets of a fund will be there when the [participants] need them."[96]

In any event, standing considerations applicable to actions by participants provide no impediment to action by the DOL – be it in the form of regulations or guidance, or enforcement actions against the fiduciaries that have abdicated their responsibilities with respect to brokerage-window investments.[97]

CONCLUSION

Despite the current widespread belief to the contrary in the plan sponsor and fiduciary community, ERISA requires that fiduciaries oversee investments offered through brokerage windows, as part of their

duty of prudence under ERISA § 404(a), in the same way that they oversee so-called "core" or "DIA" investment options. The DOL has so far effectively failed to curb this practice, and in fact, the limited and inconsistent guidance it has issued on the point has for the most part served to bolster the confidence of plan fiduciaries that they may safely abandon their responsibility for overseeing brokerage-window investments. The agency is now undertaking a comprehensive review of brokerage windows in 401(k) plans, which may well result in the DOL stepping away from any endorsement of the current regime of non-fiduciary oversight of investments of plan assets through brokerage windows.

In any event, the widespread practice of permitting brokerage-window investments uncurated by fiduciary oversight is a ripe target for litigation to correct this practice fundamentally at odds with ERISA's purpose to protect the assets of retirement plan participants by making fiduciaries responsible for offering participants only prudently selected investment options and by requiring fiduciaries to periodically monitor those investments and replace those that over time have become imprudent.

APPENDIX 1 - 25 LARGEST 401(k) PLANS (BY TOTAL ASSETS, PY 2019)

1. **Boeing: $67.2 billion – no brokerage window**
   a. Participants: 205,460
   b. Total Assets: $67,171,473,83
   c. Assets Invested Through Brokerage Window: N/A
2. **IBM: $58.2 billion – no brokerage window**
   a. Participants: 183,694
   b. Total Assets: $58,165,700,712
   c. Assets Invested Through Brokerage Window: N/A
3. **AT&T: $49.3 billion - $2.4 billion (4.8%) invested through brokerage window**
   a. Participants: 259,872

b. Total Assets: $49,280,973,000

c. Assets Invested Through Brokerage Window: $2,381,817,000

4. Wells Fargo: $48.2 billion – no brokerage window

a. Participants: 349,262

b. Total Assets: $48,176,866,174

c. Assets Invested Through Brokerage Window: N/A

5. Bank of America: $44.4 billion – no brokerage window

a. Participants: 279,148

b. Total Assets: $44,446,556,471

c. Assets Invested Through Brokerage Window: N/A

6. Lockheed: $40.6 billion - $1.5 billion (2.8%) invested through brokerage window

a. Participants: 128,863

b. Total Assets: $40,636,001,161

c. Assets Invested Through Brokerage Window: $1,146,860,000

7. JPMorgan Chase: $33.8 billion – no brokerage window

a. Participants: 271,937

b. Total Assets: $33,816,336,275

c. Assets Invested Through Brokerage Window: N/A

8. Walmart: $32.7 billion – no brokerage window

a. Participants: 1,664,901

b. Total Assets: $32,663,824,722

c. Assets Invested Through Brokerage Window: N/A

9. Northrop Grumman: $30.1 billion – $2.1 billion (7%) invested through brokerage window

a. Participants: 107,795

b. Total Assets: $30,096,862,012

c. Assets Invested Through Brokerage Window: $2,102,790,000

10. UTC: $28.6 billion – unknown amount invested through brokerage window

a. Participants: 102,954

b. Total Assets: $28,559,621,000

c. Assets Invested Through Brokerage Window: Unknown – While UTC offered a mutual fund brokerage window, its Form 5500 does not specify the assets

11. Microsoft: $27.5 billion - $1.1 billion (4.2%) invested through brokerage window

a. Participants: 109,109

b. Total Assets: $27,542,813,107

c. Assets Invested Through Brokerage Window Assets: 1,149,314,671

12. GE: $27.0 billion – no brokerage window

a. Participants: 205,186

b. Total Assets: $27,036,598,168

c. Assets Invested Through Brokerage Window: N/A

13. Verizon: $26.5 billion – no brokerage window

a. Participants: 159,874

b. Total Assets: $26,539,227,066

c. Assets Invested Through Brokerage Window: N/A

14. **Raytheon: $20.9 billion - $713 million (3.4%) invested through brokerage window**

    a. Participants: 88,044

    b. Total Assets: $20,870,028,587

    c. Assets Invested Through Brokerage Window: $713,347,371

15. **FedEx: $20.8 billion – no brokerage window**

    a. Participants: 253,208

    b. Total Assets: $20,819,143,999

    c. Assets Invested Through Brokerage Window: N/A

16. **Costco: $20.5 billion – no brokerage window**

    a. Participants: 184,587

    b. Total Assets: $20,528,057,831

    c. Assets Invested Through Brokerage Window: N/A

17. **Fidelity: $20.3 billion – unknown amount invested through brokerage window**

    a. Participants: 59,689

    b. Total Assets: $20,317,547,857

    c. Assets Invested Through Brokerage Window: Unknown

18. **ExxonMobil: $19.4 billion – no brokerage window**

    a. Participants: 41,892

    b. Total Assets: $19,432,000,000

    c. Assets Invested Through Brokerage Window: N/A

19. **Johnson & Johnson: $19.1 billion – no brokerage window**

    a. Participants: 70,206

b. Total Assets: $19,140,430,064

c. Assets Invested Through Brokerage Window: N/A

20. Chevron: $18.8 billion – no brokerage window

a. Participants: 35,611

b. Total Assets: $18,779,626,876

c. Assets Invested Through Brokerage Window: N/A

21. HCA: $18.0 billion – no brokerage window

a. Participants: 387,421

b. Total Assets: $18,025,909,149

c. Assets Invested Through Brokerage Window: N/A

22. Oracle: $17.5 billion – $1.1 billion (6.1%) invested through brokerage window

a. Participants: 79,632

b. Total Assets: $ 17,474,825,000

c. Assets Invested Through Brokerage Window: $1,057,843,000

23. Google: $17.3 billion – $287 million (1.7%) invested through brokerage window

a. Participants: 83,353

b. Total Assets: $17,290,544,625

c. Assets Invested Through Brokerage Window: $286,642,365

24. GM: $16.9 billion – no brokerage window

a. Participants: 63,352

b. Total Assets: $16,888,445,272

c. Assets Invested Through Brokerage Window: N/A

25. **Pfizer: $16.2 billion - $236 million (1.5%) invested through brokerage window**

    a. Participants: 53,828

    b. Total Assets: $16,191,259,990

    c. Assets Invested Through Brokerage Window: $235,728,000

APPENDIX 2 - FINANCIAL INSTITUTIONS WITH BROKERAGE WINDOWS

1. **Alight**

    a. In sum:

    - 2019: $20.7 million of $1.6 billion (1.1%) invested through brokerage window

    - 2018: $16.3 million of $1.5 billion (1.1%) invested through brokerage window

    b. Total Net Assets:

    - 2019: $1,800,564,000

    - 2018: $1,448,218,000

    c. Assets Invested Through Brokerage Window:

    - 2019: $20,703,000 (26.8% increase from 2018)

    - 2018: $16,333,000

    d. Broker: Pershing LLC

2. **American Express**

    a. In sum:

    - 2019: $138.4 million of $6.2 billion (2.2%) invested through brokerage window

    - 2018: $123.7 million of $5.1 billion (2.4%) invested through brokerage window

b. Total Net Assets:

  - 2019: $6,226,352,000
  - 2018: $5,110,920,000

c. Assets Invested Through Brokerage Window:

  - 2019: $138,364,000 (11.9% increase from 2018)
  - 2018: $123,618,000

d. Broker: Unknown

3. Ameriprise

a. In sum:

  - 2019: $392.4 million of $2.3 billion (16.9%) invested through brokerage window
  - 2018: $321.4 million of $1.9 billion (17.2%) invested through brokerage window

b. Total Net Assets:

  - 2019: $ 2,326,483,934
  - 2018: $ 1,868,207,461

c. Assets Invested Through Brokerage Window:

  - 2019: $ 392,378,983 (22.1% increase from 2018)
  - 2018: $ 321,412,498

d. Broker: Pershing LLC

4. Blackrock

a. In sum:

  - 2019: $29.1 million of $2.7 billion (1.1%) invested through brokerage window

- 2018: $21.2 million of $2.1 billion (1.0%) invested through brokerage window

b. Total Net Assets:

- 2019: $ 2,706,218,463
- 2018: $ 2,143,834,799

c. Assets Invested Through Brokerage Window:

- 2019: $ 29,079,769 (37.4% increase from 2018)
- 2018: $ 21,164,511

d. Broker: Merrill Lynch

5. BNY Mellon

a. In sum:

- 2019: $136.0 million of $13.7 billion (1.0%) invested through brokerage window
- 2018: $123.0 million of $11.8 billion (1.0%) invested through brokerage window

b. Total Net Assets:

- 2019: $13,685,787,944
- 2018: $11,795,133,938

c. Assets Invested Through Brokerage Window:

- 2019: $136,012,706 (10.5% increase from 2018)
- 2018: $123,033,856

d. Broker: Unknown

6. Capital One

a. In sum

- 2019: $62.5 million of $6.7 billion (0.9%) invested through brokerage window
- 2018: $47.2 million of $5.2 billion (0.9%) invested through brokerage window

b. Total Net Assets:

- 2019: $6,686,740,461
- 2018: $5,224,676,025

c. Assets Invested Through Brokerage Window:

- 2019: $62,511,080 (32.5% increase from 2018)
- 2018: $47,176,859

d. Broker: Fidelity

7. Charles Schwab

a. In sum:

- 2019: $976.8 million of $4.4 billion (22.3%) invested through brokerage window
- 2018: $767.9 million of $3.6 billion (21.4%) invested through brokerage window

b. Total Net Assets:

- 2019: $4,374,545,752
- 2018: $3,586,057,520

c. Assets Invested Through Brokerage Window:

- 2019: $976,840,742 (27.2% increase from 2018)
- 2018: $767,854,353

d. Broker: Charles Schwab

8. Citizens Financial Group

a. In sum:

- 2019: $59.7 million of $2.2 billion (2.8%) invested through brokerage window
- 2018: $44.5 million of $1.7 billion (2.6%) invested through brokerage window

b. Total Net Assets:

- 2019: $2,166,920,000
- 2018: $1,733,287,000

c. Assets Invested Through Brokerage Window:

- 2019: $59,721,000 (34.3% increase from 2018)
- 2018: $44,464,000

d. Brokers: Unknown

9. Deutsche Bank

a. In sum:

- 2019: $56.4 million of $3.7 billion (1.5%) invested through brokerage window
- 2018: $46.4 million of $3.1 billion (1.5%) invested through brokerage window

b. Total Net Assets:

- 2019: $3,688,492,114
- 2018: $3,148,724,268

c. Assets Invested Through Brokerage Window:

- 2019: $56,422,144 (21.6% increase from 2018)
- 2018: $46,382,823

d. Broker: Unknown

10. First American

a. In sum:

- 2019: $17.9 million of $1.5 billion (1.2%) invested through brokerage window
- 2018: $7.4 million of $1.5 billion (0.5%) invested through brokerage window

b. Total Net Assets:

- 2019: $1,467,500,582
- 2018: $1,521,651,127

c. Assets Invested Through Brokerage Window:

- 2019: $17,929,306 (140.8% increase from 2018)
- 2018: $7,445,203

d. Broker: Unknown

11. HSBC

a. In sum:

- 2019: $18.1 million of $4.1 billion (0.4%) invested through brokerage window
- 2018: $15.6 million of $3.4 billion (0.5%) invested through brokerage window

b. Total Net Assets:

- 2019: $4,067,090,000
- 2018: $3,433,628,000

c. Assets Invested Through Brokerage Window:

- 2019: $18,158,000 (16.5% increase from 2018)

- 2018: $15,589,000

d. Broker: TD Ameritrade

12. Principal Financial Group

a. In sum:

- 2019: $2.9 million of $3 billion (0.1%) invested through brokerage window
- 2018: $2 million of $2.4 billion (0.1%) invested through brokerage window

b. Total Net Assets:

- 2019: $2,962,300,399
- 2018: $2,449,415,053

c. Assets Invested Through Brokerage Window:

- 2019: $2,910,426 (45.9% increase from 2018)
- 2018: $1,994,147

d. Broker: Unknown

13. RBC

a. In sum:

- 2019: $97.3 million of $2.9 billion (3.4%) invested through brokerage window
- 2018: $82.1 million of $2.4 billion (3.5%) invested through brokerage window

b. Total Net Assets:

- 2019: $2,901,999,327
- 2018: $2,365,985,714

c. Assets Invested Through Brokerage Window

- 2019: $97,437,671 (18.7% increase from 2018)
- 2018: $82,113,138

d. Broker: Unknown

14. State Street

a. In sum:

- 2019: $244 million of $4.5 billion (5.4%) invested through brokerage window
- 2018: $183 million of $3.6 billion (5.1%) invested through brokerage window

b. Total Net Assets:

- 2019: $4,493,798,125
- 2018: $3,566,808,485

c. Assets Invested Through Brokerage Window:

- 2019: $244,308,611 (33.5% increase from 2018)
- 2018: $182,957,224

d. Broker: State Street

15. TD Ameritrade

a. In sum:

- 2019: $201.3 million of $1.7 billion (11.9%) invested through brokerage window
- 2018: $146.3 million of $1.4 billion (10.6%) invested through brokerage window

b. Total Net Assets:

- 2019: $1,699,131,721
- 2018: $1,383,424,096

c. Assets Invested Through Brokerage Window:

- 2019: $201,369,858 (37.7% increase from 2018)
- 2018: $146,277,471

d. Broker: TD Ameritrade

16. Truist

a. In sum:

- 2019: $217.8 million of $5.2 billion (4.2%) invested through brokerage window
- 2018: $171.2 million of $4.3 billion (4.0%) invested through brokerage window

b. Total Net Assets:

- 2019: $5,245,412,829
- 2018: $4,318,765,050

c. Assets Invested Through Brokerage Window:

- 2019: $217,782,101 (27.2% increase from 2018)
- 2018: $171,159,234

d. Broker: TD Ameritrade

17. UBS

a. In sum:

- 2019: $1.2 billion of $6.8 billion (17.8%) invested through brokerage window
- 2018: $1 billion of $5.4 billion (18.6%) invested through brokerage window

b. Total Net Assets:

- 2019: $6,791,221,949

- 2018: $5,542,941,743

c. Assets Invested Through Brokerage Window:

- 2019: $1,208,231,257 (17.1% increase from 2018)
- 2018: $1,031,899,452

d. Broker: Unknown

18. Union Bank

a. In sum:

- 2019: $22.7 million of $2.9 billion (0.8%) invested through brokerage window
- 2018: $16.5 million of $2.3 billion (0.7%) invested through brokerage window

b. Total Net Assets:

- 2019: $2,882,768,705
- 2018: $2,342,721,842

c. Assets Invested Through Brokerage Window:

- 2019: $22,648,488 (37.4% increase from 2018)
- 2018: $16,480,849

d. Broker: Unknown

19. Visa

a. In sum:

- 2019: $176.5 million of $2.6 billion (6.8%) invested through brokerage window
- 2018: $128.4 million of $2.0 billion (6.5%) invested through brokerage window

b. Total Net Assets:

- 2019: $2,603,718,403
- 2018: $1,981,297,100

c. Assets Invested Through Brokerage Window:

- 2019: $176,477,163 (37.4% increase from 2018)
- 2018: $128,428,193

d. Broker: Fidelity

NOTES

1. Some states (namely, Massachusetts, Nevada, New Jersey, and New York) impose fiduciary duties on broker-dealers, and thus brokers have "fiduciary" duties owed to their customers under state law. *See* Bailey McCann, Brokers and Investors Face a Crazy Quilt of State Regulations, Wall St. J. (Mar. 7, 2018), *https://www.wsj.com/articles/financial-advisers-and-investors-face-a-crazy-quilt-of-state-regulations-11615122000*. However, as investments made through brokerage windows in ERISA-covered plans are subject to the Act's preemption of state law, 29 U.S.C. § 1144, whether brokers handling brokerage-window investments are fiduciaries will be determined by federal law. Brokers are not considered fiduciaries under the Investment Company Act of 1940, 15 U.S.C. §§ 80a-1-80a-64, and § 514 (d) of ERISA specifically respects status determinations made by other federal statutes. *See* 29 U.S.C. § 1144(d) (explaining that nothing in ERISA is to be "construed to alter, amend, modify, invalidate, impair, or supersede any law of the United States").

2. *See* Christine Benz, 100 Must-Know Statistics About 401(k) Plans, MorningStar (Sept. 4, 2020), *https://www.morningstar.com/articles/1000743/100-must-know-statistics-about-401k-plans* (noting that the average number of options offered is 21 when target date funds are considered a single fund, 28 when target date funds with different target retirement dates are treated as separate investment options); Testimony of Alison Borland before the ERISA Advisory Council (June 24, 2021), at 3 ("In 2019, an average of 25 investment options were offered in defined contributions plans, which has been relatively consistent for the last several years.").

3. Adam Heyes, Brokerage Window, Investopedia (Jul. 8, 2021), *https://www.investopedia.com/terms/b/brokerage_window.asp*; *Moitoso v. FMR LLC*, 451 F. Supp. 3d 189, 208 (D. Mass. 2020) (citing Investopedia); Testimony of Chantel Sheaks before the ERISA Advisory Council (June 24, 2021) (same). Disclosure regulations define a "brokerage window" as a "plan arrangement[] that enable[s] participants and beneficiaries to select investments beyond those designated by the plan." 29 C.F.R. §§ 2550.404a-5(c)(1)(i)(F), 2550.404a-5(h)(4); 29 C.F.R. § 2550.408b-2(c)(1)(viii)(C). The import of this definition (and the distinction between "designated investment alternatives" and brokerage window investments) is further discussed below.

4. *See, e.g.*, Testimony of Alison Borland before the ERISA Advisory Council (June 24, 2021), at 3 ("The investment options made available through brokerage windows are usually much more numerous than in the plan menu, thus giving participants access to a broader array of stocks, bonds, mutual funds and exchange traded funds (ETFs).").

5. *See* Testimony of Kent A. Mason before the ERISA Advisory Council (June 24, 2021), § 2 ("The investments available through a brokerage window are not presented to participants as having been screened by the plan fiduciary; such investments are presented as market investments that may be used outside the oversight of the fiduciary"); *Troudt v. Oracle Corp.*, No. 16-cv-00175, 2019 WL 1006019, at *11 n.18 (D. Colo. Mar. 1, 2019) (noting that investments available through brokerage window were not monitored by plan).

6. *See* ERISA § 2(b), 29 U.S.C. § 1001(b) (explaining that the statute's policy is, inter alia, "to protect . . . the interests of participants in employee benefit plans . . . by establishing standards of conduct, responsibility, and obligation for fiduciaries of employee benefit plans"); and § 404(a), 29 U.S.C. § 1104(a) (requiring fiduciaries to minimize the risk of loss by diversifying plan investments).

7. *See* Employee Benefit Research Institute, Fast Facts: History of 401(k) Plans: An Update (Nov. 5, 2018), *https://www.ebri.org/docs/default-source/fast-facts/ff-318-k-40year-5nov18.pdf*.

8. *LaRue v. DeWolff, Boberg & Assocs., Inc.*, 552 U.S. 248, 255 (2008) ("Defined contribution plans dominate the retirement plan scene today.").

9. John Sullivan, What Is the 'Core Purpose' of a 401(k) Plan?, 401k Specialist (Sept. 7, 2016), *https://401kspecialistmag.com/core-purpose-401k-plan/* ("A large majority of plan sponsors (85 percent) think the core purpose of a 401(k) plan is to provide income sources during retirement, rather than savings").

10. *See* 29 U.S.C. §§ 1103, 1104.

11. ERISA Section 3(21)(A), 29 U.S.C. § 1002(21)(A).

12. *See* Mark Kronson, Bureau of Labor Statistics, Employee Costs and Risks in 401(k) Plans, Compensation and Working Conditions 12 (Summer 2000), *https://www.bls.gov/opub/mlr/cwc/employee-costs-and-risks-in-401k-plans.pdf*.

13. *Id*.

14. *See infra*.

15. Indeed, this is the animating thought of target-date funds, which gradually reduce investment risk in investment portfolios as participants get closer to retirement. *See* Troy Segal, Target-Date Fund, Investopedia (May 30, 2021), *https://www.investopedia.com/terms/t/target-date_fund.asp*. Of course, nothing prevents an employee from investing their non-ERISA governed funds in any high-risk endeavors of their choosing but without the governmental incentivization that comes with using tax-deferred dollars.

16. *DiFelice v. U.S. Airways*, 497 F.3d 410, 423 (4th Cir. 2007) ("[A] fiduciary must initially determine, and continue to monitor, the prudence of *each* investment option available to plan participants.") (emphasis added).

17. Nevin Adams, "Playing" With Fire?, Nat'l Assoc. of Plan Advisors (June 15, 2021), *https://www.napa-net.org/news-info/daily-news/playing-fire*.

18. Testimony of Alison Borland before the ERISA Advisory Council (June 24, 2021), at 5 (citing data from Alight Solutions, Trends & Experience in Defined Contribution Plans (2019)).

19. *See id*.

20. *See infra*.

21. Testimony of Alison Borland before the ERISA Advisory Council (June 24, 2021), at 8; *see also* Amanda Umpierrez, What to Know Before Adding an SDBA to Your Plan, Plan Sponsor (Apr. 8, 2021), *https://www.plansponsor.com/in-depth/know-adding-sdba-plan/*. ("[S]ources say self-directed brokerage accounts (SDBAs) are becoming increasingly popular").

22. Testimony of Kevin Mahoney before the ERISA Advisory Council (June 24, 2021) (citing data from the Plan Sponsor Council of America's ("PSCA") 63rd Annual Survey of Profit Sharing and 401(k) Plans, which is the most recent version of PSCA's survey, and reports on 2019 data; *see https://www.psca.org/PR_2020_63rdReport*).

23. Testimony of Alison Borland before the ERISA Advisory Council (June 24, 2021), at 8 (citing data from Alight Solutions, Trends & Experience in Defined Contribution Plans (2019)).

