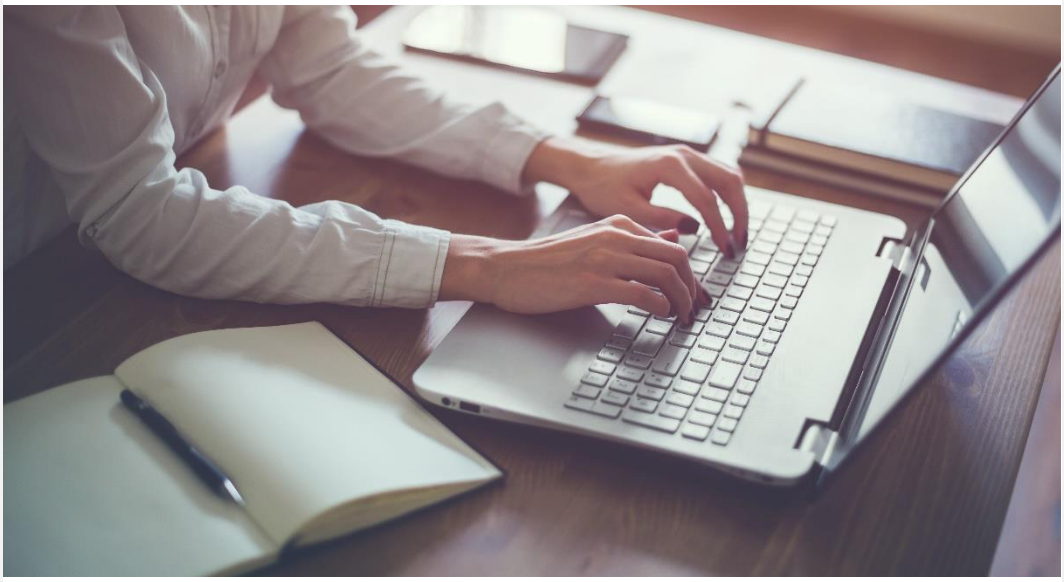
United States | Human Capital | 21 February 2025

Rewards Policy Insider
2025-04



In this Issue:

District Court Rules that 401(k) Plan Fiduciaries Violated ERISA in ESG Investment Case

In January, a district court issued a highly-anticipated order concluding that a major airline, in its capacity as fiduciary of its 401(k) plans, breached ERISA by failing to hold its investment manager accountable for "activism" involving environmental, social and governance ("ESG") investments as part of the plan's investment lineup.

Background

In June 2023, a pilot employed by a major airline filed a class action complaint in the U.S. District Court for the Northern District of Texas against the airline on behalf of participants and beneficiaries of the airline's 401(k) plans. The lawsuit alleged that, in its capacity as plan sponsor, the airline breached its ERISA fiduciary duties by selecting and retaining funds whose manager pursued ESG objectives instead of focusing exclusively on maximizing financial benefits for the plan participants. In general, ERISA requires a plan fiduciary to act solely in the interest of participants (i.e., the duty of loyalty) and to act prudently (i.e., the duty of prudence). A fiduciary must also monitor the activities of the plan's investment managers. The plaintiff alleged that when the airline hired the plan's investment manager, it knew that they prioritized non-financial ESG policy goals – such as investments that supported combatting climate change – over financial returns, which caused participants to lose money.

This case was one of the first lawsuits targeting the private sector on the issue of ESG investing, a hot-button political topic that has gained nationwide attention in recent years.

District Court Ruling

On January 10, 2025, the Northern District of Texas ruled that, while the airline did not breach its duty of prudence in connection with the design and implementation of its retirement plans, it had breached its duty of loyalty. The judge concluded that the plan's investment manager pursued ESG initiatives through its proxy voting strategies and related "ESG activism," which was not in the best financial interest of the airline's 401(k) plans. Because the airline failed to hold the investment manager accountable for this activism, it breached its duty of loyalty to the plan. The judge explained that the airline failed to take steps to review, monitor, or evaluate the investment manager's proxy voting practices and other activities.

Implications of the Ruling

It is important to note that, while this is a significant ruling, it is only a district court decision, and therefore only applies within the jurisdiction of the Northern District of Texas, not nationwide. Moreover, the judge's ruling is not the final word in this case. The January ruling included the court's findings of fact and conclusions of law on the issues, but the judge ordered the parties to file additional briefs in order to allow the court to consider an appropriate remedy and determine the amount of losses to the plan.

In addition, when a final ruling is issued by the Northern District of Texas, the airline is widely expected to appeal, meaning that an ultimate decision in the case might not come for some time. In the meantime, however, plans and investment managers that have adopted ESG policies should watch for future developments in this case.

Federal District Court Partially Dismisses ERISA Claims Based on Plan's Use of PBM

A Federal district court has dismissed certain claims against the fiduciaries of an employer-sponsored health plan relating to the plan's use of a pharmacy benefit manager (PBM) to run its prescription drug benefit. The case, which isn't over, is noteworthy because it is among the first cases challenging ERISA plans for using PBMs.

Overview

The plaintiff, apparently a COBRA participant in the employer's group health plan, alleged the plan's fiduciaries were mismanaging the plan's prescription drug benefit, which is run by a PBM. For example, the plaintiff's claim alleged that the plan was paying significantly more than the retail price available to uninsured individuals for certain generic drugs. The plaintiff also cited the plan's attempts to steer participants to a preferred mail-order pharmacy instead of retail pharmacies. According to the plaintiff, these practices result in higher premiums, deductibles, and other cost-sharing requirements for participants.