24. Testimony of Aliya Robinson before the ERISA Advisory Council (June 24, 2021), at 2 (citing results of an ERISA Industry Committee ("ERIC") member survey).

25. The first figure is drawn from Testimony of Alison Borland before the ERISA Advisory Council (June 24, 2021), at 8; the second from Testimony of Kevin Mahoney before the ERISA Advisory Council (June 24, 2021) (citing data from the PSCA's 63rd Annual Survey of Profit Sharing and 401(k) Plans).

26. Testimony of Kent A. Mason before the ERISA Advisory Council (June 24, 2021), § 1.

27. *See* Appendix 1.

28. While Some of the country's largest providers of financial services – including Wells Fargo, Bank of America, and JP Morgan Chase – have prudently shied away from providing brokerage windows, the authors' review of Form 5500s of financial institutions has identified 19 financial service companies that have brokerage windows in their 401(k) plans. *See* Appendix 2.

29. *See* Appendix 2.

30. *See* Appendix 2.

31. *See* Appendix 2.

32. *See* Appendix 2.

33. *See* Appendix 2.

34. *See* ERISA Section 406, 29 U.S.C. § 1106. This article does not address the complicated prohibited transactions issues that may arise from the use of affiliated brokers. But, it should be noted that violation of ERISA's prohibited transaction rules may subject plans to serious adverse tax consequences. The Internal Revenue Code penalizes a fiduciary who fails to remedy a prohibited transaction. A first-level tax of 15 percent is imposed upon a fiduciary who allowed the transaction to occur in the first place. I.R.C. § 4975(a). A second-level tax of 100 percent is imposed for each subsequent

"taxable period" in which the prohibited transaction is not corrected. *Id*. at Section 4975(b). The potential tax liability to the U.S. Treasury is in addition to the liability that may be owed to the participant. *See Nieto v. Ecker*, 845 F.2d 868, 874 n.6 (9th Cir. 1988) ("Moreover, section 4975 clearly contemplates that the tax does not foreclose remedial action by the Secretary of Labor and, implicitly, participants or beneficiaries as well.").

35. *Donovan v. Bierwirth*, 680 F.2d 263, 272 (2d Cir. 1982).

36. *Meinhard v. Salmon*, 164 N.E. 545, 546 (1928).

37. *Neil v. Zell*, 677 F. Supp. 2d 1010, 1019 (N.D. Ill. 2009), as amended (Mar. 11, 2010).

38. 29 U.S.C. § 1104(a)(1)(C).

39. 29 U.S.C. §§ 1104(a)(1)(A), (B), and (C).

40. *Fifth Third Bancorp v. Dudenhoeffer*, 573 U.S. 409, 419 (2014) (citation omitted).

41. *See, e.g.*, *Sweda v. Univ. of Pennsylvania*, 923 F.3d 320, 328 (3d Cir. 2019), cert. denied, 140 S. Ct. 2565 (2020) (explaining that "[a] fiduciary must prudently select investments").

42. *Tibble v. Edison Int'l*, 575 U.S. 523, 530 (2015) ("*Tibble I*").

43. *See* ERISA § 204(b)(2); 29 U.S.C. § 1054(b)(2).

44. *See* ERISA § 204(b)(1); 29 U.S.C. § 1054(b)(1).

45. *See Hughes Aircraft Co. v. Jacobson*, 525 U.S. 432, 439-40 (U.S. 1999) (explaining the inherent differences between defined contribution and defined benefit plans).

46. *Id*.

47. *See* ERISA § 204(c)(2)(A) (entitling participants in plans other than "defined benefit" plans to only those "contributions and the income, expenses, gains, and losses attributable thereto" of the participant's individual account).

48. 29 U.S.C. § 1110.

49. For further discussion of how ERISA § 410 limits fiduciaries' ability to disclaim duties, *see infra*.

50. *DiFelice*, 497 F.3d 410 at 423.

51. The most comprehensive discussion of the issue that the authors are familiar with can be found in *Moitoso*, 451 F. Supp. 3d at 205-8. However, even there the court ultimately concludes that it "need not decide this thorny issue [i.e., what duties a fiduciary owes with regard to the funds within a brokerage window], . . . because [the defendant] was not offering [the funds challenged in the action] through a brokerage window or its equivalent." *Id*. at 208. Other cases that touch upon the issue are *Ramos v. Banner Health*, 461 F. Supp. 3d 1067, 1126-27 (D. Colo. 2020), aff'd, 1 F.4th 769 (10th Cir. 2021) (granting summary judgment on plaintiffs' breach of duty claim based on defendant fiduciaries' failure to monitor brokerage-window investments because plaintiffs had failed to establish "a reasonably precise amount of damages" resulting from the failure to monitor brokerage-window investments. and that "any breach of the duty of prudence allegedly resulting by [sic] the failure to monitor . . . actually caused any economic losses," but the court seemingly accepted that the fiduciaries could face liability for its failure to monitor those investments, had plaintiffs been able to establish damages and a causal connection between the breach and those losses); and *Larson v. Allina Health Sys.*, 350 F. Supp. 3d 780, 800-2 (D. Minn. 2018) (granting motion to dismiss breach of fiduciary duty claim based on fact that, through

brokerage windows, participants had access to "too many" investment options, without addressing whether those options were subject to duty to monitor).

52. 29 U.S.C. § 1104(c)(1)(A).

53. *Id.*

54. 57 Fed. Reg. 46,922, 46,924 n. 27 (Oct. 13, 1992).

55. Compare *Tibble v. Edison Int'l*, 729 F.3d 1110, 1123-25 (9th Cir. 2013) ("*Tibble II*"), vacated on other grounds, 575 U.S. 523 (2015) (holding that Section 404(c), even when a plan meets all regulatory requirements, does not bar a suit by participants for breach of the duty of prudence in selecting investments); *Pfeil v. State St. Bank & Tr. Co.*, 671 F.3d 585, 597 (6th Cir. 2012) ("We hold that as a fiduciary, [the defendant] was obligated to exercise prudence when designating and monitoring the menu of different investment options that would be offered to plan participants."); *Howell v. Motorola, Inc.*, 633 F.3d 552, 567 (7th Cir. 2011) ("The selection of plan investment options and the decision to continue offering a particular investment vehicle are acts to which fiduciary duties attach, and that the safe harbor [of § 404(c)] is not available for such acts.") *DiFelice v. U.S. Airways, Inc.*, 497 F.3d 410, 418 (4th Cir. 2007) ("A . . . fiduciary of a defined contribution, participant-driven, 401(k) plan created to provide retirement income for employees who is given discretion to select and maintain specific investment options for participants [] must exercise prudence in selecting and retaining available investment options."); with *Langbecker v. Elec. Data Sys. Corp.*, 476 F.3d 299, 311-13 (5th Cir. 2007) (holding that § 404(c) can insulate plan fiduciaries against liability despite having "violated the duties of selection and monitoring of a plan investment," because "[Section] 404(c) recognizes that participants are not helpless victims of every error").

56. *Tibble II*, 729 F.3d at 1123.

57. 57 Fed. Reg. at 46,924 n.27.

58. *See Langbecker*, 476 F.3d at 321 (Reavley, J., dissenting) (concluding that "§ 404(c) does not shift liability for a plan fiduciary's duty to ensure that each investment option is and continues to be a prudent one" onto plan participants).

59. *Tibble I*, 575 U.S. at 530.

60. 29 U.S.C. § 1132(a)(3).

61. *See infra.*

62. 29 C.F.R. §§ 2550.404a-5(c)(1)(i)(F), 2550.404a-5(h)(4), 2550.408b-2(c)(1)(viii)(C).

63. 29 C.F.R. §§ 2550.404a-5(h)(4), 2550.408b-2(c)(1)(viii)(C).

64. Plan administrators must provide participants with "[a] description of any 'brokerage windows,' 'self-directed brokerage accounts,' or similar plan arrangements" under 29 C.F.R. §§ 2550.404a-5(c)(1)(i)(F) but do not have to provide participants with the detailed information on performance, benchmarks, fees, and expenses that is required with respect to DIAs under 29 C.F.R. §§ 2550.404a-5(d).

65. Testimony of Kent A. Mason before the ERISA Advisory Council (June 24, 2021), § 5.

66. *Moitoso*, 451 F. Supp. 3d at 206.

67. *See* Defendants' Memorandum of Law in Opposition to Plaintiffs' Motion for Summary Judgment at 6, *Moitoso v. FMR LLC*, No. 1:18-cv-12122 (D. Mass. Oct. 4, 2019), ECF No. 165 (arguing that the exclusion of brokerage windows from the

disclosure regulations "establish that fiduciaries need not monitor investments in brokerage windows and similar arrangements" because "it is a fiduciary's duty to "monitor . . . designated investment alternatives offered under the plan" (citing 29 C.F.R. § 2550.404a-5(f)), and concluding that therefore, "a fiduciary does not have a duty to monitor non-DIA investment options").

68. 29 C.F.R. § 2550.404c-1(d)(2)(iv).

69. *Moitoso*, 451 F. Supp. 3d at 206.

70. 57 Fed. Reg. at 46,924 n.27; *see also, e.g.*, *RadLAX Gateway Hotel, LLC v. Amalgamated Bank*, 566 U.S. 639, 645 (2012) ("A well established canon of statutory interpretation succinctly captures the problem: 'It is a commonplace of statutory construction that the specific governs the general.' . . . The general/specific canon is perhaps most frequently applied to statutes in which a general permission or prohibition is contradicted by a specific prohibition or permission. To eliminate the contradiction, the specific provision is construed as an exception to the general one.") (quoting *Morales v. Trans World Airlines, Inc.*, 504 U.S. 374, 384 (1992)).

71. 29 U.S.C. § 1104(a)(1). Though the focus of this article is on ERISA's fiduciary duty of prudence in the selection and monitoring of investment options, it is worth noting that the same reasoning applies to the application of ERISA's twin duty of fiduciary loyalty under § 404(a). Indeed, this very issue arose in a recent case where the plan fiduciary allowed participants to invest in a self-directed brokerage account offered through Charles Schwab, and then was alleged to have structured the offerings available through the brokerage window to include only exchange traded funds ("ETFs") affiliated with the fiduciary plan sponsor, while excluding investment options offered by competitors. *See Cervantes v. Invesco Holding Co. (US), Inc.*, No. 1:18-cv-02551, 2019 WL 5067202, at *2 (N.D. Ga. Sept. 25, 2019).

72. *Tibble I*, 575 U.S. at 529 (cleaned up) (emphasis added) (citation omitted); *see also* Plaintiffs' Reply Memorandum of Law in Support of Their Motion for Partial Summary Judgment at 9, *Moitoso v. FMR LLC*, No. 1:18-cv-12122 (D. Mass. Oct. 11, 2019), ECF No. 176.

73. *Dudenhoeffer*, 573 U.S. at 422 (internal marks and citation omitted).

74. *Id.* (internal marks and citation omitted). Indeed, the very provision that sets forth the fiduciary duty to act in accordance with plan documents explicitly states that fiduciaries must act "in accordance with the documents and instruments governing the plan insofar as such documents and instruments are consistent with other provisions of this subchapter." 29 U.S.C. § 1104(a)(1)(D).

75. 29 U.S.C. § 1110(a). This means that the following argument, often offered to support the absence of fiduciary responsibility over brokerage-window investments, is circular, as it incorrectly assumes that fiduciaries may do exactly what ERISA § 410(a) says they may not:

> The investments available through a brokerage window are not presented to participants as having been screened by the plan fiduciary; such investments are presented as market investments that may be used outside the oversight of the fiduciary. Thus, there is no duty to monitor those investments.

Testimony of Kent A. Mason before the ERISA Advisory Council (June 24, 2021), § 2.

76. *Moitoso*, 451 F. Supp. 3d at 208.

77. Testimony of Chantel Sheaks before the ERISA Advisory Council (June 24, 2021).

78. *See, e.g.*, *Moitoso*, 451 F. Supp. 3d at 207 ("[A] plan sponsor can incur liability when it fails to carefully select or monitor the service provider. . . .").

79. Testimony of Chantel Sheaks before the ERISA Advisory Council (June 24, 2021).

80. DOL FAB 2012-02 (May 7, 2012), FAQ 30, available at *https://www.dol.gov/sites/dolgov/files/EBSA/employers-and-advisers/guidance/field-assistance-bulletins/2019-02.pdf*.

81. *See LaRue*, 552 U.S. at 255-56.

82. DOL FAB 2012-02R (July 30, 2012), FAQ 39, available at *https://www.dol.gov/sites/dolgov/files/ebsa/employers-and-advisers/guidance/field-assistance-bulletins/2012-02r.pdf*.

83. *Id*.

84. *Id*.

85. 79 Fed. Reg. 49,469, 49,471-473 (Aug. 21, 2014).

86. 79 Fed. Reg. 49,469 (emphasis added). The DOL, unfortunately, neither issued a report on the information it received in response to its 2014 Request, nor did it at that time provide any further guidance, or act in any other way based on the information provided. This inaction may have encouraged fiduciaries who allow brokerage-window investments in their 401(k) plans to believe that they remained free to ignore their fiduciary duties regarding those investments.

87. 2021 Advisory Council on Employee Welfare and Pension Benefit Plans, Understanding Brokerage Windows in Self-Directed Retirement Plans (May 26, 2021), *https://www.dol.gov/sites/dolgov/files/EBSA/about-ebsa/about-us/erisa-advisory-council/2021-advisory-council-issue-statement-brokerage-windows.pdf*.

88. *Id*.

89. *See, e.g.*, *Lujan v. Defs. of Wildlife*, 504 U.S. 555, 560 (1992); *Braden v. Wal-Mart Stores, Inc.*, 588 F.3d 585, 591-92 (8th Cir. 2009).

90. 29 U.S.C. § 1132(a)(1), (2); *LaRue*, 552 U.S. at 261-63; *but see Cervantes*, 2019 WL 5067202 at *8-9 (indicating that a plaintiff may have standing to challenge fiduciary conduct regarding a brokerage window without having personally invested through it, so long as the allegation "arises from the same misconduct that injured his retirement savings and the retirement savings of all participants.").

91. *See* Fed. R. Civ. P. 23(a)(1) (requiring that "the class is so numerous that joinder of all members is impracticable"). As a general rule of thumb, a minimum of 40 class members is necessary to satisfy the Rule 23 numerosity requirement. *See, e.g.*, 5 William B. Rubenstein, Newberg on Class Actions§ 3:12 ("As a general guideline . . . a class of 40 or more members raises a presumption of impracticability of joinder based on numbers alone.").

92. 29 U.S.C. § 1132(a)(3).

93. *Spokeo, Inc. v. Robins*, 578 U.S. 856, 136 S. Ct. 1540, 1549 (2016), as revised (May 24, 2016) (explaining that whereas "a bare procedural violation, divorced from any concrete harm" does not "satisfy the injury-in-fact requirement of Article III," the "violation of a procedural right granted by statute can be sufficient . . . to constitute injury in fact" if there is a "risk of real harm").

94. *Brock v. Robbins*, 830 F.2d 640, 647-48 (7th Cir. 1987) (further recognizing that where "certain trustees have acted imprudently, even if there is no monetary loss as a

result of the imprudence, then the interests of ERISA are furthered by entering appropriate injunctive relief.); *see also Moitoso*, 451 F. Supp. 3d at 218 ("Equitable relief is an available remedy for individuals even when the Plan as a whole has not suffered losses, if such relief is 'appropriate.'").

95. *Shaver v. Operating Engineers Loc. 428 Pension Tr. Fund*, 332 F.3d 1198, 1203 (9th Cir. 2003).

96. *Brock*, 830 F.2d at 647-48.

97. *See* 29 U.S.C. § 1132(a)(5) (empowering the DOL bring suit "to enjoin any act or practice" that violates ERISA, to "redress" violations, and "enforce any provision" of ERISA).

State-Facilitated Retirement Savings Programs: A Policymaker's Guide to ERISA and the Tax Code for IRAs and 401(k)s

David E. Morse and Angela M. Antonelli

The objective of this article is to provide policymakers with a primer about ERISA and the Tax Code, how these federal laws and their regulations pertain to IRAs and 401(k)s, and what this means for state-facilitated retirement savings programs. This article was originally published as a white paper by the Center for Retirement Initiatives McCourt School of Public Policy Georgetown University.
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For more than a decade, federal and state policymakers have been developing solutions for providing all private sector workers with simple, low-cost, easily accessible ways to save for retirement. Today, millions of American private sector workers are not offered a way to save for retirement by their employers, and employers are not required to offer

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The authors would like to thank Rikki A. Sapolich-Krol, partner at K&L Gates, and Sarah Mysiewicz Gill, associate at Groom Law Group, for their helpful review and comments.

The findings and conclusions in this article are the responsibility of the authors and do not necessarily reflect positions or policies of K&L Gates, or any other organization. This article should not be construed as legal advice.

their workers a retirement savings plan. As a result, some estimated 57.3 million private sector workers (46 percent)[1] lack access to an employer-sponsored retirement savings plan and even more are projected to suffer financial hardship in retirement.[2] This gap is distributed inequitably, affecting mostly employees of small businesses, "gig" and part-time workers, lower-income workers, younger workers, minorities, and women.

Workers are much more likely to save for retirement if they have access to a retirement savings plan through their employers. This access gap is one of the reasons that retirement readiness continues to deteriorate. Although workers can open individual retirement accounts ("IRAs") and save on their own, they rarely do.[3] The good news is that when offered a workplace savings solution, particularly one in which they are enrolled automatically, most people choose to consistently save a portion of their paychecks.[4]

The two types of retirement savings vehicles that have shown the greatest potential for states[5] to close the savings access gap are auto-IRAs and 401(k)s. State auto-IRAs are state-facilitated payroll withholding IRA saving programs that certain employers[6] are required to make available to their employees.[7] For a state-facilitated 401(k) defined contribution ("DC") savings plan model, the state would establish a turnkey 401(k) "plan-in-a-box." While the 401(k) could take the form of a "single employer plan," with each employer technically sponsoring its own plan, it is more likely to be a multiple employer plan ("MEP") or pooled employer plan ("PEP") – an aggregated plan in which more than one employer participates and potentially benefits from scaling and cost efficiencies.

In both the state-facilitated auto-IRA and 401(k) models, covered employees would automatically contribute a specified default percentage of each paycheck, the contribution rate could gradually escalate over time, and savings would be invested in a default investment fund. Employees would have the freedom to choose a different contribution level or other investments from the program's pre-selected menu, or to opt out of contributing and not participate. The choice whether to save would always be voluntary for the employee. To implement either savings model, the state would contract with external providers, including recordkeepers, institutional trustees, and investment managers, to create a turnkey program.

Auto-IRAs and 401(k)s each have strengths and drawbacks, mainly because of differences in federal laws – the Employee Retirement Income Security Act of 1974 ("ERISA") and Internal Revenue Code of 1986 ("Tax Code") – and the regulations governing their operations.[8] The most-significant distinction is that states can require employers to facilitate their workers' participation in an auto-IRA but not a 401(k), and employers may contribute to a 401(k) but not an auto-IRA. IRAs generally are exempt from ERISA's federal preemption rules if

employers do not endorse or contribute to the program and certain other requirements are satisfied.[9] ERISA probably would prohibit a state-mandated 401(k) requirement on employers. Table A compares the basic features of state facilitated IRAs and 401(k)s.

Table A. A Comparison of the Basic Features of State-Facilitated IRA vs. a 401(k)

Program/ Feature	**IRA**	**401(k)/DC**
ERISA Regulation	Non-ERISA	ERISA
Administrative Simplicity	Yes	Somewhat (single plans vs. MEP affects burden on employers)
Contributions Allowed	Employee pre-tax/Roth	Employee pre-tax/Roth; and Employer
Investments	Employee chooses from plan "menu," including a state-pooled and professionally managed option and/or private sector (third-party) options	Employee chooses from plan "menu," including a state-pooled and professionally managed option and/or private sector (third-party) options
Employers Required to Adopt	Yes, can be under current law	Unlikely
Auto-enrollment with Employee Opt-Out	Yes	Yes
Pros	• Employer mandate allowed • Simple • Low-cost • Easier to establish	• Some complexity but flexible design • Employees may contribute $19,500 ($26,000 ≥ age 50); • Allows employer contributions
Cons	• Relatively low contribution levels of $6,000 ($7,000 ≥ age 50) • No employer contribution • Investment risk on participant • Participant leakage	• Some participant leakage,[55] depending on plan design • Investment risk on participant

The objective of this article is to provide policymakers with a primer about ERISA and the Tax Code, how these federal laws and their regulations pertain to IRAs and 401(k)s, and what this means for state-facilitated retirement savings programs. After reviewing the question of ERISA applicability to state auto-IRAs and an overview of the federal Tax Code and IRA rules, this article then explores how ERISA and the Tax Code rules apply to 401(k)s, including the new rules allowing states (and others) to possibly lower 401(k) costs by sponsoring group 401(k) MEPs and PEPs.

ERISA AND AUTO-IRAS

What is ERISA?

ERISA was enacted to protect participants in private sector employee benefit plans from improper administration, inadequate or misleading communications, and dishonest handling of plan benefits and assets.[10] Encompassing 401(k) and other DC arrangements and traditional pension (defined benefit) plans, the key elements of an ERISA-regulated retirement plan are the payment of post-employment income and employer involvement as sponsor, overseer, and/or administrator.[11]

In addition to protecting workers, ERISA established a national administrative scheme by preempting "any and all state laws [that] relate to any employee benefit plan."[12] The Supreme Court has limited ERISA preemption to state laws regulating "a central aspect of plan administration," such as ERISA's reporting and disclosure regime, determining eligibility to participate, or the amount of benefits.[13] Thus, a state law requiring that certain employers facilitate employee paycheck savings through a state auto-IRA program would not be preempted if: (1) the state auto-IRA program was itself not an ERISA retirement plan and (2) the state enabling law establishing a new state savings program did not affect a central aspect of an employer's operation of its own retirement plan.

IRAs Are (Generally) Not ERISA Plans

IRAs, which predate the passage of ERISA, typically would not be ERISA plans even though they are retirement savings vehicles, because they are personal savings accounts established and controlled by individuals and not employers. By way of contrast, a 401(k) plan is an ERISA plan because of the high degree of employer involvement and control, including the employer's selecting the investments and service providers, setting plan terms, and making benefit determinations, as well as the ability of employers to contribute.

Employer-Offered IRAs Meeting Certain Criteria Are Not ERISA Plans

What if an employer wanted to help workers save by setting up a payroll withholding program with one or more IRA providers? Would the employer's involvement turn the IRA into an ERISA-regulated plan? The Department of Labor ("DOL"), which enforces ERISA, has issued "safe harbor" guidance to address this question and, in general, the answer is that employer involvement does not turn an IRA into an

ERISA-regulated retirement savings plan if the employer's activities are kept to a ministerial (mostly nondiscretionary) level. Indeed, one of the DOL's first actions when ERISA took effect was to issue a four-part safe harbor from ERISA regulation for employer-offered IRAs. Under this safe harbor, an IRA program would be exempt from ERISA if:

1) The employer did not contribute on behalf of employees;

2) The employer did not endorse the program;

3) The employer did not receive any financial advantage (kickback); and

4) Each employee's contributions to the IRA were completely voluntary.[14]

Over the years, the DOL expanded that safe harbor to allow additional degrees of employer involvement. These DOL safe harbors are discussed in more detail in Appendices A and B.

State Auto-IRAs Not Interpreted as Subject to ERISA

When states began adopting auto-IRAs, it was clear that they satisfied the existing DOL IRA safe harbor because the employers had no discretion, decision-making, or control; employers simply had to facilitate worker participation by cooperating with the program administrator and processing payroll withholding.[15] In addition, because employers lack control and are legally only required to facilitate their employees' participation, employers do not sponsor or maintain the programs. Even without the DOL safe harbor, most legal experts concluded that, because the state or state-appointed board is in control of the program, and there is a lack of employer sponsorship, responsibility, or ongoing maintenance, a state-facilitated auto-IRA is not an ERISA plan.

In 2016, in the waning days of the Obama Administration, states received some additional support when the DOL finalized additional safe harbor guidance specific to state auto-IRAs outlining the conditions that a program could satisfy to automatically be exempt from ERISA.[16] Although this guidance was subsequently nullified by Congress in 2017 at the request of the Trump Administration, states continued to move forward with the adoption of the programs based on both the original DOL IRA safe harbor that remains in place and judicial limitations on ERISA preemption.[17] For a more detailed discussion of the 2016 DOL IRA safe harbor guidance for state-facilitated programs, see Appendix B.

Current Legal Consideration: Courts, Preemption and State Auto-IRAs

In the only judicial decision involving auto-IRAs and ERISA to date, the U.S. District Court for the Eastern District of California held that the California program, known as CalSavers, is not an ERISA-regulated retirement plan and the California statute was not preempted by ERISA.[18] Specifically, the court, in *Howard Jarvis Taxpayers Assn v. The California Secure Choice Retirement Savings Program,* found that the degree of employer involvement in facilitating CalSavers was minimal and the program was not established or maintained by an employer. The district court stated that to be an ERISA-regulated plan, "an employer's administrative duties must involve the application of more than a modicum of discretion" and that "an employer who makes no promises to its employees regarding an employee benefit plan or its coverage" has not established or maintained a plan. Simply remitting payroll deductions to an auto-IRA without discretion regarding the money does not turn an employer into a plan sponsor. Because CalSavers is not an ERISA plan and does not affect any employer's operation of an ERISA plan, the state law – including the requirement that employers without a plan of their own facilitate (allow their employees to participate in) CalSavers – is not preempted. The decision has been appealed to the U.S. Court of Appeals for the Ninth Circuit and oral arguments were heard on February 8, 2021.[19] [Update: In a unanimous decision, the Ninth Circuit agreed with the district court ruling that "CalSavers is not an ERISA plan because it is established and maintained by the State" and does not "interfere with ERISA's core purposes."[20]]

Although there are three operating state-facilitated auto-IRAs and a number of others in the planning stage, there have been no challenges seeking ERISA preemption of an auto-IRA statute or state program other than *Jarvis*. For further analysis of related federal case law, see Appendix C.

States Should Follow Federal Guidance and Legal Interpretations to Avoid ERISA Preemption

The bottom line for policymakers is that existing law gives states room to establish auto-IRA programs and to require that employers facilitate their employees' participation in auto-IRA programs. Nevertheless, states embarking on this approach should take care to limit covered employers' responsibilities to ministerial tasks, such as registering with the program administrator, providing certain employee census information, properly withholding eligible employees' contributions from their wages, and timely and accurately transmitting those amounts

to the program. Employers should not have administrative decision-making or fiduciary authority. Policymakers should consider both the existing DOL safe harbor and the disapproved auto-IRA safe harbor (See Appendices A and B) in designing a program. Policymakers and their counsel also should continue following developments in this still-emerging area of law.

THE TAX CODE AND AUTO-IRAS

States establishing auto-IRA programs can choose between offering a Roth IRA and traditional IRA as the default vehicle while allowing participants to choose the other type. In designing state auto-IRA programs, policymakers have to be aware of the differences between these two options. However, Roth and Traditional IRAs are similar in many ways, including:

- *Eligibility & Vesting*. An individual must have "earned income" at least equal to their IRA contribution. Earned income includes salary, wages, bonuses, tips, and self-employed earnings. Of course, the individual is always 100 percent vested in the IRA.[21]

- *Investments*. The typical IRA investment is a mutual fund, including target date or lifecycle funds. The state may limit the program's investment options to a pre-selected "menu" of funds.[22] Although too speculative an investment and expensive for recordkeeping to be suitable for an auto-IRA, investments in individual stocks and bonds are allowed, but an IRA may not invest in "collectibles" such as art, coins and jewelry or buy life insurance.[23]

- *Contribution Limits*. For 2021, the annual contribution limit is $6,000, or $7,000 if the individual will be at least 50 years old by the end of the year. These amounts are adjusted annually for inflation. IRA contributions exceeding the dollar limit (or made by someone not eligible to contribute) must be withdrawn by the date federal income taxes are due for the year. Otherwise, the individual must pay a six percent excise tax on excess contributions each year until corrected.

- *Saver's Credit*. The federal Saver's Tax Credit ("Saver's Credit") is available for traditional and Roth IRA contributions (and 401(k) contributions) of up to $2,000 for individuals and

$4,000 for couples. The credit is between 10 percent and 50 percent of the amount contributed and is phased out for taxpayers earning above $33,000 for individuals, $49,500 for heads of households, and $66,000 for married couples in 2021. The Saver's Credit is in addition to the tax deduction for a traditional IRA or 401(k) contribution. The tax credit can serve as an incentive to boost retirement savings, and if Congress would make it refundable, the boost to long-term retirement savings could be significant.[24]

- *Withdrawals and Distributions*. IRA withdrawals taken before age 59 1/2 are hit with a 10 percent added excise tax. (For a Roth IRA, the excise tax only applies to the portion of the withdrawal attributable to investment income.) There are exceptions for disability, death, certain types of hardship, and first-time homebuyers, among others. A participant may not borrow from their IRA or use it as loan collateral.

- *Beneficiaries*. IRA owners may designate one or more beneficiaries. A married individual may name a non-spouse without spousal consent. Auto-IRAs should consider using a default beneficiary hierarchy for individuals who do not name a beneficiary.

- *IRA Document*. An IRA must be in writing. Fortunately, the Internal Revenue Service ("IRS") provides Form 5305, 5305A, or 5305RA – short and user-friendly documents that states may use to create Roth and traditional IRAs. The forms lay out the basic Tax Code rules and state that the IRA owner and provider agree to cooperate with one another.

- *Exclusive Benefit*. An IRA must be held by a bank, an IRS-approved non-bank institution, or an insurance company in an account maintained for the exclusive benefit of the owner. Also, an IRA may not engage in certain related party "prohibited transactions," such as using the IRA as collateral for a loan.[25]

- *ERISA as Benchmark*. For more than 40 years, ERISA has provided a workable system of fiduciary standards and best practices for running a retirement program, protecting participants, and resolving disputes over benefit claims. Policymakers may wish to consider this ERISA "infrastructure" in creating state rules and consumer protections for any state-facilitated auto-IRA program.

How Are Roth IRAs and Traditional IRAs Different?

There are three key distinctions between Roth and traditional IRAs that policymakers should keep in mind: 1) A Roth IRA has an income-based eligibility restriction (discussed below); 2) Roth IRA contributions are not tax-deductible but, if certain holding and timing conditions are met, distributions at the time of retirement are 100 percent tax-free; and 3) Roth IRAs are not covered by the age 72 minimum distribution requirement.[26]

Table B highlights the differences between Roth and traditional IRAs.

Table B. A Comparison of the Tax Treatment of IRAs vs. 401(k)s

	Traditional IRAs	**Roth IRAs**
Eligibility	Individual must have a salary, self-employment earnings, or other taxable compensation. There is no age maximum.	Same as traditional, and individual (plus spouse if married, filing a joint return) must have modified adjusted gross income (MAGI) below specified limits. For 2021, the limits are as follows. *Single filer* with MAGI of: • Up to $125,000 – full contribution • $125,000–$140,000 – partial contribution • $140,000 or more – not eligible *Joint filers* with MAGI of: • Up to $198,000 – full contribution • $198,000–$208,000 – partial contribution • $208,000 or more – not eligible
Deductible Contributions	*For 2021*: Contributions are tax-deductible if individual (and spouse) are not covered by a 401(k) or other retirement plan. This means that contributions come out of employee paychecks pre-tax and are instead taxed upon distribution at retirement. If covered by a retirement plan, contribution deductible only if income is below certain limits. For 2021:	Roth contributions are not tax-deductible.

	Single filer, covered by a retirement plan at work, with MAGI of: • $65,000 or less – fully deductible, phased out for income between $65,000–$75,000 and • $75,000 or more – nondeductible *Joint filer, covered by a plan at work*, with MAGI of: • $104,000 or less – fully deductible • $104,001–$124,000 – partially deductible • $124,000 or more – nondeductible	
Federal Income Tax Treatment on Contributions and Earnings	Earnings grow tax-deferred until distributions begin. Distributions are taxed as ordinary income. Withdrawals of nondeductible contributions are not taxed.	Withdrawals of contributions are not taxed. Qualified distributions are tax-free. Earnings on nonqualified distributions earnings are taxed as ordinary income and may be subject to a penalty.
Penalties on "Early" and "Late" Distributions	Distributions from contributions and earnings can be taken after age 59 1/2 without a federal tax penalty. Minimum (based on life expectancy) withdrawals ("RMDs") must begin by age 72. Late distributions subject to 50 percent excise tax. Distributions before age 59 1/2 are subject to a 10 percent penalty tax unless certain exceptions are met, including: • disability • periodic installment payments • the distribution is used to cover certain medical bills • the distribution is used to pay health insurance premiums during unemployment lasting at least 12 weeks • the distribution is used for post-secondary education expenses • the distribution is used to purchase a first home ($10,000 maximum) • certain distributions up to $5,000 related to the birth or adoption of a child. Distributions to beneficiaries on an owner's death are also exempt from the 10 percent penalty.	Distributions from earnings are tax-free if the initial contribution to the IRA was made at least five years ago and the individual is: • age 59 1/2 • disabled • using the funds for a first home purchase (up to $10,000) Payments made to beneficiaries after the five-year period are also tax- and penalty-free. Payments made before the end of the five-year period are penalty-free. Distributions from earnings are not subject to the 10 percent penalty if they qualify for an exception – same as exceptions for traditional IRAs.

State-Facilitated Auto-IRA Programs: Choosing a Roth IRA as the Default Option

The first three active auto-IRA programs – OregonSaves, Illinois Secure Choice, and CalSavers – all have chosen the Roth IRA as the default while also making the traditional IRA available.

Generally, someone expecting to be in a higher tax bracket at the time of retirement is financially better off by contributing to a Roth IRA than a traditional IRA, because distributions at the time of retirement will not be taxed. Beyond potential tax benefits, Roth IRAs have the advantage of not requiring minimum distributions at age 72. From an administrative perspective, a Roth IRA also makes it easier to process a participant's "do-over" request to dis-enroll after participating for only a few pay periods, because the return of contributions is non-taxable and penalty-free. (Return of any investment income – likely to be small – would be taxable, and probably subject to the 10 percent early withdrawal penalty.)

States using a Roth IRA as the default will have no way of knowing whether a participant will exceed the Roth IRA income limit for the year. Contributions that exceed the income limit are hit with a six percent excise tax unless withdrawn by the individual's income tax filing deadline. (The six percent tax is imposed annually until corrected.) Thus, state program communications should clearly inform participants of the earnings limit and correction rules for Roth IRAs and/or traditional IRAs.

Although there are strong reasons for using a Roth as the default, states should consider allowing participants to elect a traditional IRA, either because they earn too much for a Roth IRA or the traditional version meets personal retirement or tax planning objectives.

ERISA AND 401(k)S, MEPS AND PEPS

A 401(k) can be viewed as an IRA on steroids. Both employees *and* employers may contribute, at combined limits more than triple that of IRAs, with a broader range of available investments and more-flexible program design. Of course, these 401(k) advantages are achievable only if the employer chooses to establish a plan. As previously noted, however, ERISA would preempt a state requirement that an employer offer its workers a 401(k).

An employer can create its own single employer plan, or become part of a multiple employer plan ("MEP") or pooled provider plan ("PEP"). In a single employer plan, each company sponsors, controls, and is responsible for its own plan. MEPs and PEPs are comingled plans that several employers can join.

Employers have many reasons for not offering a retirement plan, such as cost, complexity, and potential fiduciary liability.[27] A state-facilitated 401(k) would seek to encourage employers to offer a retirement savings plan by minimizing these concerns and doing much of the legwork. The state, or a state-selected board, would screen and hire a team of providers – recordkeeper, administrator, investment managers, trustees, lawyers, and advisors – to establish the necessary plan documents and administrative infrastructure. In addition to doing much of the heavy lifting for employers, this "401(k) in a box" may have significantly lower administrative and investment costs and added services than employers, especially small to mid-size employers, could negotiate on their own. In that regard, a MEP- or PEP-aggregated structure may give the state greater bargaining power in negotiations with providers over fees and services.

What follows is an overview of the special MEP or PEP considerations affecting the entities that may join or sponsor the program; the general ERISA and Tax Code rules applicable to all 401(k)s; and some program design considerations for policymakers, including which format may be most appropriate. The same ERISA and Tax Code rules apply regardless of whether it would be a state-facilitated plan or a private sector employer-sponsored plan.

Differences Between 401(k) MEPs and PEPs

MEPs predate ERISA, while PEPs are brand-new, created by the Setting Every Community Up for Retirement Enhancement Act of 2019 (the "SECURE Act").[28] The first PEPs were expected to launch in 2021. The differences between MEPs and PEPs are subtle – employers and certainly employees are unlikely to notice – but are important for states to consider.

The DOL requires that employers joining a MEP share a commonality of interests, such as an association of businesses in the same field (e.g., lawyers, Realtors®, plumbers) or in the same locality (e.g., a particular state).[29] Under these rules, a state could establish a MEP for employers located in their state but probably would have to keep out-of-state employers from joining. The DOL's rationale for the commonality rule is that a "bona fide" association of employers will be best to monitor service providers and stymie fraud or abuse.

PEPs are not covered by the commonality requirement that applies to MEPs. While any employer may join, the PEP must be operated by a "pooled plan provider": an entity agreeing to be the plan's named fiduciary, responsible for the plan's overall operations and registered with the DOL. The PEP itself must have a system for the smooth running of

the program and collecting contributions, and enable employers and participants to withdraw from the plan without unreasonable restrictions or fees. While it may be possible for a state board to qualify as a pooled plan provider, most (probably all) states would want to hire a third-party financial, recordkeeping, or consulting firm for that role to shift the pooled provider's ERISA fiduciary duties from the state to a qualified private sector professional.

ERISA Requirements

ERISA establishes standards for establishing and running a 401(k) or other DC plan, including the fiduciary duties of prudence and acting in the best interest of participants and beneficiaries, and imposes participant disclosure and government reporting requirements. A plan is established by a "plan sponsor" through a written plan document.[30] All employee and employer contributions and investment earnings must be held in a "bullet-proof" trust or an insurance company annuity, and only used to pay benefits or cover legitimate plan expenses.[31]

1. *ERISA Fiduciaries and Their Duties.* The plan sponsor and anyone with control over plan assets – such as a trustee or money manager – is an ERISA fiduciary. Anyone with authority to appoint or fire a fiduciary is themselves a fiduciary.[32] Thus, fiduciary responsibility can never be fully "outsourced" to a third party because hiring that third party is a fiduciary act.

   Fiduciaries are expected to be experts (or hire expert advisors) and to act prudently for the exclusive benefit of participants.[33] However, perfection is not required; just prudent and well-thought-out, reasonable decision-making. Fiduciaries are obligated to avoid self-dealing or taking actions that are adverse to the plan. Finally, ERISA (and the Tax Code) penalize certain "prohibited transactions" between a plan and a related party, including the direct or indirect sale, exchange, or leasing of any property, lending of money, or supplying goods and services between the plan and a party in interest.

2. *Special Investment Consideration*. A large portion of fiduciary efforts concerns plan investment. ERISA 404(c) allows fiduciaries to offload much of their fiduciary responsibilities by making participants responsible for investing their own plan accounts.[34] For this to happen, participants must be given a choice of at least three diversified investments funds: an S&P 500 fund, an

international fund, or a fixed-income fund; the opportunity to switch investments at least quarterly; and, of course, proper disclosure to participants. Participants not making an investment election, perhaps because they were auto-enrolled, are defaulted into a diversified "target date," "lifecycle," or similar all-in-one diversified investment fund.[35] Even under this ERISA 404(c) exception, though, the plan fiduciaries are responsible for selecting and monitoring the investments offered on the fund lineup, including the default fund.[36]

3. *Reporting and Disclosure Requirements*. The ERISA disclosure obligations include giving participants a "plain English" summary plan description ("SPD"), a notice of plan amendments and information on plan fees and investment options.[37] Participants must receive quarterly benefit statements and, starting in 2021, an estimate of the monthly lifetime retirement income a participant and his/her spouse might reasonably expect from their current plan savings.[38] Each plan generally must file an annual report with the IRS including an audited financial statement and other investment information.

4. *Paying for Plan Startup & Operations*. Most, if not all, states will want their plans to be self-sustaining and cover all their costs, such as recordkeeping and investment fees, as well as expenses for lawyers, consultants, auditors, and employee education and communication. Each employer could pay for its share of these expenses, but DC plans typically pass on most costs to participants through embedded investment fees or a separate fee deducted from each employee's account. ERISA requires that all fees paid by the plan or participants be reasonable.[39]

An additional fee consideration for states is who pays for the state's own startup and ongoing costs. States could insist that the plan administrator or pooled plan provider cover these costs. Alternatively, certain expenses possibly could be paid by the plan itself, such as through a small, extra asset-based charge. However, ERISA forbids charging participants for "settlor expenses": activities that benefit the employer and not the plan or its participants. Logically, state costs should not be settlor charges, since the state does not have any employees covered by the plan and is acting to promote retirement savings by workers. States should seek legal guidance about this point.

THE TAX CODE AND 401(k)S

While ERISA focuses on fiduciary behavior, the Tax Code seeks to encourage participation by lower-paid workers and prevent "unfair" advantages for owners, senior executives, and other key employees. 401(k) and other retirement plans must be "tax qualified" by meeting a series of mathematical "discrimination" tests, operating rules, and limits intended to keep the plan from benefiting highly compensated employees ("HCEs") too much. In 2021, an HCE is generally anyone owning five percent or more of the employer or who earned at least $130,000 (indexed) in 2020.

There also are rules for employee and employer contributions, vesting, restrictions on withdrawals, and what terms need to be in the official plan document. For example:

1. *Eligibility to Participate*. A plan may cover all employees, but the Tax Code permits exclusion of certain employees, such as new hires, part-timers, individuals under age 21, or workers in certain specified categories (such as those at a particular location), as long as the plan passes "coverage" tests by including sufficient numbers of non-HCEs.[40]

2. *Employee and Employer Contributions*. Employee 401(k) contributions are tax-deferred up to the Tax Code's limits – for 2021, $19,500 for those under age 50 and $26,000 for those who will be at least 50 by year-end.[41] (Dollar limits are indexed annually for inflation.) Alternatively, a plan may allow employees to make Roth 401(k) contributions up to these same limits. Unlike with IRAs, any participant may make a Roth 401(k) contribution regardless of income. Many plans allow employees to choose between traditional and Roth 401(k) contributions.

   Employers may match employees' contributions (e.g., 50 percent of the first six percent contributed) and/or make non-matching contributions (e.g., three percent of each worker's pay). Plans typically give employers flexibility to reduce future contributions or to wait until the end of the year before deciding how much, if any amount, to contribute.

3. *Vesting*. Employees are always 100 percent vested in their own contributions and, depending on the plan's terms, employer contributions can vest anywhere from immediately to over three to six years.[42] Forfeitures of nonvested contributions when a participant leaves may be used by the employer to reduce future

contributions or pay plan expenses, or as an additional contribution for the remaining participants.

4. *Spousal Rights.* A married DC plan participant must designate their spouse as beneficiary unless the spouse consents in notarized writing to waive this right. Upon divorce or legal separation, a court may issue a domestic relations order, called a QDRO, requiring that the plan transfer part (or even all) of the participant's benefit to a plan account set up for the ex-spouse.[43]

5. *Loans and Withdrawals.* The Tax Code permits a plan to allow participants to borrow from their account. Generally, loans may not exceed $50,000 and must be repaid, with interest, over five years.[44] Plans also may allow employees to withdraw their savings for "hardship," such as to prevent eviction or pay funeral costs, home purchase, and college tuition. Loan defaults and withdrawals are taxable and may be hit with a 10% excise tax if the participant is under age 59 1/2, unless certain exceptions apply.[45]

   The availability of loans and withdrawals may encourage employee contributions by allowing access to funds in financial emergencies. However, "leakage" – spending retirement savings before retirement – is a concern, and many 401(k) programs offer free financial education and budgeting assistance to encourage savings. Some plans restrict loans and hardship beyond the Tax Code requirements to reduce leakage.