The basic legal issue is whether the fiduciaries violated their core ERISA duties of prudence and loyalty to the plan's participants and beneficiaries with respect to hiring and monitoring the PBM. But the story is focused more on questions about how PBMs operate, and whether they prioritize their own profits over getting better deals for health plans and their participants. The PBMs themselves generally are not ERISA fiduciaries, so ERISA does not provide any legal recourse against them.

ERISA Fiduciary Claims Dismissed

Without addressing the merits of the plaintiff's fiduciary breach claims, the district court dismissed them because if found the plaintiff lacked "standing" to sue. Under the Constitution, only someone who has actually been injured has "standing" to bring a lawsuit. If a plaintiff fails to establish that they have "standing" to sue, then their claims will be dismissed.

Here, the district court concluded the plaintiff does not have "standing" to sue because the claimed injuries of higher premiums and cost-sharing are, at best, "speculative and hypothetical." With respect to the plaintiff's claims that she paid more for certain prescription drugs, the court concluded that it could not provide any relief because she had met the plan's out-of-pocket limit for prescription drugs.

What's Next?

The plaintiff could appeal the district court's dismissal. Another possibility is to file an amended complaint with additional plaintiffs who might be able to demonstrate "standing."

Additionally, the court did not dismiss the plaintiff's claims that the plan failed to provide certain documents as required by ERISA. So, the plaintiff can proceed with that claim, even if they choose not to pursue the others.

And regardless of the ultimate disposition of this case, plaintiffs' attorneys, regulators, and legislators at both the state and federal levels will likely continue to look for ways to address concerns about PBMs during 2025 and beyond.

IRS Proposes Regulations on SECURE 2.0 Roth Catch-up Rules

The Internal Revenue Service ("IRS") issued proposed regulations providing guidance on the provisions in the SECURE 2.0 Act of 2022 ("SECURE 2.0") that affect how retirement plan participants can make "catch-up" contributions to their accounts.

Background

Individuals age 50 or older are permitted by law to make additional "catch-up" contributions to certain retirement accounts in excess of the annual contribution limit, if their plan permits such contributions. SECURE 2.0 enacted a handful of provisions that impacted the catch-up contribution rules, including provisions establishing:

- A new "Roth catch-up mandate," which provides that 401(k), 403(b), and governmental 457(b) plan participants with wages over $145,000 (adjusted for inflation) in the prior year may make age-based catch-up contributions only on a *Roth* (after-tax) basis and not on a pre-tax basis. This provision was originally supposed to go into effect beginning in 2024, but the IRS extended the effective date to 2026.
- A new "enhanced catch-up," which provides that employees age 60-63 can make additional catch-up contributions to their 401(k), 403(b), governmental 457(b), SARSEP, SIMPLE IRA, and SIMPLE 401(k) plans.
- A new rule increasing the contribution limits for SIMPLE IRA and SIMPLE 401(k) plans sponsored by an employer with 25 or fewer employees to 110% of the limits that would otherwise apply for such plans in 2024 (adjusted for inflation).

Proposed Regulations Clarify Key Aspects of the Roth Catch-up Rules

In January, the IRS published proposed regulations addressing the SECURE 2.0 provisions described above. The IRS proposes that the effective date of these regulations would be for years beginning six months after the publication of the future final rules.

Highlights of the proposed regulations include:

- ***Roth mandate based only on FICA wages.*** The proposed regulations provide that the $145,000 wage threshold for the Roth catch-up mandate is based on FICA wages, and self-employed individuals and employees (such as certain state and local government employees) whose compensation is not considered wages for FICA purposes will not be subject to the mandate. This is consistent with preliminary guidance that the IRS provided on the Roth catch-up mandate in 2023.

- *Correcting errors in applying the mandate.* The proposed regulations include two methods for plans to correct errors when administering the Roth catch-up mandate, i.e., when a plan allows a participant who is subject to the mandate to contribute to the plan on a pre-tax basis rather than a Roth basis. The employer can either: (1) recharacterize the Roth contribution and report it on the employee's Form W-2; or (2) correct the error via an in-plan Roth conversion, which is reported on the Form 1099-R.

- *Plans are not required to offer Roth contributions.* The proposed regulations would allow an employer to avoid the Roth catch-up mandate by not offering Roth contributions in its plan at all.

- *Plans are not required to offer enhanced catch-up contributions.* The proposed regulations would confirm that a plan that allows catch-up contributions for employees age 50 or older is *not* required to offer enhanced catch-up contributions for employees age 60-63.

- *SIMPLE plans.* The proposed regulations incorporate the increased catch-up limit of $3,850 (adjusted for inflation) that applies under a SIMPLE IRA or SIMPLE 401(k) plan pursuant to SECURE 2.0.

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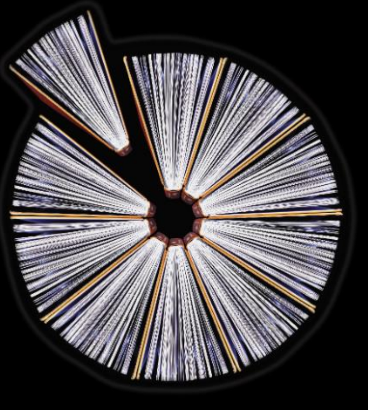

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