6. *Distributions.* Plan distributions must begin by the later of age 72 or retirement (five percent owners must withdraw by 72 even if still employed).[46] Retirees may choose to receive their benefits in any form allowed by the plan document. Typically, these include lump sums and installments. There is increasing interest in encouraging participants to use all or a portion of their account to buy a lifetime annuity from an insurance company to help manage their assets to last in retirement. While many experts agree that providing a lifetime income option would be beneficial, there is a need to develop more attractive and cost-effective options that both employers and employees demand. New types of lifetime income solutions are being developed to meet this emerging need for DC plans to generate a reliable stream of income in retirement as with a traditional DB plan.

7. *Tax Code Violations*. Plan administrators should have procedures (including regular testing) to prevent over-contributions and discrimination. Even with the best practices in place, mistakes will occur, and violation of any of the Tax Code requirements could theoretically cause a plan to be "disqualified." Disqualification causes the retroactive loss of all favorable tax benefits: Participants are immediately taxed on vested benefits, even if not paid out; the plan must pay income tax on its investment earnings; the employer can lose its tax deduction; and participants and the employer may have interest and tax penalties.

   Fortunately, because of these draconian consequences, the IRS is loath to disqualify a plan. Instead, it has created a series of procedures where an employer can correct a qualification defect.[47] Depending on the relative size and nature of the error, and how it was caught (by the employer and self-corrected or by the IRS in an audit), almost all errors may be fixed by undoing the mistake, making all participants whole, and – for certain egregious violations – the employer paying an IRS user fee or penalty.

8. *Bad Apples, MEPs, and PEPs.* Generally, the Tax Code nondiscrimination qualification rules apply separately to each employer participating in a MEP or PEP.[48] Although the IRS asserts that one employer's violation infects the entire plan,[49] the "bad apple" will not affect the other (good apple) employers, as long as the plan administrator has policies to avoid, find, and fix mistakes; instructs the bad apple employer to fix the error; and notifies participants of the how the problem is being addressed. Finally, if the offending employer does not act, the slice of the plan attributable to the bad apple employer must be spun-off into a separate plan. Such correction protocols will protect the state, MEP or PEP, employers, and participants from punishment for the sins of another.[50]

State-Facilitated 401(k) Plan Considerations: Plan Type, Design and Fiduciary Responsibilities

While a single employer, MEP, or PEP approach can all be appropriate for a state-facilitated 401(k), a state should consider the following key considerations with respect to the selection of plan design and the extent to which that selection affects the degree of fiduciary responsibility assumed by the state:

1. *Single Employer 401(k) Plan.* A state-facilitated single employer 401(k) would entail the state selecting the administrator/recordkeeper, trustee, and investment lineup, and then developing the program's terms. To join, employers (in or out-of-state) would complete a fill-in-the-blank "prototype" plan adoption agreement. Legally, each employer would sponsor its own plan (hence the term "single employer"), with authority to amend the plan, alter investments, etc. By selecting the providers and program features, the state would curate the choices available to adopting employers, thus simplifying administration and (ideally) enabling the state to negotiate favorable fees.

2. *A MEP or PEP Plan Has Advantages Over a Single Plan.* While the single employer, MEP, or PEP approach can all be appropriate for a state-facilitated 401(k), policymakers may favor group plans in general and PEPs in particular for two reasons. First, a PEP could be offered to both in-state employers and outsiders. While a state would be primarily concerned with expanding coverage for its own residents, out-of-state employers would add to the asset base, potentially lowering per-participant plan costs. Indeed, this is the model used by many State 529 college tuition reimbursement programs. Second, the state can outsource most (but probably not all) of its ERISA fiduciary responsibility to the pooled plan provider.

3. *ERISA Fiduciary Responsibility.* The choice of single employer, MEP, or PEP approach could affect the degree, if any, of fiduciary responsibility assumed by the state or state-appointed board tasked with selecting, monitoring, and (if necessary) running the program. As previously discussed, someone with authority to appoint or remove an ERISA fiduciary is themselves a fiduciary. However, states are well-situated to act as fiduciaries and should be able to manage any fiduciary status comfortably, first by following careful processes to select providers (and states already have detailed procurement rules in place) and then by obtaining robust indemnification protections from all providers. States are likely to already have fiduciary exposure (albeit, under state law, not ERISA) for their 529 accounts and other programs geared for the private sector.[51]

4. *Tools and Flexibility to Encourage Plan Participation.* Experience with private sector 401(k)s and active auto-IRA programs shows, beyond doubt, that automatic participation (with opt-outs) dramatically increases savings levels.[52] Thus, policymakers should insist that plan documents require that covered employees be

automatically enrolled at a set contribution rate and escalate their contributions increase annually until reaching a specified level. Policymakers should be careful not to set the contribution default rate too low, because that would slow the progress of savers. For example, the Massachusetts CORE program sets a six percent default contribution rate for plan participants. Research has shown that employees readily accept higher default contribution rates than the traditional three percent, which is becoming increasingly less common in private sector employer-sponsored plans.[53]

To encourage employers to join the plan, policymakers should allow employers some flexibility to choose eligibility rules, contribution rates, and other plan features from a menu of terms established by the state. However, employer flexibility must be balanced with state efforts to keep administrative costs low and worker savings high. In addition, plan design could minimize the possibility of a qualification violation by taking advantage of various Tax Code safe harbor provisions. For example, the Tax Code gives a 401(k) plan with auto-enrollment and a minimum level of fully vested matching or other employer contributions a free pass on many of the non-discriminations rules.[54]

CONCLUSION

State-facilitated auto-IRAs and 401(k)s are two strong options for policymakers to consider as ways to make significant progress in closing the retirement access gap and offer millions of private sector workers the opportunity to save for retirement. While it is possible that the new PEPs authorized by the SECURE Act can provide another option for employers, including those that do not currently offer a plan, it is unlikely that PEPs will cover the majority of the 57 million private sector workers who currently lack access. The two efforts should be viewed as complementary rather than competitive.

The key distinctions between the two options for state-facilitated retirement savings programs are 1) an auto-IRA is not preempted by ERISA; 2) a 401(k) is an ERISA-regulated plan that offers higher contribution limits for participants and employers, but 3) this means that a state can require that employers allow employees to save through an auto-IRA, while employers must adopt a 401(k) voluntarily. Policymakers will have to weigh the pros and cons of each before choosing a solution. A state could take a dual track: first establishing

an auto-IRA or 401(k) and, once that is fully operational, adding the other type. However, if the objective is to close the access gap, far more workers are going to begin to save if most, if not all, employers are required to offer their workers access to a way to save.

APPENDIX A

The U.S. Department of Labor's Existing IRA Safe Harbor Guidance

One of the DOL's first actions when ERISA went into effect was to issue a safe harbor for payroll deduction IRAs. The regulation states that an IRA program is not an ERISA pension plan if:

(1) No contributions are made by the employer;

(2) Employee participation is completely voluntary;

(3) The sole employer involvement is to collect contributions through payroll deductions and remit them to the IRA sponsor and to permit, without employer endorsement, the sponsor to publicize the program to employees; and

(4) The employer receives no compensation (other than for certain permitted services actually performed).[56]

In 1999, the DOL issued Interpretive Bulletin 99-1 as part of its efforts to encourage retirement savings through payroll deduction IRAs. The Bulletin noted that "over half of the private wage and salary workforce does not have employment-based retirement coverage" and that this lack of coverage was most-prevalent among employers with fewer than 100 employees. The Bulletin then observed that small employers do not sponsor retirement plans in part due to the "administrative complexity and burden" and the "risk of commitment to an ongoing expense in the face of financial uncertainties." While noting that employees could set up their own IRAs, the DOL concluded that they are more likely to "make use of an individual retirement savings vehicle that is offered in an employment setting and features regular withholding." The Bulletin stressed the DOL's "long-held view that an employer who simply provides employees with the opportunity for making contributions to an IRA through payroll deductions does not thereby established a 'pension plan.'"

The Bulletin also said that the employer endorsement and voluntary participation requirements are interrelated. Thus, according to the Bulletin, for a program to be completely voluntary, the employer cannot "endorse or recommend either the [IRA] sponsor or the funding media" and should inform employees that other IRA vehicles are available outside the program and that an IRA may not be appropriate for an employee. On the other hand, an employee's participation would not be voluntary if they were coerced into contributing.

Some employer involvement is allowed in a payroll deduction IRA. Thus, in a payroll IRA program that was invested in a Prudential Insurance group annuity contract, the DOL permitted the employer to accept Prudential's upcoming plan of demutualization/public offering and decide how the demutualization proceeds should be divided among IRA participants.[57] The DOL noted that the ruling was based on three factors: (1) actions of an independent third party caused the need for the employer to act; (2) the employer would be acting in accordance with New Jersey insurance law; and (3) the employer's actions were one-time acts that would not involve employer retaining any ongoing discretion in administering or operating the IRAs.

The DOL allowed an even greater and ongoing level of employer involvement when it ruled that an employer could select three IRA sponsors from a pool of applicants, periodically review each sponsor's performance, replace any underperformers, and negotiate for and receive a written indemnification from each sponsor.[58]

APPENDIX B

Obama Administration's DOL 2016 Auto-IRA Safe Harbor

Rescinded by the Trump Administration and Congress

In 2016, during the waning days of the Obama administration, the DOL issued an extra IRA safe harbor specifically for state auto-IRAs ("2016 Safe Harbor").[59] One of the first actions of the Trump administration and the new Congress in 2017 was to "disapprove" (i.e., revoke) the 2016 Safe Harbor (along with a slew of other unrelated regulations by other government agencies) pursuant to the Congressional Review Act ("CRA").[60] The CRA provides Congress with a simplified procedure to issue a "disapproval resolution" revoking certain recent federal regulations and prohibiting federal agencies

from issuing a new rule that is "substantially the same" as the revoked regulation. The disapproval resolution simply provided that the 2016 Safe Harbor will have "no force or effect." The 2016 Safe Harbor disapproval resolution also appears to have revoked the related "preambles" published with the regulation by the DOL. The disapproval resolution revoking the 2016 Safe Harbor does not reference the 1975 Safe Harbor.

While there is little judicial precedent on the effect of a CRA disapproval resolution, most experts understand that the regulatory landscape is as if the 2016 Safe Harbor had never been issued.

REMAINING PRECEDENTIAL VALUE OF THE 2016 SAFE HARBOR

The 2016 Safe Harbor provided 11 conditions, essentially derivative of the 1975 Safe Harbor, but applicable only to state IRA programs. The 2016 Safe Harbor conditions were:

(1) The program is established by state law;

(2) The program is implemented and administered by the state or its delegate;

(3) The state or its delegate is responsible for the security of payroll deductions and employee savings (including through existing state wage and antitheft laws);

(4) The state or its delegate provides for employee notices and an enforcement mechanism;

(5) Employee participation is voluntary;

(6) Rights of participants and beneficiaries are enforceable only by such individuals, their representatives, and the state or its delegate;

(7) Employer involvement is limited to processing and remitting payroll withholdings, distributing notices and program information to employees, and providing information to the state or its delegate;

(8) The employer does not contribute to the program and does not give employees compensation or other financial incentives to contribute;

(9) Employer participation is mandated by state law;

(10) The employer has no discretionary authority or responsibility under the program; and

(11) The employer is not compensated (directly or indirectly) for participating in the program except for certain state provisions of the employer's actual or reasonably estimated program costs.

In deliberating whether, and under what terms, to issue the 2016 Safe Harbor, the DOL argued that a payroll withholding program that nudged employees into saving through automatic enrollment elections would not satisfy the "completely voluntary" condition of the 1975 Safe Harbor. The DOL concern was that a program's auto-enrollment or escalation feature could cause an employer to exercise undue influence over an employee's participation and that contributions that were made without an affirmative opt-in election might not be completely voluntary. Although there is no semantic or logical difference between "voluntary" and "completely voluntary" participation, the DOL's concern, expressed in the preambles to the 2016 Safe Harbor, appears to have been directed at programs in which there is some employer involvement in the auto-enrollment process.

Conversely, the preambles do not argue that a program with automatic employee elections in which an employer had no control over the program's terms, was neutral over whether employees should contribute, did not solicit employee elections, and was required by state law to make the program available to employees, would fail the completely voluntary condition. Thus, for example, if a state program mandates employer participation and limits employer activity to facilitating wage deferrals and transmitting contributions to the program IRAs, there is no "volition" by employers that would constitute an "establishment" of the IRAs.

APPENDIX C

ERISA Coverage and Preemption

An Overview of Judicial Case Law and Interpretation

INTRODUCTION

Auto-IRA preemption analysis boils down to two simple questions. First, is the state program itself an ERISA plan? Once it is determined

that an auto-IRA is not an ERISA plan, the preemption question is whether a state law requiring certain employers to facilitate the program (make it available to workers) "relates to" an ERISA-regulated plan. In other words, does the state law affect employers' operation or management of any 401(k), DC, or other ERISA plans that they offer or require them to establish an ERISA plan?

THE COURTS ON DEFINING WHAT IS AN ERISA PLAN

The Supreme Court has found that an ERISA plan does not exist when an employer assumes no responsibility to pay benefits on a regular basis, and there is no need for ongoing administrative practices associated with providing benefits.[61] The question of whether a plan is "established or maintained by an employer" is one of fact "to be answered in light of all the surrounding facts and circumstances from the point of view of a reasonable person."[62] In applying this test, the crucial factor is whether the employer intends to provide benefits on a regular and long-term basis.[63] To ascertain whether an employer has established an ERISA benefits plan, courts will look to

(1) Internal or distributed documents;

(2) Oral representations;

(3) The existence of a fund or account to pay benefits;

(4) Actual payment of benefits;

(5) A deliberate failure to correct known perceptions of a plan's existence;

(6) The reasonable understanding of employees, and

(7) The intentions of the putative sponsor.[64]

ERISA's regulation of employee benefit plans presumes a level of administrative and operational activity, since the employer's activities with respect to a plan are vulnerable to abuse.[65] The purpose of the "established or maintained by an employer" requirement is to "ascertain whether the plan is part of an employment relationship by looking at the degree of participation by the employer in the establishment or maintenance of the plan."[66] A plan is established when the employer has taken affirmative steps to extend benefits, for example, by financing or

arranging financing to fund benefits, establishing a procedure for disbursing benefits, or representing to employees that the employer has established a plan.[67] Without documentary evidence, even an employer's alleged promise to provide benefits does not establish an ERISA plan.[68] A plan is established when the employer has taken affirmative steps to extend benefits by, for example, financing or arranging financing to fund benefits, establishing a procedure for disbursing benefits, or representing to employees that they have established a plan.[69] Even an employer's alleged promise to provide benefits, without documentary evidence, does not establish an ERISA plan.[70]

The Supreme Court has found that a plan does not exist when an employer assumes no responsibility to pay benefits on a regular basis and there is no need for ongoing administrative practices associated with providing benefits.[71] The question of whether a plan is "established or maintained by an employer" is one of fact "to be answered in light of all the surrounding facts and circumstances from the point of view of a reasonable person."[72] In applying this test, the crucial factor is whether the employer intends to provide benefits on a regular and long-term basis.[73] To ascertain whether an employer has established an ERISA benefits plan, courts will look to:

(1) Internal or distributed documents;

(2) Oral representations;

(3) The existence of a fund or account to pay benefits;

(4) Actual payment of benefits;

(5) A deliberate failure to correct known perceptions of a plan's existence;

(6) The reasonable understanding of employees; and

(7) The intentions of the putative sponsor.[74]

THE COURTS ON ERISA PREEMPTION

A good example of the U.S. Supreme Court's current thinking about when ERISA preempts a state law involved Vermont's so-called "all-payer" health data collection law. In *Gobeille v. Liberty Mutual Ins. Co.*,[75] the Supreme Court held that the Vermont law was preempted because it imposed significant data collection and reporting

requirements on all health programs in the state, including "self-insured" ERISA-regulated plans. The court noted that since everything is "related" to everything else, ERISA use of that term must be narrowly construed; Congress intended to protect plans and plan administrators from "interference with the uniformity of ... administration" and financial burdens of compliance; and preemption should keep the states from regulating "a central aspect of plan administration." The court described ERISA's reporting, disclosure, and recordkeeping rules as a "central" and "essential part" of ERISA and thus preempted the Vermont law because it added a significant level of reporting rules onto ERISA plans.

With the Supreme Court setting the standards for addressing preemption, two California cases show that states may address the health and retirement needs of private sector workers without running afoul of ERISA. The first is a Ninth Circuit analysis of a local health ordinance and the second is a 2020 district court decision ruling that CalSavers, California's auto-IRA program, is not preempted by ERISA.

Golden Gate Restaurant Association v. City and County of San Francisco

In *Golden Gate Restaurant Association v. City and County of San Francisco*, the Ninth Circuit found that the San Francisco Health Care Security Ordinance, which included a mandate that employers spend a specified amount each year for their employees' healthcare, either through payment of insurance premiums, reimbursement for medical expenses, or paying into a medical program administered by San Francisco, was not preempted by ERISA.[76] The court determined that the ordinance did not regulate benefits or charges for benefits because it "did not require employers to establish their own ERISA plans or to make changes to any existing ERISA plans" and it was "not concerned with the nature of the health care benefits an employer provides to its employees." Further, the court determined that the ordinance provided discretion to ERISA administrators to determine plan eligibility and entitlement to particular benefits, and that the city payment option gave employers a realistic alternative to paying benefits under an ERISA plan and something in return for their payments to San Francisco.

THE COURTS AND STATE AUTO-IRAS: *JARVIS V. CALIFORNIA SECURE CHOICE*

In the only legal challenge to an auto-IRA, the District Court for the Eastern District of California ruled that CalSavers, California's

auto-IRA program, was not an ERISA plan and that the state enabling legislation was not preempted by ERISA. Relying on *Golden Gate,* among other decisions, the court found in *Howard Jarvis Taxpayers Association v. The California Secure Choice Retirement Savings Program*[77] that the degree of employer involvement in facilitating CalSavers was minimal and the program was not established or maintained by an employer. The court also found that "an employer's administrative duties must involve the application of more than a modicum of discretion in order for those duties to amount to an ERISA plan" and "an employer who makes no promises to its employees regarding an employee benefit plan or its coverage" has not established or maintained such plans. Simply remitting payroll deductions to an auto-IRA without discretion regarding the monies does not turn an employer into a plan sponsor.

After ruling that CalSavers was not an ERISA plan, the court went on to hold that the statute creating the program was not preempted by ERISA because it did not interfere with existing ERISA plans or impose additional on ERISA plans. Indeed, the statute only applied if there were no ERISA plan. [Update: In a unanimous decision, the Ninth Circuit agreed with the District Court ruling that "CalSavers is not an ERISA plan because it is established and maintained by the State" and does not "interfere with ERISA's core purposes."[78]]

CONCLUSION

With the state (not employers) in charge of all aspects of program management and decision-making, auto-IRAs should be considered non-ERISA plans. State auto-IRA laws only affect employers that do *not* sponsor or maintain an ERISA retirement plan; state auto-IRA requirements do not apply to employers offering workers a 401(k), DC, or pension plan. Thus, state auto-IRAs should not be regulated by ERISA and the state mandate should not be preempted under the "relates to" clause.

NOTES

1. Antonelli (2020). What are the Potential Benefits of Universal Access to Retirement Savings? Georgetown University Center for Retirement Initiatives in conjunction with Econsult Solutions, Inc.

2. Munnell, Chen & Siliciano (2021). "The National Retirement Risk Index." Issue in Brief 21-2;

3. Chen & Munnell (2017). "Who Contributes to Individual Retirement Accounts?," Issue in Brief 17-8.

4. *See "What Are the Potential Benefits of Universal Access to Retirement Savings?" and* Vanguard, "How America Saves."

5. While New York City, Seattle, and other cities and counties also are exploring solutions to the coverage and savings gap, this article refers to simply to "states" for convenience.

6. Typically, state law would mandate coverage by for-profit and not-for-profit employers that do not offer any retirement plan with, perhaps, an exception for employers with under a specified number of employees and/or time in business (e.g., two or three years). The employer mandate would apply to workers in the state.

7. Several states, such as New York and New Mexico, have enacted or are considering auto-IRA legislation that does not require employer participation. To date, no such voluntary programs are in operation. There is little, if any, statistical evidence about whether employers would voluntarily join an auto-IRA rather than a 401(k) plan or simply continue to offer no retirement plan to their workers. This article does not address state auto-IRA programs without employer mandates.

8. This article follows the common usage that the term "ERISA" only refers to the fiduciary, participant safeguards, reporting and disclosure, and enforcement rules found in Title I of ERISA. Technically, the Internal Revenue Code ("Tax Code") rules that govern the favorable income tax treatment afforded to qualified retirement plans also are found in ERISA, in Title II. With a few exceptions, the Department of Labor ("DOL") regulates Title I and the Internal Revenue Service ("IRS") regulates Title II.

9. Of course, there are numerous other considerations that policymaker may wish to consider beyond the employer mandate. For example, IRAs are simple, easily portable, and essentially cost-free to employers while 401(k)s are more-robust savings vehicles but can add to employer costs. *See Antonelli (2020), What Are the Potential Benefits of Universal Access to Retirement Savings?,* p. 32.

10. ERISA does not apply to federal, state, or local governmental plans; that is, retirement plans for a government entity's own employees; however, a plan created and/or operated by a government entity for private sector employees would not be considered a governmental plan. A state could not escape ERISA regulation simply by bringing private sector workers into its own government retirement plan.

11. A union or other labor organization also may sponsor an ERISA plan. Section 3(2)(A) of ERISA.

12. ERISA Section 514(a); *Egelhoff v. Egelhoff*, 532 U.S. 141, 148 (2001) (quoting *Fort Halifax Packing Co. v. Coyne*, 482 U.S. 1, 9 (1987)).

13. *Gobeille v. Liberty Mutual Ins. Co.* 136 S. Ct. 936 (2016).

14. DOL Reg. § 2510.3-2(d).

15. J. Mark Iwry (Autumn 2020). Observations on Coverage, CalSavers, and ERISA Preemption, 33 Benefits L.J., No. 3).

16. DOL Reg. § 2510.3-2(h).

17. H.J. Res 66, 115th Cong. (2017).

18. *Howard Jarvis Taxpayers Assoc. v. Cal. Secure Choice Retirement Savings Program*, E.D. Cal., No. 2:18-cv-01584-MCE-KJN.

19. After years of non-involvement, the Trump administration filed a statement of interest in the *Jarvis* district court proceeding and the DOL filed an amicus brief in the

Jarvis Ninth Circuit appeal, both arguing in favor of preemption. The DOL's participation in the case was withdrawn in a February 5, 2021, filing with the Ninth Circuit, stating that the DOL "does not support either side."

20. *Howard Jarvis Taxpayers Association v. California Secure Choice Retirement Savings Program*, 2021 Employee Benefits Cas. (BNA) 168089, 2021(9th Cir. 2021) page 4.

21. Tax Code Section 219(c)(1) allows certain non-working spouses to contribute to an IRA.

22. Due to an unfortunate interaction between the Tax Code and federal securities law, an IRA cannot invest in certain stable value funds, but it appears that they may invest in group annuity contracts offering similar book value guarantees. Stable value-type investments typically have higher interest rates than money market funds, an important consideration because money market rates, after deducting program fees, can be negative. Similarly, an IRA cannot invest in a separate account or commingled fund – a lower fee alternative to mutual funds that many larger 401(k)s use to reduce participant costs.

23. Tax Code Sec. 408(m).

24. For example, a young worker with a modest income who simply follows default IRA savings choices for 40 years could generate as much as $14,320 and, if Congress would enact a refundable Saver's Tax credit, as much as $21,300, per year in additional income at retirement. For more about the potential benefits of the Saver's Credit, see Antonelli (2020), What are the Potential Benefits of Universal Access to Retirement Savings? Georgetown University Center for Retirement Initiatives in conjunction with Econsult Solutions, Inc.

25. Tax Code Sec. 408(a).

26. Tax Code Sec. 408A.

27. GAO (2013). "Retirement Security: Challenges and Prospects for Employees of Small Businesses (GAO 13-748T)," *http://www.gao.gov/assets/660/655889.pdf for Research on Labor and Employment*, p. 4.

28. Pub. Law 116-94.

29. DOL Advisory Opinion 2012-04A, May 25, 2012. In 2019, the DOL regulations also allowed a bona fide professional employer organization (PEO) and certain other employee leasing organizations to establish a MEP for the leased employees. DOL reg. Sec. 2510.3-55

30. ERISA Sec. 402.

31. ERISA Sec. 412(a).

32. ERISA Sec. 3(21)(A).

33. ERISA Sec. 404. The ERISA fiduciary duties have been famously described as the "highest known to law." *Donovan v. Bierwirth*, 680 F.2d 263, 272 fn.8 (2d Cir. 1982).

34. ERISA Sec. 404(c); DOL Reg. Sec. 2550.404c-1.

35. ERISA Sec. 404(c)(5); DOL Reg. Sec. 2550.404c-5.

36. Lately, ESG-type funds that consider a company's environmental, social, and governance policies and practices in making stock selections are being added to plan investment lineups. The Obama DOL viewed ESG screens as prudent if the fund

manager did not sacrifice the ERISA goals of return and diversification. The Trump DOL went in the other direction, requiring that the plan investment fiduciary take extra steps and focus solely on investment potential before offering participants an ESG option. The Biden DOL is expected to return to a more-accommodative or at least neutral position; states should still consult their attorneys and financial consultants before adding an ESG fund.

37. ERISA Sec. 105.

38. Morse (Autumn 2020). "Annuity Illustrated," 33 *Benefits Law Journal*, No. 3.

39. There have been dozens of class action suits against sponsors and vendors, seeking return of too-high fees.

40. Tax Code Sec. 410(b).

41. Tax Code Sec. 402(g).

42. Tax Code Sec. 411(a).

43. Tax Code Secs. 401(a)(11) and 414(p).

44. Tax Code Sec. 4975.

45. Tax Code Secs. 401(k)(2) and 72(t).

46. Tax Code Sec. 401(a)(9).

47. IRS Rev. Proc. 2019-19.

48. IRC Secs. 413(c)(6) & 410(b).

49. Treas. Reg. 1.413-2(a)(3)(iv). Both Democrats and Republicans want to encourage 401(k) coverage, and recent legislation and Congressional pressure have softened the bad apple rule. Many experts have encouraged Congress to remove the rule entirely.

50. The danger may be mostly illusory: We are not aware of any instance where the IRS penalized all employers or the plan itself due to one employer's violation.

51. The argument that the state is not a fiduciary might be strongest with single employer plans and PEPs. For single employer plans, states could claim that they merely curate the program, while each adopting employer has control over adoption and the ability to switch service providers. With PEPs, the state could assert that the pooled provider is completely in charge.

52. Ellis, Munnell, and Eschtruth (2014). Falling Short: The Coming Retirement Crisis and What to Do About It, Oxford University Press.

53. David C. John and William R. Shiflett (April 2017). Higher Initial Contribution Levels in Automatic Enrollment Plans May Result in Greater Retirement Savings: A Review of the Evidence, AARP Public Policy Institute.

54. Tax Code Sec. 401(k)(12) & (13).

55. Leakage is a term that refers to plan fund withdrawals made by participants from IRAs or 401(k)/defined contribution plans. Data from HelloWallet, for example, suggest that 75 percent of 401(k) plan participants breached their savings because of basic money management problems, and 26 percent of 401(k) participants used their 401(k) savings for non-retirement needs. *http://www.hellowallet.com/wp-content/files_mf/hellowallet_retirementbreach2.pdf*.

56. DOL Reg. § 2510.3-2(d).

57. AO 2001-03A (Feb. 15, 2001).

58. AO 82-27A (June 16, 1982).

59. DOL Reg. § 2510.3-2(h).

60. H.J. Res. 66, 115th Cong. (2017).

61. *Fort Halifax Packing Co.*, 482 U.S. at 12.

62. *Deibler v. United Food & Commercial Workers' Local Union 23*, 973 F.2d 206, 209 (3d Cir. 1992).

63. *SeeDeibler*, 973 F.2d at 209 (citing *Wickman v. Nw. Nat'l Ins. Co.*, 908 F.2d 1077, 1083 (1st Cir. 1990)).

64. *Henglein v. Informal Plan for Plant Shutdown Benefits for Salaried Employees*, 974 F.2d 391, 400 (3d Cir. 1992).

65. *Fort Halifax Packing Co. v. Coyne*, 482 U.S. 1, 16 (1987).

66. *Peckham v. GEM State Mut. of Utah*, 964 F.2d 1043, 1049 (10th Cir. 1992) (holding that an employer's subscription to a multi-employer group insurance trust that provides employers with insurance for their employees, the purchase of insurance for its employees, and the listing of insurance in the company manual as an employee benefit created an employment relationship that satisfied the "established or maintained" requirement).

67. *Ed Miniat, Inc. v. Globe Life Ins. Group, Inc.*, 805 F.2d 732, 739 (7th Cir. 1986).

68. *See, e.g.*, *Harris v. Arkansas Book Co.*, 794 F.2d 358, 360 (8th Cir. 1986) (holding that an employer's alleged promise to provide retirement benefits did not constitute the establishment of an employee pension plan, despite making payments to another employee after that employee's retirement).

69. *Ed Miniat, Inc. v. Globe Life Ins. Group, Inc.*, 805 F.2d 732, 739 (7th Cir. 1986).

70. *See, e.g.*, *Harris v. Arkansas Book Co.*, 794 F.2d 358, 360 (8th Cir. 1986) (holding that an employer's alleged promise to provide retirement benefits did not constitute the establishment of an employee pension plan, despite making payments to another employee after that employee's retirement).

71. *Fort Halifax Packing Co.*, 482 U.S. at 12.

72. *Deibler v. United Food & Commercial Workers' Local Union 23*, 973 F.2d 206, 209 (3d Cir. 1992).

73. *See Deibler*, 973 F.2d at 209 (citing *Wickman v. Nw. Nat'l Ins. Co.*, 908 F.2d 1077, 1083 (1st Cir. 1990)).

74. *Henglein v. Informal Plan for Plant Shutdown Benefits for Salaried Employees*, 974 F.2d 391, 400 (3d Cir. 1992).

75. *Gobeille v. Liberty Mutual Ins. Co.* 136 S. Ct. 936 (2016).

76. 546 F.3d 639, 642-43 (9th Cir. 2008).

77. *Howard Jarvis Taxpayers Assoc. v. Cal. Secure Choice Retirement Savings Program*, E.D. Cal., No. 2:18-cv-01584-MCE-KJN.

78. *Howard Jarvis Taxpayers Association v. California Secure Choice Retirement Savings Program*, 2021 Employee Benefits Cas. (BNA) 168089, 2021 (9th Cir. 2021) page 4.

The Ultimate Custom-Designed Solution for Managing Pension Risk

Zorast Wadia and Richard J. Bottelli, Jr.

Managing risk is currently top of mind for corporate pension plan sponsors and their advisors. That is especially true right now, as passage of the American Rescue Plan Act of 2021 has given sponsors more breathing room to reassess their risk management strategies and decide on the best way forward. Plan sponsors and advisors looking to manage risk might be tempted to offload their liabilities to third-party insurers. They might be considering freezing their defined benefit pension plans and relying on defined contribution plans, or de-risking via a glide path or liability-driven investment strategy. By jumping straight to these types of solutions, however, plan sponsors are ignoring what should be the crucial first step in managing risk: choosing the right plan design.

No one plan works exactly the same for every employer, but by embracing the flexibility and customization options that come with hybrid plans – such as cash balance plans and variable annuity pension plans – employers can create retirement incentives that meet their specific financial and human resources goals while balancing risk, weathering market volatility, and providing secure lifetime income protection for plan participants.

Managing risk is currently top of mind for corporate pension plan sponsors. That is especially true right now, as passage of the American Rescue Plan Act of 2021 ("ARPA") has given sponsors more breathing room to reassess their risk management strategies and decide on the best way forward.

With the growing popularity of pension risk transfer making headlines in recent months, plan sponsors looking to manage risk might be tempted to offload their liabilities to third-party insurers.[1] They might be considering freezing their defined benefit ("DB") pension plans and relying on defined contribution ("DC") plans, or derisking via a glide path or liability-driven investment strategy. By jumping straight

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to these types of solutions, however, plan sponsors are ignoring what should be the crucial first step in managing risk: choosing the right plan design.

Plan participants also face increased uncertainty, particularly those benefiting only under DC plans. In addition to having to choose among an array of investment options, they face the very real risk of outliving their money into retirement.

Corporate pension plan sponsors have more options than they might think when it comes to retirement plans. No one plan works exactly the same for every employer, but by embracing the flexibility and customization options that come with hybrid plans – such as cash balance plans and VAPPs – employers can create retirement incentives that meet their specific financial and human resources goals while balancing risk, weathering market volatility, and providing secure lifetime income protection for plan participants.

WHAT ARE HYBRID PLANS?

Hybrid plans share certain aspects of both DB and DC plans. Because of their unique mix of features and their flexible design, hybrid plans tend to balance risk more equitably between plan sponsors and participants than either traditional DB plans or DC plans. Plan sponsors working with their advisors can fit their unique needs with those of plan participants, forming the ultimate customized plan design under which risk is shared by both. In this article, we focus on two major types of hybrid plans and compare their distinctive features and advantages with those offered by more traditional DB plans. We also point out some key differences between what we typically think of as cash balance plans and VAPPs.

Cash Balance Plans

One of the best-known types of hybrid plans, cash balance plans, are becoming an increasingly popular choice for employers offering pension plans. According to industry research, new cash balance plans increased 17 percent in 2020 – compared with just two percent growth for 401(k) plans – and now make up 42.1 percent of all defined benefit plans.[2]

In a cash balance plan, employers pay a contribution each year into a participant's (hypothetical) account, and the participants also receive investment returns based on a predetermined benchmark rate that is usually linked to bond indices, such as the 30-year treasury, and can also be linked to actual investment returns, like VAPPs. A cash

balance plan is a DB plan in that the plan sponsor bears the responsibility of investing the assets and paying the participants a defined amount. But it differs from a traditional DB plan in that the payout is structured more like that of a DC plan, with the benefit expressed as a total account balance rather than an annuity paid out at the end of an employee's career.[3]

While small and midsize businesses in particular have embraced cash balance plans, larger companies have also shown increased interest in this type of hybrid plan over a more traditional DB plan. Among the 14 percent of Fortune 500 employers that offered a DB plan to salaried new hires in 2019, 71 percent offered a cash balance plan while only 18 percent offered a traditional final average pay plan; the remaining sponsors offered alternative DB plan designs.[4]

Variable Annuity Pension Plans

Reflecting the need for additional alternatives to traditional DB plans, another hybrid variant has been generating interest in recent years. VAPPs adjust participants' benefits each year based on the investment returns on the plan's assets. In this way, VAPPs can remain well funded regardless of market conditions (neither investment returns nor bond yield curves cause underfunding), and combine the guaranteed lifelong income protection characteristic of DB plans with the stable costs for employers offered by DC plans such as 401(k)s.

A distinctive feature of a VAPP is the "hurdle rate," an internal rate (generally between three percent and five percent) included within the plan's provisions. Participant benefits fluctuate each year according to the difference between investment returns and the hurdle rate. If returns exceed the hurdle rate, benefits increase; if they do not, benefits go down. Unlike most traditional DB plans or even a cash balance plan, a VAPP is expected to provide some protection against inflation. Returns in excess of the hurdle rate will grow the benefit over time, providing participants with benefit increases even during retirement.[5]

Since 2014, when the Internal Revenue Service ("IRS") issued regulations providing guidance for hybrid pension plans,[6] employers have had more options when it comes to modifying VAPPs as their chosen plan design. Many VAPPs are sustainable income plans ("SIPs"), which include a stabilization reserve, where a portion of investment returns in good years are held back to prevent benefits from decreasing in years when the hurdle rate is not met. In order to fund a stabilization reserve, SIPs typically establish a cap on returns. Investment returns that exceed the cap are automatically placed in reserve to provide downside protection in leaner years.

HOW HYBRID PLANS CAN WORK FOR BOTH PLAN SPONSORS AND PARTICIPANTS

Even as passage of ARPA has given plan sponsors some breathing room in the form of increased pension relief, concerns about rising inflation may provide additional motivation for many employers to reassess their pension risk management strategy. Hybrid plan designs offer a solution for plan sponsors who may be concerned about the sustainability of their current pension plans, but still believe DB plans are the best option for providing real retirement security for their employees.

In contrast with traditional DB plans, hybrid plan designs are extraordinarily flexible tools that can be designed to fit an individual employer's needs. While many cash balance plans offer benefits in the form of lump sums rather than annuities, and VAPPs usually provide for annuities rather than lump sums, both options are allowable within each plan – along with many other customization options.

Similarly, hybrid plans offer guaranteed lifetime income to plan participants concerned with eventually spending down account balances during retirement.

In the end, an effectively designed hybrid plan meets the particular needs of the plan sponsor and participants. It balances risk equitably between employer and employees, reduces the risk of underfunding, can protect participants' benefits against the effects of inflation, and goes a long way toward protecting both sides from market volatility.

More Equitable Distribution of Risk

In traditional DB plans, the plan sponsor bears the weight of the major risks associated with retirement plans. These include (1) investment risk, the risk that the value of plan assets will decline due to market losses; (2) interest rate risk, whereby lower interest rates bring pension liabilities up and create volatile funding requirements; and (3) longevity risk, the risk of not knowing how long plan participants will live. DC plans, on the other hand, shift the full weight of investment and longevity risks to plan participants. In DC plans, participants are responsible for investing their account balances and managing withdrawals during their retirement.

A hybrid plan balances retirement risk more equitably between plan sponsors and participants. In a cash balance plan, the plan sponsor is responsible for investing the plan's assets and paying participants a defined benefit (similar to a traditional DB plan). Assuming the sponsor employs basic asset-liability management strategies to mitigate investment risk, this type of plan can result in fully secured

benefits with limited market risk for either participants or the plan sponsor.[7] In a SIP, retirement risk is balanced even more carefully: Interest rate risk is essentially eliminated, which ensures that plan liabilities stay predictable over time. The inclusion of a stabilization reserve provides additional downside protection for both plan sponsors and participants.

Of course, it is impossible to eliminate risk entirely, and there is always the possibility that plan participants can collectively outlive the actuarial tables. Though hybrid plans require employers to bear the weight of such longevity risk, pooling large groups of participants together allows mortality experience to become more predictable. Plan sponsors will find this a very manageable risk compared with the substantial volatility involved with investment returns and interest rates.

Lower Cost and Reduced Underfunding Risk for Plan Sponsors

The cost of hybrid plans for plan sponsors can be less than for traditional DB plans.

While in final average pay DB plans, the amount of compensation in a pension plan is determined by a formula including a final average salary – usually the last few years of an employee's career, or the highest-paid years – the cash balance plan and VAPP designs are based on a career average pay accrual pattern. This benefit accrual pattern generally remains steady throughout the employee's career, helping employers avoid the higher cost leveraging effects of traditional DB plans, a particular current concern due to uncertain inflation expectations.

In the case of a VAPP, which insulates plan sponsors from investment risk and interest rate risk, the plan remains fully funded in all market environments, with assets and liabilities remaining at the same level. This equilibrium ensures that sponsors avoid Pension Benefit Guaranty Corporation ("PBGC") premiums associated with underfunding. As a result, sponsors get to make predictable contributions and enjoy increased stability of accounting results without worrying about market volatility.[8]

Lifelong Income Protection for Participants

Employers want to sponsor a retirement benefit that meets their human resources objectives while keeping their costs and liabilities manageable. Pension plan participants want a benefit that's not only

meaningful but is going to be there into retirement. A hybrid plan can meet both of these standards.

With the prevalence of 401(k) and other DC plans in today's retirement market, a majority of Americans face the risk of not having any guaranteed income in retirement. Cash balance plans, although they resemble DC plans in some aspects, provide greater security for plan participants. Because cash balance plans are still DB plans, participants can elect to receive their benefits as a stream of annuity payments rather than a lump sum payout upon retirement.[9]

Participants in a stabilized VAPP get the same secure lifelong income protection that a DB plan offers, but they receive an added benefit of some expected protection from inflation even in retirement. As plan assets are typically invested with a target return that is higher than the hurdle rate, excess returns can be expected to drive growth in the benefit over the years that continues during retirement, helping retirees meet rising medical costs and cost-of-living expenses affected by inflation.[10]

HYBRID PLANS CAN WORK FOR EVERYONE

The idea that cash balance plans, variable annuity pension plans, and other hybrid options work best only for small businesses is swiftly becoming outdated. Because of their flexible structure and array of options, hybrid plans can work just as well for businesses with 10-15 plan participants as for those with thousands, particularly plans reflecting collectively bargained benefits.

When it comes to pension risk management, plan sponsors would do well to start with the plan design phase first, rather than jumping right to freezing plans, transferring risk, or relying solely on DC plans. This is especially true in the current climate, with the additional pension relief measures put in place by ARPA.

With solid guidance and expertise, plan sponsors need to look beyond traditional DB plans and find the exact platform that works for them, based on their risk tolerance and their specific needs as well as risk sharing with plan participants. The ultimate flexible, well-designed hybrid plan will better balance risk between employers and participants, guard against market volatility, and provide genuine lifetime income protection for participants when they need it most.

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Welfare Plans: To-Do's and Checklists

Karen R. McLeese

One year comes to a close and another starts anew; it is time for retrospection and a look forward. As 2022 begins, the current administration is focused on shoring up regulations to clarify and implement much of the legislation enacted in the last year. Some of the legislation was a long time coming, such as the transparency provisions in the No Surprises Act. Other statutes were enacted to provide relief to a workforce still struggling to deal with the COVID-19 pandemic, such as the American Rescue Plan Act ("ARP"). This column will serve as a checklist for compliance of the new requirements and options in health and welfare plans.

AMERICAN RESCUE PLAN ACT

We begin with a statute enacted in 2021. The American Rescue Plan Act was signed into law by President Biden on March 11, 2021.[1] Among the many ARP provisions is a temporary but significant adjustment to the amount of employee contribution funds made to employer-provided dependent care assistance program ("DCAP")[2] benefits which the employee can exclude from their taxable income.

Normally, the amount of employee contributions that can be excluded for DCAP benefits is limited to $5,000 ($2,500 if married filing separately), subject to earned income limitations. For 2021 only, the ARP increases the amount employees can exclude from their 2021 gross taxable income for employer-provided DCAPs to $10,500 and $5,250 respectively. The excludable amounts revert to $5,000 and $2,500 for the 2022 taxable year, barring any change in the law.

Checklist Item: Employers must ensure plan documents are amended to reflect this change, and notify employees accordingly.

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TAXPAYER CERTAINTY AND DISASTER RELIEF ACT

On December 27, 2020, the Consolidated Appropriations Act ("CAA") of 2021 became law.[3] The CAA included the Taxpayer Certainty and Disaster Tax Relief Act ("the Act"). The Act, in §214, included several provisions relating to flexible spending accounts ("FSA") and DCAPs.

Generally, a health flexible spending arrangement ("health FSA") plan may, but is not required to, include a provision that allows unused dollars to be carried over to the subsequent plan year. This carryover feature must be available to all FSA plan participants. The maximum amount that a plan can allow to be carried over is tied to a cost of living adjustment, indexed annually. The carryover limit equals 20 percent of the salary reduction limit. For 2021, the salary reduction limit was $2,750; the carryover limit was $550.[4]

The Taxpayer Certainty and Disaster Relief Act allows plans to offer the following:

Section 214 Carryover

Section 214(a) and 214(b) of the Taxpayer Certainty and Disaster Relief Act are collectively known as the "§214 carryover." Section 214(a) allows health FSAs and DCAPs to carry over unused benefits or contributions from plan year 2020 into plan year 2021, even if this would exceed the 2020 carryover limit of $550. Section 214(b) allows health FSAs and DCAPs to carry over unused benefits or contributions from plan year 2021 into plan year 2022.

An employer has discretion whether to exercise this option, whether to provide this option to all or some FSA/DCAP participants (subject to nondiscrimination rules), the carryover amount allowed and the date by which it must be used, and whether employees can opt out in order to preserve their eligibility to contribute to an HSA.

For DCAPs, the temporary carryover is treated like a DCAP grace period amount for reporting purposes. The employer reports the elected amount in Form W-2 Box 10. The employee reports the amount used in the tax year on Form 2441. If the amount used in a tax year exceeds $5,000, it is subject to taxation. Remember that generally, DCAPs do not allow carry-overs.

Extended Grace Period for Incurring Claims

Section 214(c)(1) of the Taxpayer Certainty and Disaster Relief Act allows health FSAs and DCAPs to extend the grace period during which a participant can apply unused funds from a previous plan year

to expenses incurred (i.e. claims incurred) during the grace period in the new plan year. The grace period can be extended up to 12 months, up from the current regulatory limit of two months 15 days. This applies to plan years ending in 2020 and 2021.

Note, FSAs, as well as DCAPs, can have either a carry-over feature or a grace period feature, but cannot have both.

Post-Termination Reimbursements ("Spend-Down") for Health FSAs

Section 214(c)(2) of Taxpayer Certainty and Disaster Relief Act allows health FSAs to adopt a "spend-down" feature similar to that available for DCAPs. Employers can permit employees who cease plan participation during calendar years 2020 and 2021 to continue receiving reimbursements from their unused benefits/contributions through the end of the plan year in which the employee ceased participation, and taking into account any available grace period. The employer has discretion to determine the length of "spend-down" period and to limit the employee's "spend-down" amount to only the amount of salary contributions up to the date employee ceased participation. The employer can also decide whether to let employees opt out in order to preserve their eligibility to contribute to an HSA.

Employees who ceased plan participation due to a COBRA qualifying event will still be considered to have a loss of coverage requiring COBRA notification; however, they can receive health FSA reimbursements for expenses incurred post-cessation, i.e. use the "spend-down," through the end of the plan year, taking into account any available grace period, regardless of whether they elect COBRA continuation coverage.

"Carry Forward" Rule for Dependents Who "Aged Out" During the Pandemic

If an employee is (A) enrolled in a DCAP for a plan year whose enrollment period ended on or before 1/31/2020, and the employee (B) has one or more dependents who (i) became 13 years old during the plan year or the employee (ii) has unused funds available for the next plan year, Section 214(d) allows the age limit to temporarily be raised to age 14 so that the employee can apply their unused balance for DCAP expenses. The dependent needs to have reached age 13 in the plan year whose enrollment period ended on or before January 31, 2020. This provision is available regardless of whether an employer has applied the §214 carryover or the extended grace period

under §214(c) (as discussed above). Employers have discretion as to whether to exercise this option, and the unused amount that can be applied.

Change in Election Amount (Relaxation of Status Change Rules)

Section 214(e) allows health FSAs and DCAPs to permit prospective mid-year election changes for plan years ending in 2021. A previous IRS Notice provided relaxation of status change rules for plan years ending in 2020, and the current Notice extends this benefit for 2021 plans.[5]

Employers can allow employees to (1) make an election for new coverage – including health, vision, or dental coverage, (2) revoke an election, (3) increase an election, or (4) decrease an election. Employers have discretion whether to exercise this any or all of these election changes, the number and extent of election changes permitted, and the time period during which an employee can make election changes.

Employers who allow employees to revoke health, dental, or vision coverage must obtain a written attestation from the employee that the employee has already enrolled (or will immediately enroll) in coverage not sponsored by the employer. Employer can rely on the employee's written attestation unless the employer has actual knowledge otherwise. No written attestation is required for revocation of FSA or DCAP coverage.

For further clarification on implementation of the Section 214 relief, employers should review the relevant IRS Notice.[6]

Checklist item: Employers opting to implement any of this optional temporary relief must ensure plan documents are amended to define the parameters of the changes the employer is permitting. The deadline to amend plan documents is the last day of the calendar year following the plan year to which the change relates. For changes made to plan years ending in 2020, plan amendments had to be made by December 31, 2021.

MENTAL HEALTH PARITY

The Mental Health Parity and Addiction Equity Act of 2008 ("MHPAEA") prohibits group health plans and health insurance issuers from imposing more restrictive limitations mental health/substance use disorder ("MH/SUD") benefits than the limitations applied to medical or surgical benefits. This includes financial limitations such as

cost-sharing amounts, quantitative limitations such as visit limits, and non-quantitative treatment limitations ("NQTLs") such as fail-first policies or step therapy protocols.

The Consolidated Appropriations Act ("CAA") of 2021, imposes an express obligation on individual and group health plans, both insured and self-funded, to perform and document comparative analyses of their design and application of NQTLs on MH/SUD benefits. Beginning February 10, 2021, the CAA also require plans, to make these comparative analyses available to the Department of Labor, Health and Human Services, and Treasury, i.e. the "tri-governing agencies," to applicable state authorities, and to plan participants upon request. For plans subject to ERISA a plan sponsor must respond to an information request by a plan participant within 30 days, as per ERISA disclosure standards.

The comparative analyses must be "sufficiently specific, detailed, and reasoned," with thorough documentation including information regarding the factors, evidentiary standards, processes, and strategies used to determine applicable NQTLs. The DOL offers a Self-Compliance Tool that outlines a process for plans and issuers to conduct their comparative analyses.[7]

Checklist item: Sponsors of insured plans should confirm with their insurers that the comparative analysis has been performed and is available upon request. Sponsors of self-funded plans should work with their third-party administrator to ensure compliance.

NO SURPRISES IN THE LATEST "NO SURPRISES ACT" REGULATIONS

As discussed in a previous column,[8] the No Surprises Act ("the Act") was also enacted as part of the Consolidated Appropriations Act of 2021. The No Surprises Act imposes a variety of conditions on the provision of items and services in the following three scenarios: (1) emergency items or services provided at an out-of-network facility; (2) non-emergency items or services provided by an out-of-network provider at an in-network facility; and (3) air ambulance services. The No Surprises Act is applicable to plan/policy years beginning on or after January 1, 2022.

First, plans and issuers must cover emergency items and services without prior authorization and without regard to plan terms or conditions – other than benefit exclusions, benefit coordination, or permitted waiting periods. This applies regardless of whether or not the items and services are being furnished by an in-network provider or facility.

Second, plans and issuers must limit also limit the individual's (enrollee's) cost-sharing for the aforementioned items and services to the cost-sharing amounts that an individual would pay to in-network providers and facilities. Moreover, the cost-sharing amounts must count towards in-network deductibles and out-of-pocket maximums. The first set of regulations clarifying the Act focus on how the enrollee's cost-sharing amounts for the above-listed items or services may be calculated.[9]

Next, the core of the No Surprises Act is the prohibition on balance billing for the above-listed scenarios. The Act carves a small exception on balance billing prohibitions for emergency items or services provided by an out-of-network provider at an in-network facility, if the provider makes certain disclosures to the individual/enrollee, and the individual gives their informed consent to receive the item or service, thereby waiving the balance billing protections. The July regulations included specific notice and consent requirements to satisfy this exception to balance billing.

The exception on balance billing is not available for services furnished by out-of-network providers in an in-network facility in certain circumstances where surprise bills are likely to occur, and where the individual receiving the items and services may either be unaware that the provider is out-of-network, or not have the option of using an in-network provider. This is commonly the case with ancillary services, such as, for example, radiology or anesthesiology.

Because the No Surprises Act prohibits the issuance of a balance bill to the enrollee, it is left up to the plan/issuer and the out-of-network facility or provider to come to an agreement on payment of the balance bill.

Independent Dispute Resolution Process

On October 7, 2021, the Department of Labor Employee Benefits Security Administration ("EBSA"), Department of Health & Human Services ("HHS"), Internal Revenue Service ("IRS"), and Office of Personnel Management ("OPM") issued a second set of interim regulation implementing the No Surprises Act.[10] The regulations are effective as of the date of their publication, October 7, 2021, and focus on the resolution of balance billing through the Independent Dispute Resolution process.[11]

As you may recall, the parties in dispute, i.e., the plan or issuer on one side, and the provider or facility on the other, can negotiate among themselves to reach an agreement on the amount payable for the items and services provided. The dispute resolution process actually begins with an open negotiation period of 30 days between the parties. For parties that cannot come to an agreement in that time, there is the independent dispute resolution ("IDR") process.

The regulations clarify that although the parties can enter the Independent Dispute Resolution process, the parties are free to continue negotiating among themselves. If an agreement is reached between the parties before the IDR entity's determination, the parties' own agreement controls.

The parties have, altogether, three business days to select a certified IDR entity for the process. No later than 10 business days after the IDR entity is selected, each party must submit their proposed amount payable offer through the federal IDR portal. No later than 30 business days after the IDR entity is selected, the IDR entity will choose among the proposed offers. The regulations clarify that it is not the role of the IDR entity to determine whether each party's offer has been calculated correctly, but rather, to consider whether each party has presented credible information informing the circumstances on which each party's offer was calculated. The IDR entity is also prohibited from considering certain factors, such as the usual and customary charges for an item or service, or the reimbursement rates under Medicare or other similar programs. The IDR entity will issue its decision to the parties in writing, and the plan or issuer has 30 calendar days from the date of the determination to render payment to the provider or facility. In addition to the IDR process outlined above, the regulations establish the IDR entity's recordkeeping and reporting requirements.

OTHER TRANSPARENCY REQUIREMENTS

The No Surprises Act also includes additional transparency requirements, most of which were initially intended to be applicable to plans beginning on or after January 1, 2022. The compliance deadlines for the following transparency requirements have been delayed, as listed.

Effective December 27, 2020

Plans must already be in compliance with the Act's prohibition on gag clauses.

Effective January 1, 2021 (Good Faith Compliance Standard)

Plans must make a good faith effort to comply with the following, effective January 1, 2022. The date for regulation issuance on these topics is uncertain.

1. *ID cards.* Plan identification cards must list the plan deductible, out-of-pocket maximum, and a telephone number and website for consumer assistance.

2. *Provider directory*. Plans must verify and update their provider directory every 90 days.

3. *Continuity of care*. If plan and provider terminate their contractual relationship while an enrollee is a continuing care patient, the plan must timely notify the enrollee that the provider/facility is no longer in-network. The enrollee has a right to continued transitional care, if enrollee notifies the plan of such need, and can continue medical care under the same terms and conditions for 90 days or until such time as the individual is no longer a "continuing care patient."

Effective July 1, 2022

Providers must make public a yearly list of their standard charges for items and services. The list must be available as a comprehensive, machine-readable file.

Effective December 27, 2022

Plans must make available a report of each plan's 50 most costly drugs, the 50 drugs with the greatest increase in plan expenditures over the prior year, total spending on health care services, average monthly premiums, and any impact on premiums from rebates, fees, or other remuneration paid by drug manufacturers.

Effective January 1, 2023

Plans must provide price comparison guidance over the phone and have a price comparison tool available on plan website. Enrollees must be able to see cost-sharing information by plan year, geographic region, item/service, and provider.[12]

Implementation Delayed Indefinitely

Probably a great relief to plans and issuers, the current administration has indefinitely delayed implementation of the Advanced

Explanation of Benefits ("Advanced EOB") requirement. Under the Act, plans/issuers of non-grandfathered plans would be required to provide an enrollee with an advance EOB containing the following information:

- Whether or not provider/facility is in-network;
- Contracted rate;
- If provider/facility is out-of-network, how to find in-network provider/facility;
- Good faith estimate provided by provider/facility;
- Good faith estimate of plan coverage;
- Good faith estimate of enrollee's current standing regarding deductibles and out-of-pocket maximums; and
- Disclaimer if item/service is subject to limitations such as preauthorization, concurrent review, fail-first protocols, or step-therapy.

Because of the complexity of implementing this requirement, this Act provision is currently on hold.

CONCLUSION

To the extent that any of these changes impact the terms and conditions of the plan, it is necessary to review and amend the plan document and the summary plan description ("SPD") as appropriate. Employers and plan sponsors, especially those subject to ERISA, will want to work closely with the applicable insurer, third party administrator ("TPA") or other service provider to ensure compliance. Plan sponsors have a fiduciary responsibility to administer their plans in accordance with the law; this responsibility includes monitoring service providers.

Plan sponsors should also remain aware that we remain under the ERISA §518 "outbreak period" window during which certain plan deadlines can be disregarded for a period of up to one year.[13] Deadlines can be disregarded only for a period of one year from what would have been the original event compliance deadline. Effectively, each individual has their own outbreak period, which is the first to occur of one year from the individual's applicable event or 60 days following the end of the national emergency.

Some of the deadlines that can be disregarded include:

- Election period for COBRA continuation coverage;
- HIPAA special enrollment period; and
- Date for individuals to file a benefit claim, appeal an adverse decision, or seek external review.

If the SPD does not accurately describe the outbreak period, the SPD should be modified. In addition, to the extent the plan covers coronavirus testing (required for the duration of the public emergency currently scheduled to run through January 16, 2022), the SPD should reflect these applicable terms and conditions. Remember that the COVID-19 vaccine (all approved versions) are covered as a preventive benefit pursuant to the Affordable Care Act ("ACA"). This too should be reflected in the SPD. In sum, plan fiduciaries should take steps to minimize the possibility of individuals losing benefits, by sending affirmative notices, and continuing to act "reasonably, prudently, and in the interest of workers and their families."

NOTES

1. Pub. L. No. 117-2.

2. IRC §129.

3. Pub. L. No. 116-260.

4. IRS Notice 2020-33, available at *https://www.irs.gov/pub/irs-drop/n-20-33.pdf*.

5. IRS Notice 2020-29, available at *https://www.irs.gov/pub/irs-drop/n-20-29.pdf*.

6. IRS Notice 2021-15, available at *https://www.irs.gov/pub/irs-drop/n-21-15.pdf*.

7. Available at *https://www.dol.gov/sites/dolgov/files/EBSA/laws-and-regulations/laws/mental-health-parity/self-compliance-tool.pdf*.

8. Karen R. McLeese, "No Surprises Act" Regulations on Balance Are Not Surprising, *Benefits Law Journal*, Vol. 34, No. 3 Autumn 2021.

9. 86 FR 36872, available at *https://www.federalregister.gov/documents/2021/07/13/2021-14379/requirements-related-to-surprise-billing-part-i*.

10. 86 Fed. Reg. 55980.

11. Available at *https://www.federalregister.gov/documents/2021/10/07/2021-21441/requirements-related-to-surprise-billing-part-ii*.

12. No Surprises Act §114.

13. *See https://www.federalregister.gov/documents/2020/05/04/2020-09399/extension-of-certain-timeframes-for-employee-benefit-plans-participants-and-beneficiaries-affected.*

Expansion of the Million Dollar Compensation Deduction Limitation on the Horizon for Publicly Held Corporations

Dominick Pizzano, Henrik Patel and Kenneth Barr

The stimulus package portions of the American Rescue Plan Act of 2021 (the "ARPA"), an approximately $1.9 trillion piece of COVID-19 relief, funding and tax legislation which President Joe Biden signed into law on March 11, 2021, may have received most of the public's attention. However, the ARPA also contains an amendment to Section 162(m) of the Internal Revenue Code that needs to be on the financial radar of publicly held corporations. Section 162(m) generally limits the ability of publicly held corporations to deduct compensation amounts in excess of $1 million in any year with respect to certain executives of the corporation (i.e., "covered employees").[1]

The Section 162(m) ARPA amendments are currently set to expand the reach of Section 162(m) to cover a larger number of highly paid individuals working for publicly held corporations effective with tax years beginning on and after January 1, 2027.[2] Such expansion is consistent with other recently enacted laws that also featured provisions broadening the scope of the deductible compensation limitation of Section 162(m).[3] In a previous column we discussed the impact of the Tax Cuts and Jobs Act of 2017 (the "TCJA") on Section 162(m) and provided a summary of the history, purpose and impact of its rules based on the guidance then in effect.[4] After the final regulations under Section 162(m) and certain other changes to the proposed regulations were issued, a subsequent column[5] examined the new guidance

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in order to identify the differences from and similarities to the prior guidance. Now that ARPA is amending Section 162(m) to capture more executives under the "covered employees" definition, publicly held corporations will need to further examine their pay practices and the tax deductions available. Accordingly, this column will review the new rules provided under the ARPA and provide such employers with proactive planning tips to prepare for the January 1, 2027, effective date.

RULES IN EFFECT PRIOR TO ARPA

The following is a brief summary[6] of Section 162(m) prior to the enactment of ARPA provided solely to set the background and establish context for the most recent ARPA amendment:

The Omnibus Budget Reconciliation Act of 1993 added Section 162(m) to the Internal Revenue Code, with final regulations adopted in 1995.[7] Section 162(m) generally prevents "publicly held corporations" from taking a corporate tax deduction for "applicable employee remuneration" paid to any "covered employee" in excess of $1 million.[8] For taxable years beginning on or before December 31, 2017, the term "covered employees" applied to the individual serving as the CEO as of the last day of the taxable year, in addition to the three most highly compensated officers whose compensation was required to be reported to shareholders pursuant to the U.S. Securities and Exchange Commission's ("SEC") disclosure rules.[9]

Beginning in 2018, the TCJA expanded the definition of "covered employees" to include the firm's principal executive officer ("PEO"), principal financial officer ("PFO") or any individual acting in such capacity during the taxable year, in addition to its three most highly compensated officers aside from the PEO and PFO.[10] Furthermore, the final rule introduced an "evergreen" feature mandating that "covered employees" included any individual who was a "covered employee" for any taxable year beginning after December 31, 2016.[11] As a result, any individual that was a "covered employee" for a tax year beginning on or after January 1, 2017, would remain a "covered employee" for all future taxable years regardless of changes in their employment status (e.g., "covered employees" who changed their role in the company so they would no longer be a "covered employee" or "covered employees" who terminated employment but are still receiving payments from a nonqualified deferred compensation plan or otherwise would continue to count as "covered employees"). Accordingly, under the TCJA, there could be more than five "covered employees" whose compensation would not be deductible if it exceeds the $1 million dollar threshold

RULES IN EFFECT POST-ARPA

While a plethora of other ARPA provisions may have received greater press coverage (for example, the inclusion of $1,400 stimulus checks to U.S. citizens); the amendments to Section 162(m) are certainly major news for publicly held corporations and their top executives and other highly compensated employees. Under the ARPA, Section 162(m) continues to apply the $1 million compensation deduction limitation to the "core five" executives which will still consist of a publicly held corporation's PEO, PFO and three highest-paid executive officers currently covered by Section 162(m). However, the ARPA also extends this limitation to include an additional five highest-paid employees whether or not they are officers of the corporation.[12] As a result, not only does the new law double the core number of individuals captured by the "covered employee" definition by increasing the potential affected group from five to at least ten (note: this number could increase if circumstances require certain legacy "covered employees" to also be included), but it also extends eligibility beyond the C-suite executives as the deduction limitation's reach is no longer restricted to only executive officers.[13]

CORPORATE CHALLENGES CREATED BY THE EXPANSION OF THE COVERED EMPLOYEE GROUP

Publicly held corporations may now be faced with increased administrative challenges when, effective with tax years beginning on and after January 1, 2027, they face the prospect of having to monitor not only an increased number of "covered employees," but also highly paid individuals who are not executive officers. It is important to note that these new five non-officer employees will not be subject to the TCJA evergreen rule (i.e., the once a "covered employee," always a "covered employee" rule that will continue to apply to the "core five." Thus, while the "core five" executives will always be "covered employees" as long as they continue to receive compensation from the corporation, this new group of the additional five other highly compensated employees are only "covered employees" for the relevant taxable year and such employees will not be "covered employees" in subsequent years unless they again qualify as one of the five additional employees for such tax year. Since this latter group is likely to change from year to year, additional tracking of employees will be required.[14]

Therefore, under these new rules, publicly held corporations will now have to track the following three groups for purposes of monitoring the deduction limitation:

(1) anyone who served as a PEO or PFO for the taxable year;

(2) the next three highest-compensated officers for the taxable year; and

(3) the next five highest-compensated employees regardless of whether or not they are officers.

Employers will need to determine the "covered employees" in group 1 and 2 for each taxable year as these employees will continue to remain as "covered employees" in all subsequent tax years. "Covered employees" in group 3 will need to be tracked from year to year as such "covered employees" will likely change from year to year.

Since monitoring this expanded group of "covered employees" and communicating these new rules to employees may prove difficult, corporations may wish to engage third party consultants to assist with these tasks. The challenge presented with having to track this new group 3 rests not only with the need to monitor them on an annual basis, but also with the expansion of the "covered employee" group to employees beyond the C-suite. Under the pre-ARPA rules, publicly held corporations already had to identify the five individuals in groups 1 and 2 because they were the "named executive officers" ("NEOs") the corporation was required to report under the Securities Exchange Commission disclosure rules.[15]

Since the new rule will also apply to employees generally (as opposed to officers as determined for purposes of the Securities Exchange Act of 1934 (the "Exchange Act")), this change will likely result in having to include individuals who do not hold policy-making positions within the corporation but now have to be included by virtue of receiving atypically high compensation in a single year (e.g., signing bonus upon hire, change in control payment, severance amount, large retention or incentive-based compensation awards, etc.). Consequently, certain corporate sectors where talent-based pay fluctuates greatly may be disproportionately impacted by being forced to deal with an ever-changing covered employee group annually. Particularly problematic is that under the current Section 162(m) rules, compensation taken into account in identifying "covered employees" is determined pursuant to the methodology applicable to compensation disclosure rules under the Exchange Act and therefore may include amounts that are at risk but will not necessarily be actually earned.[16]

Many publicly held corporations may already have tally sheets or other methodology in place for tracking compensation paid to their executive officers thereby enabling them to accurately and efficiently track such compensation for both Section 162(m) and Exchange Act

disclosure purposes. However, with ARPA generally doubling the annual covered employee group and the new expansion of the group to non-officer employees, these companies will now most likely have to create new tracking programs in order to identify and monitor compensation paid to these newly "covered employees." Finally, foreign private issuers ("FPIs") required to register securities under Section 12 or file reports under Section 15(d) of the Exchange Act are subject to Section 162(m), without regard to whether the compensation payable to their executives must be disclosed under the Exchange Act.[17] Now that ARPA has expanded the covered employee group, FPIs may need to develop a system to determine whether or not any compensatory costs are borne by U.S. taxpayers in the group and if they are, whether they may be affected by these rules.

KEY ISSUES TO BE DETERMINED

Effective Date?

As previously discussed, the text of the ARPA indicates that the new rules will not become effective until tax years beginning on and after January 1, 2027.[18] However, whether or not that effective date remains intact is the topic of some debate. Those who oppose the changes imposed by the law hope that the delayed effective date buys time as much can change in Congress during such a delay. In contrast, it is also apparent that Congress, regardless of any changes in the composition of its members, is most likely going to need more rather than less revenue offsets given the additional infrastructure and other spending bills that are pending. Since this Section 162(m) amendment is estimated to boost revenue by $7.8 billion over its first five years, it seems an unlikely candidate to be repealed prior to its effective date.

In contrast, the House Ways & Means Committee's recent proposal (released in draft form on September 13, 2021) in the budget reconciliation bill, referred to as the "Build Back Better Bill" would accelerate the effective date of the ARPA changes to Section 162(m) to tax years beginning after December 31, 2021.[19] If this bill passes and the provision makes it into the final legislation as currently drafted, employers would have very little time to prepare for these major modifications to Section 162(m) in the next tax year. Perhaps the most difficult challenge would be presented by the new need to calculate total compensation for non-executive employees for whom such calculations were not previously prepared and, in many cases, tracked in such a manner.

Accordingly, taxpayers may wish to consider consulting with their tax advisers now to determine and mitigate the potential impact should this acceleration of the effective date occur. In certain cases,

there might be opportunities to mitigate the effects of the changes by accelerating compensation into 2021 (e.g., paying a bonus in 2021 that normally would be paid in early 2022) or by accelerating the vesting of restricted stock that otherwise would vest in early 2022. However, depending on the nature of any such acceleration, the taxpayer should also consult their legal counsel to ensure that it does not create a Section 409A violation prior to implementing such acceleration.

OTHER PROVISIONS IN THE BUILD BACK BETTER BILL PROPOSAL

In addition to accelerating the effective date of the expanded "covered employee" definition, the Build Back Better Bill proposal also includes the following clarifications/changes to the existing Section 162(m) provisions:

- Modification of the definition of "applicable employee remuneration" (i.e., the term used to describe the types of compensation that count toward the $1 million deductible compensation limit) to expressly include (1) performance-based compensation, (2) commissions, (3) post-termination compensation, (4) beneficiary payments and (5) compensation for services to a publicly held corporation even if not directly paid by such company.[20]

- Expanding the application of the Section 414 aggregation rules[21] to all entities subject to Section 162(m) in order to provide that compensation paid for by different members of a controlled group would be aggregated for purposes of determining whether and to what extent a "covered employee" exceeds the limit on deductible compensation. The proposal also authorizes the IRS to issue regulations implementing the aggregation rule, including regulations to prevent avoidance of the deduction limitation (i.e., classifying individuals as other than an employee or compensating individuals through a pass through or other entity).[22]

Issuance of Additional Guidance Prior to Effective Date?

In the event that the original delayed effective date of the ARPA remains in place (i.e., effective for taxable years beginning on and after January 1, 2027), taxpayers and practitioners may receive additional guidance in the form of Treasury regulations prior to

having to implement procedures to accommodate and comply with the new rules. It would be highly beneficial for such guidance to include grandfather provisions for deferred compensation and/or other compensation arrangements already in place prior to the effective date. However, there is no guarantee that such relief will be provided.

Planning Pointers for Preserving Deductions

Since the new rules under the ARPA create the potential for yearly turnover of the next five highest-paid individuals who must be counted as "covered employees", publicly held corporations may be able to preserve their corporate compensation deductions by structuring current and deferred compensation programs to limit payments to potential employees that may be included in such group to ensure that they do not receive compensation in excess of $1 million in any taxable year during which they may be required to be included in the covered employee group. For example, companies may look to limit current compensation during such years and instead defer compensation payments to a later year after the recipient is no longer a "covered employee," such as after they terminate employment. Alternatively, companies may elect to provide additional compensation in the year prior to ARPA becoming effective or the taxable year in which the employee might be subject to these rules, such as by increasing bonus payments, in order to manage which employees are included in the expanded group.

Additional Practical and Business Issues for Consideration

The potential impact of the new ARPA rules creating a significantly increased amount of nondeductible executive compensation may lead corporations to place a significant emphasis on the deductibility of compensation at the expense of continuing to pay incentives and other executive compensation in a manner consistent with their corporate strategic objectives. Companies who do so may face challenges from executives and employees who may think that such discretionary adjustments to payments or determinations regarding ordinary course awards or compensation increases are no longer being determined based on performance or merit, but instead are being solely influenced by the corporation's objective to avoid exceeding the deductibility limitation of Section 162(m). Alternatively, if corporations are not able to create a combination of current and deferred

compensation arrangements that allow them to maintain sufficient levels of pay for their top executives and highly-compensated employees while remaining within the deductible limits, the resulting increase in the amount of nondeductible senior employee compensation may lead to an increase in shareholder claims of mismanagement and/or corporate waste.

CONCLUSION

Even if the original January 1, 2027, effective date of the new Section 162(m) rules survives, publicly held corporations should begin reviewing their compensation arrangements and begin deferred tax planning sooner rather than later because the effect of the ARPA could negatively impact their future compensation deductions if sufficient planning is not completed. There is no doubt that deferred compensation programs will serve a key role as corporations seek to continue to provide their key employees with the desired levels of pay without exceeding the deductible limits in the process.

In addition, employers will need to implement new systems to accurately identify and track the expanding group of covered employees who will be subject to the deduction limitation under the new rules. Of course, if the proposed acceleration of the effective date of these new rules under the Build Back Better Bill is passed, it will create an immediate sense of urgency for this planning and systems implementation.

Given the complexity involved with the new rules, the necessary tracking systems that should now be implemented and the need to review existing compensation arrangements as a prerequisite to determining what, if any, changes should be considered, publicly held corporations should consult their employee benefit consultants and legal advisors in order to prepare for the upcoming transition.

LEGISLATIVE UPDATE

The foregoing column mentions the potential impact that the Build Better Back Act could have on the rules discussed therein, including a proposed acceleration of the effective date of the expansion of the "covered employee" group change from January 1, 2027 to January 1, 2022. As of press time, the Build Better Back Act has been passed through the House of Representatives but still is awaiting Senate approval and then must be signed by President Biden before becoming law. The proposed acceleration of the above-referenced January 1, 2027 effective date did not survive in the final version released from

the House; however, the other Section 162(m) changes included in the original version of the Build Better Back Act have been retained in the version that is now being reviewed in the Senate. Such changes, which currently do remain effective as of January 1, 2022 and are summarized in the column, include an aggregation requirement and clarification of the "applicable employee remuneration" definition.

NOTES

1. I.R.C. Section 162(m)(1).

2. American Rescue Plan Act of 2021, Pub. L. No. 117-2, § 9708, 135 Stat. 4, 206 (2021).

3. *See e.g.*, Tax Cuts and Jobs Act of 2017, Pub. L. No. 115-97, § 13601, 131 Stat. 2054, 2155 (2017).

4. *See* our previous column,"Interim Section 162(m) Guidance including Notice that the Days for Amending Plans with Respect to Delaying Distribution of Non-Deductible Deferred Compensation are Dwindling," *Benefits Law Journal*, Vol. 33, No. 4 Winter 2020.

5. *See* our previous column, "Final Section 162(m) Rule Review: Deducting the Differences and Similarities from the Prior Guidance," *Benefits Law Journal*, Vol. 34, No. 1 Spring 2021.

6. For a comprehensive review of the Section 162(m) rules in effect prior to ARPA, see our two previous columns on this topic referenced above.

7. Omnibus Budget Reconciliation Act of 1993, Pub. L. No. 103-66, §13211, 107 Stat. 312, 469 (1993).

8. I.R.C. Section 162(m)(1).

9. Omnibus Budget Reconciliation Act of 1993, Pub. L. No. 103-66, §13211, 107 Stat. 312, 469 (1993).

10. Tax Cuts and Jobs Act of 2017, Pub. L. No. 115-97, §13601, 131 Stat. 2054, 2155 (2017).

11. *Id.* at § 13601(b).

12. American Rescue Plan Act of 2021, Pub. L. No. 117-2, §9708, 135 Stat. 4, 206 (2021).

13. This number could increase if circumstances require certain legacy "covered employees" to also be included.

14. Implementing guidance may address how this group of covered employees will be determined in taxable years in which the transaction occurs (e.g., whether the new group might need to be greater than five, calculating the groups separately for each company).

15. Regulation S-K, 17 C.F.R. §229.402(a)(3) (2021).

16. *See* I.R.C. § 162(m)(4) (includes any remuneration, including benefits, in any medium other than cash, except as expressly excluded); *see also* 17 C.F.R. §229.402(a)(2) (requiring "all plan and non-plan compensation awarded to, earned by, or paid to the named executive officers").

17. *Id.* at 86483.

18. American Rescue Plan Act of 2021, Pub. L. No. 117-2, §9708, 135 Stat. 4, 206 (2021).

19. Build Back Better Act of 2021, H.R. 5376, 117th Cong. § 138501(b) (2021) (released in draft form on September 13, 2021).

20. *Id*. at §138501(c).

21. *Id*. at § 138501(a) (currently applicable only to "covered health insurance providers" under Section 162(m)).

22. *Id*.

Benefits Litigation After the Transformation of the Federal Courts

Diane M. Soubly

The investiture of a justice hastily nominated, confirmed, and sworn in at what some term a COVID-19 super-spreader event has transformed the U.S. Supreme Court from a five-person to a six-person conservative majority.

Unless two of the conservative justices combine to resolve matters on narrow grounds, the Court will likely reject a balancing approach of competing constitutional interests that informed almost 70 years of constitutional decisions in favor of elevating religious liberty and moral conscience to super status.

Courts confront challenges to the federal vaccine mandates; and the Supreme Court is poised to revisit abortion access, to review hospital reimbursement rates for Medicare patients, and to assess 401(k) fees.

A sixth conservative justice will likely exacerbate the seismic transformation of the Court and embolden broader conservative arguments. Where litigants previously tailored arguments narrowly to convince a single swing vote to join a narrow five-person majority, they now need not tone down their rhetoric and can advance broader arguments in the face of a "spare" conservative vote.

This column first comments on the multidistrict litigation ("MDL") in which, by random lottery, the U.S. Court of Appeals for the Sixth Circuit will address 34 cases challenging the Occupational Safety and Health Administration ("OSHA") vaccine-or-test mandate for employers with 100 or more employees. The recent Centers for Medicare

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and Medicaid Services ("CMS") Interim Final Rule ("IFR") requires that Medicare- and Medicaid-certified facilities subject to CMS rules prevent unvaccinated health care workers without legally enforceable religious exemptions or medical accommodations from caring for patients. If some workers will quit or lose employment and benefits rather than subject themselves to a COVID-19 vaccine, the shortage of workers in the healthcare industry will increase. Courts have preliminarily enjoined both IFRs.

This column then describes a number of cases pending before the Supreme Court, including the Texas restrictions on abortion access, the highly anticipated case addressing the reproductive freedom of pre-viability abortion, two cases addressing hospital reimbursement, and fee litigation against a private university with substantial endowments.

CONTROVERSIAL FEDERAL VACCINE MANDATES

Pursuant to Fed. Rule Civ. P. 15 and Section 6(f) of the Occupational Health and Safety Act, 29 U.S.C. § 655(f), over a two-week period in November 2021, Republican-led states and various national and international unions filed 34 petitions in all 12 federal circuit courts of appeal[1] for review of the OSHA Interim Final Rule ("IFR") known as the "vaccine or test" mandate.

The OSHA IFR, issued November 4, 2021, requires employers with 100 or more employees to mandate COVID-19 vaccines for all employees who are not legally entitled to a religious exemption or a medical accommodation, or a medical contraindication for a vaccine, with unvaccinated employees subject to weekly testing.[2] While benefits designers and litigators are familiar with counting to find applicable large employers ("ALEs") under the Affordable Care Act, the OSHA IFR delineates its own factors for counting.[3]

The vaccine or test" mandate, issued under a finding of "grave danger" due to the deadly nature of the virus and the rise in cases because of the Delta variant, applies to all unvaccinated workers in all industries, including unvaccinated health care workers "not covered by [the OSHA Emergency Temporary Standard] 29 CFR 1910.501."[4]

Unvaccinated workers must wear acceptable face coverings and who report to a workplace where other individuals such as coworkers or customers are present at least once every seven days must be tested at least once every seven days and must provide documentation of the test results to the employer.[5]

Under Rule 25.5 of the Judicial Panel on Multidistrict Litigation ("JPML"), the name of each federal circuit was lettered on a ping pong ball, and, with a witness watching, the Clerk of the JDML selects a ping pong ball on random draw.[6] On November 8, the U.S. Department of

Justice ("DOJ") filed a letter in the Sixth Circuit consolidated case relating to the JPML lottery and succinctly explaining the procedure followed after the lottery, i.e., the federal circuits are expected to transfer their cases to the Sixth Circuit.[7]

Under that procedure on November 16, 2021, the Sixth Circuit became the designated circuit court to hear all of the petitions. The Panel Order to that effect is then served on the agencies and the clerks of all of the federal appellate circuit courts, after which the other federal circuit courts are to transfer their cases to the Sixth Circuit.[8]

The government has moved to dissolve the stay issued by the U.S. Court of Appeals for the Fifth Circuit, in a hastily filed opinion replete with obiter dictum (unnecessary to reach because the panel found that OSHA had no authority to enter the rule because it had not met the "grave danger" requirement for issuing an emergency rule) blasting the IFR as illegal and unconstitutional (both overinclusive and underinclusive).[9]

In contrast to the flurry of federal petitions challenging the OHSA IFR in all 12 federal circuits, the CMS IFR addressing mandatory vaccines for health care workers has inspired challenges in the Fifth, Eighth, and Eleventh Circuits at this writing. The CMS IFR does not provide an alternative of testing for unvaccinated health care workers working in certain Medicare- and Medicaid-certified facilities subject to CMS rules.[10]

Instead, the CMS IFR mandates that covered facilities must not permit unvaccinated health care workers (except for those with legally enforceable religious exemptions or medical accommodations or documented medical contraindications according to CDC guidelines) to come into direct contact with patients or staff.[11] The Attorneys General of several states, led by Louisiana, secured a "nationwide" injunction against the CMS IFR in federal district court in the Eastern District of Louisiana. See "The Mouse That Roared" below.

A common theme of the petitions and challenges? The concept that religious liberty and individual moral conscience overrides the public welfare, mandatory vaccine and mask-wearing. Exacerbating the shortage of workers in the healthcare industry and in other industries where the narrow religious exemption or the medical accommodation will be narrowly read, some workers will quit or lose employment and benefits rather than subject themselves to a COVID-19 vaccine.

While the litigation is ongoing, labor and employment practitioners have advised that employers and plan designers begin to comply with the requirements of the OSHA and CMS IFRs. For example, the uploading and recording of vaccination information on employees should be stored in files separate from an employee's personnel file. All of the medical information relating to individual employees should be stored in compliance with the Americans with Disabilities Act rules

for "medical inquiries" and with HIPAA and HITECH (the "final HIPAA Rules").

To further illustrate, paid time off ("PTO") policies (often described in wrap plan documents or handbooks containing information about employee plans) should be adjusted to provide an employee for time off in order to get the vaccine. Definitions in short-term disability plans might need to take into account leaves for reactions to the vaccines and/ or the prolonged problems associated with COVID-19 long haulers.

In addition, human resources personnel and employee benefit designers may wish to consider designing a non-HIPAA-governed wellness plan so that there are no incentive limits such as would govern under HIPAA-governed plans (or no incentives if the information is controlled under the Genetic Information Nondiscrimination Act ("GINA")).

SUPREME COURT WATCH

Oral argument in November and December of 2021 contained six cases of note for employee benefits designers and benefits litigators.

Access to Abortion

To date, three cases revisit abortion as a reproductive right during the 2021 term. The first two cases, *Women's Whole Health Network v. Jackson*[12] and *U.S. v. Texas*,[13] argued on November 1, 2021, address Texas Senate Bill 8 ("SB 8"), characterized as a bounty law, under which the State of Texas has attempted to preclude abortions any time after six weeks of pregnancy, with no exception for rape or incest.

In an effort to avoid federal court review, the state has apparently delegated to any person, no matter where that person is located in the enormous state, the right to claim a $10,000 statutory "reward" for bringing an action against anyone who assists any one or provides care to any woman who disobeys the state ban on abortions. No case has preclusive effect, so one violation can inspire an indefinite number of cases against the same individual, each time for a $10,000 bounty. The chilling effect of the law on the right to abortion has been dramatic, almost completely restricting abortion access and causing clinics to close throughout the state.[14]

Over a scathing dissent by Justice Sotomayor, which chastised the majority for refusing to protect the constitutional right to abortion, the Supreme Court refused to grant an emergency application on its shadow docket in order to stay the effect of SB 8, which went into effect on September 1, 2021.

At least, the Court did grant the petitioners' second emergency request to hear the case on an expedited basis. As this column "went to press," the Court issued its opinion keeping the abortion ban at six weeks.[15]

The majority opinion, written by Justice Gorsuch, carefully noted that the merits questions relating to the Texas Heartbeat Act, enacted in 2021, were not before the Court. Five members of the Court concluded that the petitioner abortion clinics could pursue a pre-enforcement challenge to the Act forbidding abortions after six weeks against some state officials but not others.

The majority dismissed the state court clerk and the state district judge from the lawsuit under the doctrine of sovereign immunity. In doing so, the majority rejected the argument of petitioners that they could seek a class action-like remedy against state officials who might enforce the act in the future. The majority noted that there existed no present case or controversy between all other state officials and the petitioners at the pre-enforcement stage. The majority also dismissed the Texas attorney general because the petitioners had not shown any specific rule or law providing him with the power to enforce the act, and because a court could not enjoin the world at large or the challenged laws. The majority also dismissed the individual defendant based on his affidavit that he had no intention of filing a lawsuit for bounty against any violator of the act. The majority then noted that eight of the justices agreed that sovereign immunity does not bar the pre-enforcement challenge of the petitioners against the remaining defendants, all of whom were state licensing officials with the power to enforce violations of the act against petitioners.

Finally, in an express answer to Justice Sotomayor's dissent, the majority suggested other means by which the petitioners could also challenge the Texas law. The majority also carefully noted that the Court was not prejudging the possibility of other challenges, including a constitutional challenge under federal law.

Alone of all the justices, Justice Thomas stated his position in a separate concurrence in the majority opinion except for his dissent that sovereign immunity barred pre-enforcement challenges against all of the defendants.

Chief Justice Roberts wrote a separate concurrence, agreeing with the result that the petitioners could continue their challenge against the licensing defendants. Joined by Justices Kagan, Sotomayor and Breyer, Chief Justice Roberts dissented on the ground that the Texas act threatened the rule of law:

> The clear purpose and actual effect of S. B. 8 has been to nullify this Court's rulings. It is, however, a basic principle that the Constitution is the "fundamental and paramount law of the

> nation," and "[i]t is emphatically the province and duty of the judicial department to say what the law is." *Marbury* v. *Madison*, 1 Cranch 137, 177 (1803). Indeed, "[i]f the legislatures of the several states may, at will, annul the judgments of the courts of the United States, and destroy the rights acquired under those judgments, the constitution itself becomes a solemn mockery." *United States* v. *Peters*, 5 Cranch 115, 136 (1809). The nature of the federal right infringed does not matter; it is the role of the Supreme Court in our constitutional system that is at stake.

In her dissent, joined by Justices Kagan and Breyer, Justice Sotomayor challenged the Texas act as a blatant attempt to subvert a constitutional right through a litigation process that forced abortion clinics in Texas to close. She expressly warned that states could soon follow with similar statutes to avoid judicial review and to nullify any constitutional right recognized by the Supreme Court with which the states disagree, just as states had done in their attempts to reenact the effects of slavery after the Civil War. Labelling the challenge to federalism "no hypothetical," Justice Sotomayor explained that the majority opinion rewarded Texas' efforts to deny a constitutional right through months of procedural litigation, and that such efforts could extend to guns rights and religious liberties.

On December 16, 2021, in a "Miscellaneous Order" signed by Justice Gorsuch, the applicants' petition for a prompt order was granted, but the case was remanded to the Fifth Circuit. The Order rebuffs the petitioners' request that the matter be remanded to a different federal district judge and contributes to the delay that Justice Sotomayor predicted.

On December 1, 2021, the Court heard oral argument in a third case, *Dobbs v. Jackson Women's Health Organization*,[16] in which the Court will reassess whether all pre-viability prohibitions on elective abortions are unconstitutional. Given the loss of the Court's conscience on constitutional precedent (the late Justice Ginsburg), and given the Court's gain of three justices with fundamental religious perspectives, it is likely that plan sponsors, employee benefits designers, and employee benefits litigators should watch for the Court's decision in this case for its impact on benefit plans and policies.

In a two-hour oral argument in *Dobbs* on December 1, the Court's conservative justices signaled a likely cut back on the reproductive privacy rights of women. The government lawyers taking an "all or nothing" approach on *Roe v. Wade* and *Planned Parenthood v. Casey* repeatedly addressing abortion as a fundamental right, while the Mississippi Solicitor General returned, no matter what the question, to the theme that *Roe* and *Casey* were "wrongly decided" and had kept the Court in a "political battle" that it could not resolve for 50 years.

With some states ready to tighten the period within which a woman can secure an abortion even if even the Court does not overrule *Roe*, the six-week test under Mississippi law that resulted in one lone abortion clinic left standing in the state may well be on track for approval by the Court, even if that short pre-viability period was not directly before the Court in *Dobbs*.

Three of the conservative justices (Justices Alito, Thomas, and Gorsuch) pushed the government by questioning whether an erroneous opinion like *Plessy v. Ferguson* should be overturned as quickly possible. Ironically, the Roberts Court took years before explicitly overruling the *Korematsu* case in *Trump v. Hawaii*. Some states, among them Mississippi, have enacted statutes that will automatically take effect curtailing abortions if the Court overturns *Roe*. Justices Kavanaugh and Barrett both signaled their willingness to do so, with Justice Barrett asking why the "safe haven" laws in all 50 states (under which mothers can give up their babies up for adoption) would not "take care of the problem." Chief Justice Roberts pointedly questioned why a woman would not know of her pregnancy in 15 weeks.

Whatever the reach of the *Dobbs* decision, it will only increase the litigation before the Court. Pending in the legal pipeline are cases challenging existing pre-viability restrictions, and such litigation will only increase if the Court permits the Mississippi law to stand. Returning the battle to the state legislatures under the guise of federalism or "the will of the people" may simply replace one prolonged legal battle with another.

Hospital Reimbursement

Two cases involving hospital reimbursement were set for oral argument in November 2021. On November 29, 2021, the Court heard argument in *Becerra v. Empire Health Foundation*,[17] in which the Foundation challenges whether the Secretary of Health and Human Services permissibly included in a hospital's Medicare fraction, for purposes of calculating additional payment for hospitals that serve a "significantly disproportionate number of low-income patients," all of the hospital's patient days of individuals who satisfy the requirements to be entitled to Medicare Part A benefits, regardless of whether Medicare paid the hospital for those particular days.

The second case, *American Hospital Association v. Becerra*,[18] argued on November 30, 2021, addresses whether, under *Chevron* deference permits the Department of Health and Human Services to set reimbursement rates based on acquisition cost and vary such rates by hospital group if it has not collected adequate hospital acquisition cost survey data. In addition, the Court will decide whether 42 U.S.C. § 1395l(t)(12) precludes petitioners' suit challenging HHS's adjustments.

Section 401(k) Fee Case Reinvigorated

Another case, *Hughes v. Northwestern University*[19] questions whether allegations that the plan fiduciaries of a defined-contribution retirement plan breached their fiduciary duty of prudence, when the plan charged its participants fees that substantially exceeded fees for alternative available investment products or services, are sufficient to state a claim against plan fiduciaries for breach of the duty of prudence, in violation of ERISA § 404(a)(1)(B).

The oral argument in *Hughes*, the case dismissed on pleadings by the U.S. Court of Appeals for the Seventh Circuit, revealed the difficulty that the justices experienced in articulating a standard of liability at the pleading stage for a case alleging that fiduciaries violated their duty of prudence to retirement plan participants by offering the 401(k) plan participants a stock account option with a history of underperformance and substantially higher fees that did not provide "comparative worth" to the participants, all despite available, less fee-generating alternatives.

Justice Kagan questioned whether a fiduciary could fulfill its duty of prudence when it failed to use its leverage to negotiate a better package or more reasonable fees simply by telling self-directed participants that it offered some investments at lower fees. Justice Sotomayor rejected the argument that fee litigation actually harmed participants, where some litigation had benefitted participants by resulting in lower fees.

Justice Thomas felt that the case simply resulted in hindsight questioning of fiduciary conduct and simply disagreed with the investment choices of the university. Justices Gorsuch and Alito suggested that the allegations in such cases were beyond the capacity of federal judges to manage. Justice Kavanaugh noted that such cases, if they survived motions to dismiss, bludgeoned plan fiduciaries into settlement without reaching the merits.

As litigation that parrots many of the allegations leveled earlier in similar 401(k) fee suits, the outcome in *Hughes* may resolve a dozen cases held in abeyance for the opinion that will probably take the Court until June 2022 to craft.

INJUNCTIONS AGAINST ENFORCEMENT OF THE CMS IFR AND OSHA IFR DISSOLVED – FOR NOW

The CMS IFR – No Longer Enjoined Nationwide

Nationwide Injunction and Appeal: As this column went to print, a federal district judge in the Western District of Louisiana issued a

"national" injunction that forbids every person in Health and Human Services and CMS from implementing the CMS IFR requiring non-exempted health care workers to become fully vaccinated against by January 4 "as to all health care providers, suppliers, owners, employees, and all others covered by the CMS IFR."[20] The district court carved out of the injunction the 10 states subject to a preliminary injunction entered by a district court in the Eastern District of Missouri. The government appealed the injunction to the U.S. Court of Appeals for the Fifth Circuit Court.[21] Hours later, in response to the government's motion, the federal district judge refused to lift the injunction. The parties are now briefing in response to the government's a motion to dissolve the injunction.

On December 15, 2021, the Fifth Circuit lifted the nationwide injunction against enforcement of the CMS IFR and enforced the stay only in the 14 states actually before the district court. The court noted that nationwide injunctions were rare and distinguished the prior immigration cases in which it had approved a nationwide injunction. Citing Justice Gorsuch's opinion criticizing such injunctions (discussed below), the court recognized that other states not before the court might well have endorsed the CMS IFR. For now, the Fifth Circuit continued the stay against the enforcement of the CMS IFR in Arizona, Alabama, Georgia, Idaho, Indiana, Kentucky, Louisiana, Mississippi, Montana, Ohio, Oklahoma, South Carolina, Utah, and West Virginia.

The 10-State Injunction: The government appealed the injunction entered by the district court in the Eastern District of Missouri to the U.S. Court of Appeals for the Eighth Circuit.[22] That injunction restrained the government from all implementation of the CMS IFR in 10 states, some of which are outside the jurisdiction of the Eighth Circuit. The district court also refused to lift the stay; and, by emergency motion, the government sought to dissolve the injunction pending appeal. On December 14, 2021, in a 2-1 order with no explanation or opinion, the Eighth Circuit denied the emergency motion. At this writing, the injunction remains in place in Alaska, Arkansas, Iowa, Kansas, Nebraska, Missouri, New Hampshire, North Dakota, South Dakota, and Wyoming.

Eleventh Circuit Disparages National Injunction and Refuses to Issue Injunction Requested by Florida: On November 24, 2021, a federal district court in Florida refused to issue a stay of the CMS IFR because the state had failed to prove irreparable harm. That denial was the "first-in-time appeal" on the issue of whether the CMS IFR should be stayed. Five days after filing its appeal in the Eleventh Circuit, the State of Florida filed a "Time-Sensitive Motion for Injunction Pending Appeal" on November 29.[23] By order on December 5 (with the bases for the order in an opinion issued on December 6), the Eleventh Circuit criticized nationwide injunctions and refused to enter an injunction, so the

CMS IFR is enforceable in Florida, particularly given the Fifth Circuit's stay of the nationwide injunction.

THE OSHA IFR – DISSOLVED, FOR NOW

On December 3, 2021, the Sixth Circuit (selected as the winner of the Judicial Panel on Multidistrict Litigation lottery) denied a motion to transfer the MDL case to the Fifth Circuit or the District of Columbia Circuit, denied the many motions for emergency stay of the OSHA IFR in light of the government's motion to dissolve the Fifth Circuit stay, denied the many amicus petitions in support of the emergency motion to stay as moot, and set a new briefing schedule for consolidated responses to the government's motion and a consolidated reply from the government in response.

On December 15, 2021, the en banc court of the Sixth Circuit issued an order denying the states' petitions for an initial review by the en banc court of the merits of the injunction showings, "because less than a majority of the active judges voted for initial en banc review." Of the 16 active-status judges on the en banc court, three did not join any opinion (Judges Griffin, Gibbons, and Stranch) and apparently did not vote in favor of the initial en banc review, or the majority of nine of 16 would have been reached.

In a brief opinion concurring in the denial, Judge Karen Nelson Moore explained (joined by Judges Cole, Clay, White, and Donald) that a three-judge panel (already assigned but unnamed) would first decide the government's motion for enforcement of the OSHA IFR. In a lengthy opinion dissenting from en banc review, Justice Sutton (joined by eight Republican-appointed colleagues including Judge Bush) treated the merits of the question along party lines (e.g., the power to address pandemics belongs to the states). An additional dissenting opinion by Judge Bush (joined by no one) celebrated American exceptionalism as a model to the world over dictatorships that do not enforce their bills of rights before he, too, addressed the merits.

Both dissenting opinions clearly signaled that the three-judge panel would be a hollow exercise if it upheld the OSHA IFR, assuming that as least nine of the active-status Sixth Circuit judges would vote to uphold the stay.

Two days later, on December 17, 2021, the panel issued its 2-1 opinion. In the majority opinion, Judge Stranch (appointed by President Obama), joined in full by Judge Gibbons (appointed by President George W. Bush) dissolved the Fifth Circuit's injunction against the OSHA IFR and found that no injunction should issue,

because OSHA had the authority to issue the "vaccine-or-shot" rule, the Secretary had demonstrated both "grave danger" and "necessity, the major questions doctrine did not apply, the OSHA IFR did not offend the federal constitution, and the irreparable harms asserted were only speculative.

The anemic dissent by Judge Lawson addressed some but not all issues raised by the states and, perhaps, explains why Chief Judge Sutton (who wrote the opinion in the 2-1 marriage equality opinion later reversed sub nom *Bostock v. Clayton County, Georgia*) released his lengthy dissenting opinion from the decision not to grant initial en banc review by leapfrogging the panel.

That same day, 26 business associations then submitted an emergency application for leave to the Supreme Court seeking a reinstatement of the stay and a stay of agency action.

At 1 a.m. on December 18, 2021, the state petitioners seeking to invalidate the OSHA IFR also filed an emergency application for leave to the Supreme Court to reinstate the stay and stay of agency action. In the alternative, however, the states also filed a petition for writ of certiorari before judgment.

THE MOUSE THAT ROARED – CONCERNS ABOUT NATIONWIDE INJUNCTIONS

The only purposed nationwide injunction in place as this article goes to press is the injunction against the federal contractor guidance issued in conjunction with Executive Orders.

Can one federal district court stop the government from enforcing either IFR or the federal contractor rules against any person anywhere in the nation or overrule a sister court in another state?

The Supreme Court has recently cast doubt on such nationwide injunctions. In 2020, the Court (5-4) granted a stay of a district court's nationwide injunction prohibiting enforcement of a DHS final rule against anyone anywhere in the country.[24] In a concurring opinion joined by Justice Thomas (both of whom were in the majority), Justice Gorsuch explained that such injunctions direct the government in how it must act towards persons who are not parties to the case:

> When a district court orders the government not to enforce a rule against the plaintiffs in the case before it, the court redresses the injury that gives rise to its jurisdiction in the first place. But when a court goes further than that, ordering the government to take (or not take) some action with respect to those who are strangers to the suit, it is hard to see how the court could still be acting in the judicial role of resolving cases and controversies. Injunctions

> like these thus raise serious questions about the scope of courts' equitable powers under Article III.[25]

Justice Gorsuch cited with approval Justice's Thomas's concurrence in *Trump v. Hawaii*.[26] In Thomas's view, such injunctions are incompatible with the equitable powers given to federal judges under the federal constitution.[27]

With prescience, Justice Thomas decried so-called national injunctions for "tak[ing] a toll" on the federal judicial system and for encouraging "forum shopping," the practice of legal maneuvering in a "legal blitz" of the courts to ensure "favorable" judges at the trial and appellate level.[28] With the increasing issuance of "national" injunctions by trial courts in the last decade, Justice Thomas wearily warned, every case becomes a "national emergency" for the courts and for the Executive Branch.[29] Not authorized by statute, universal injunctions would violate the constitution even if they were so authorized, he argued, because they are "inconsistent with our history and our traditions." He concluded that, when courts issue such "legally and historically dubious" injunctions, "this [Supreme] Court is duty-bound to adjudicate their authority to do so."[30]

In refusing to acknowledge the legitimacy of the nationwide injunction entered by the Louisiana district court, the Eleventh Circuit chastised the district court for failing to provide comity to its sister court in Florida, applied the purported nationwide injunction outside of the rare circumstances in which such nationwide injunctions have been applied in the past, and attempted to stymie the percolation of various views from various courts.[31] The Eleventh Circuit devoted half of its 44-page opinion to the problems created by nationwide injunctions, citing opinions by both Justice Gorsuch and Justice Thomas and a wealth of other Supreme Court and federal appellate cases.

The politicized run-up by Republican governors and attorneys general to secure a quick decision by the Supreme Court on individual liberty and government overreach underscores the significance of the prior administration's rush to name three conservative members to the Court.

With the pandemic again accelerating, and with rising deaths among the unvaccinated and overtaxed hospitals, will we someday look back on this politicization of the pandemic as the federal courts' less than stellar hour? Or will we remember that three Sixth Circuit judges (two appointed by George W. Bush and one appointed by Barack Obama) declined to join a vote or an opinion to bypass initial panel review, and that two judges of the Eleventh Circuit criticized the nationwide injunction and spoke independently – all to assist the process of percolating the various views from various courts?

Will we find it hopeful for the rule of law that the Fifth Circuit determined that a nationwide injunction was not appropriate for the CMS IFR?

Can we even find it hopeful that, after the en banc court of the Sixth Circuit allowed the panel to issue its opinion, two judges of the Sixth Circuit from "both sides of the aisle" signed a majority opinion dissolving the injunction against the OSHA IFR, on the grounds that OSHA had the authority to issue the IFR and had demonstrated both "grave danger" and "necessity, and that the states had not demonstrated a likelihood of success on the seldom-used "major questions" or their constitutional arguments and had posited only speculative irreparable harms?

Or should we expect quick review and reinstatement of the stay by a polarized Supreme Court with an ultra-conservative majority?

And will we see the Supreme Court further erode its own credibility and the public's belief in the rule of law by blocking enforcement of the OSHA IFR in the face of a resurgent pandemic, taking a particular toll on the unvaccinated, and a possible shutdown of the economy in 2022?

And do we see the law's delay to frustrate constitutional rights at work in Justice Gorsuch's remand of the Texas Heartbeat Act to the Fifth Circuit and not to a new trial judge?

DENOUEMENT

With the legal quagmire likely to last longer, what should health care providers and large employers do, in light of these legal developments?

First, there is a distinction between withdrawing an IFR and suspending its enforcement. In the so-called "vaccine mandate" cases, the federal agencies have ceased to enforce the OSHA and CMS IFRs while the government battles to dissolve the injunctions. In contrast, on other occasions, an agency has withdrawn a regulation asked a court to hold the case in abeyance for the new iteration. Not so here.

CMS IFR: With injunctions against the CMS IFR lifted in all states but the 10 states before the Eighth Circuit, then the government may immediately seek to enforce the regulations.

Delayed Enforcement of OSHA IFR: On December 18, 2021, the Biden Administration announced that it would extend the two dates on which it would enforce OSHA IFR requirements, and on which OSHA may begin to assess penalties. *By January 10* (as would have been required by December 5 prior to the Fifth Circuit injunction), under 29 CFR § 1910.501(d)(1) or (2) an employer must have established, implemented, and enforced EITHER a written mandatory vaccination policy compliant with 29 CFR § 1910.501 OR a written policy

permitting employees to choose either to be vaccinated or to submit to weekly testing, requiring proof of vaccination, and other mitigating measures such as social distancing compliant with 29 CFR § 1910.501 – except for subsection (g) of 29 CFR § 1910.501.

By February 9 (as would have been required by January 4 prior to the Fifth Circuit injunction), employers are to have a testing program in place that complies with subsection (g) of 29 CFR § 1910.501. Employers are reporting that, rather than simply requiring the unvaccinated to "mask up" in the workplace, they are requiring universal masking by all employees in common areas of the workplace.

The risks and consequences to health care providers and suppliers and to other employers with more than 100 employees remain high for non-compliance. During the legal confusion while the court processes play out, and with the spike in the highly transmissible Delta virus and the Omicron variant while European nations experience another wave of lockdowns, the prudent health care provider or supplier, the prudent federal contractor, and the prudent employer will continue on course to create policies and procedures for carrying out the OSHA and CMS IFRs, stopping short of terminating or otherwise disciplining employees who refuse to become vaccinated or to provide proof of vaccination or who have been denied exemptions.

In the absence of injunctions, private health care providers and suppliers and employers concerned about potential lawsuits from vaccine hesitant staff can take some comfort in two cases within the Sixth Circuit, one in the Southern District of Ohio and in the other in the Eastern District of Kentucky. Please note that other courts are free to disagree with these district courts. In those cases, *before* the issuance of the CMS IFR in early November, hospitals *as private parties* (not governmental actors or compelled by a governmental actor) mandated vaccines for their health care workers unless they qualified for a religious or medical exemption. Plaintiffs ultimately sought orders to restrain the hospitals from compelling their vaccinations, inquiring about their vaccination status, and terminating them if they remained unvaccinated.

The Kentucky district court denied the motion for such an extraordinary remedy, in part because the health care provider defendants were not state actors.[32] The next week, the Ohio district court followed suit.[33]

Ruling against plaintiffs, some of whom had been granted exemptions by defendants but still sued, Judge Black reasoned that, even if the hospitals had been state actors, the Supreme Court had, in his view, correctly upheld a municipal vaccine mandate authorized by Massachusetts law during the smallpox epidemic of the early 20th Century against a constitutional challenge that such vaccine mandates offended individual liberty:

> [T]he liberty secured by the Constitution of the United States to every person within its jurisdiction does not import an absolute right in every person to be, at all times and in all circumstances, wholly freed from restraint. There are manifold restraints to which every person is necessarily subject for the common good. On any other basis, organized society could not exist with safety to its members. Society based on the rule that each one is a law unto himself would soon be confronted with disorder and anarchy. Real liberty for all could not exist under the principle which recognizes the right of each individual to use his own, whether in respect of his property or person, regardless of the injury that may be done to others.[34]

Second, of particular interest to employee benefits designers and practitioners, on December 2, the Biden administration released a new nine-point plan to make available $2 billion in funds for free at-home testing for Americans eligible for vaccines and to require health plans to reimburse for any testing costs:

> *Expanding Free At-Home Testing for Americans:* Today, the President will announce new steps to ensure that Americans has access to free at-home testing. First, the more than 150 million Americans with private insurance – who now are able to get tests covered in physician offices, pharmacies, and clinics with no cost sharing – will also be able to get at-home tests reimbursed by their insurance. Second, for those not covered by private insurance, in addition to more than 20,000 federally supported free testing sites across the U.S., at-home tests will be distributed through key community sites, such as health centers and rural clinics. The Biden Administration has taken significant steps to increase testing in the country since January. We are on track to quadruple the supply of rapid at-home tests that we had in late-Summer. Today's actions will help Americans access the tests they need to help them stop the spread of COVID-19 to others.

> *Providing health plan coverage of no-cost rapid, over-the-counter (OTC) COVID-19 tests*: To expand access and affordability of at-home COVID-19 tests, the Departments of Health and Human Services, Labor and the Treasury will issue guidance by January 15th to clarify that individuals who purchase OTC COVID-19 diagnostic tests will be able to seek reimbursement from their group health plan or health insurance issuer and have insurance cover the cost during the public health emergency. Workplace screening would remain consistent with current guidance. Today's announcement follows the President's September action directing

more than $2 billion to accelerate the production of rapid tests and an additional $1 billion investment in procuring at-home tests. Over the same time period, FDA authorized five additional over-the-counter tests. A total of 8 tests are on the market today; no test was on the market when the President took office.[35]

CONCLUSION

With the transition from the late great Justice Ginsburg to a conservative justice, the Supreme Court has transformed into a more conservative court, poised to elevate religious liberty and individual conscience over other competing constitutional rights. Employee benefits designers and benefit litigators need to pay attention to the cases before the Supreme Court in the last two months of 2021.

The challenges to the vaccine mandates will, like the global pandemic itself, take time to resolve. In the meantime, prudent employers will comply with the fast-approaching dates in the OSHA IFR and the CMS IFR vaccine mandates.

Various justices on the Court have expressed the view that, as the pandemic has changed, so must case law from the pandemic in the early years of the 20th Century.

As they have with each seismic fluctuation in employee benefits law, from the various tacking in ERISA preemption law to the attempt to wipe the slate clean of long-standing regulations in the last administration, employee benefits practitioners and benefits litigator should be prepared to pivot and to comply with new direction from the Court.

NOTES

1. *Ky et al v. OSHA et al.*, C.A. No. 21-4031 (6th Cir. 2021), ECF 28, Notice of Filing with Judicial Panel on Multidistrict Litigation, pp. 9-35 (chart detailing all 34 cases).

2. 86 Fed. Register, No. 212, 61,402 (November 5, 2021).

3. 86 Fed. Register at 61,513 - 61,516.

4. 86 Fed. Register at 61,421.

5. 86 Fed. Register at 61,552 - 61,553, §§ 1910.501(e), (f), (g), and (i).

6. *See* Rules of the Judicial Panel on Multidistrict Litigation, available at *https://www.jpml.uscourts.gov*.

7. *Ky et al. v. OSHA et al.*, Case No. 21-4031, ECF 8.

8. *See* Rule 25 of Rules of the Judicial Panel on Multidistrict Litigation.

9. *BST Holdings et al. v. OSHA et al.*, C.A. No. 21-60845, Doc. 00516085110 (Nov. 12, 2021).

10. 86 Fed. Register, No. 212, 61,554 - 61,627.

11. *Id.*

12. No. 21-463.

13. No. 21-588.

14. *See https://reproductiverights.org/case/texas-abortion-ban-whole-womans-health-jackson/.*

15. No. 21-463 (Dec. 10, 2021) (slip op.).

16. No. 19-1392.

17. No. 20-1312.

18. No. 20-1114.

19. No. 19-1940.

20. *Louisiana v. Becerra*, 3:21cv03970 (W.D. La. 11.30.2021).

21. *Louisiana v. Becerra*, Case No. 21-30734.

22. *Missouri v. Biden* (Case No. 21-3725).

23. USCA11 Case No. 21-14098.

24. *Department of Homeland Security v. New York*, 140 S. Ct. 599 (2020) (Mem.).

25. *Id.* at 599-600.

26. 138 S. Ct. 2392 (2018) (concurring opinion, J Thomas) 138 S. Ct. 2424-29.

27. *Id.* at 2425.

28. *Id.*

29. *Id.*

30. 138 S. Ct. at 2429.

31. USCA11 Case No. 21-14098.

32. *Beckerich v. St. Elizabeth Med. Ctr.*, No. CIV 21-105-DLB-EBA, 2021 WL 4398027 (E.D. Ky. Sept. 24, 2021).

33. *Harsman v. Cincinnati Children's Hospital Medical Center et al.*, Case No. 1:21cv00597 (USDC S.D. Ohio, Sept. 30, 2021).

34. *Jacobson v. Massachusetts*, 197 U.S. 11, 26 (1905).

35. *See https://www.whitehouse.gov/briefing-room/statements-releases/2021/12/02/fact-sheet-president-biden-announces-new-actions-to-protect-americans-against-the-delta-and-omicron-variants-as-we-battle-covid-19-this-winter/.*

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BENEFITS LAW JOURNAL

VOL. 34, NO. 4 / WINTER 2021

Winter/10041438-0200