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HOT TOPICS IN EMPLOYEE BENEFITS

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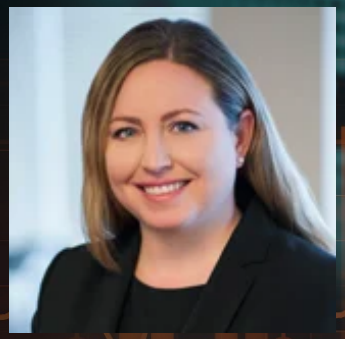

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Department of Labor Update: ESG Rule

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ESG: Not Just Environmental

Environmental

- Greenhouse gas emissions
- Climate change
- Energy use
- Water use
- Pollution
- Hazardous waste
- Recycling
- Sustainability
- Deforestation

Social

- Corporate giving and philanthropy
- Working conditions / supply chain
- Workplace health and safety
- Compensation and benefits
- Internal pay equity
- Employee opportunity
- Labor and human rights
- Child and forced labor
- Diversity and inclusion
- Supplier practices

Governance

- Board structure and composition (including tenure and diversity)
- Executive compensation
- Corruption
- Shareholder rights
- Enterprise risk management
- Audit oversight
- Disclosure and reporting
- Ethics and compliance
- Privacy and cybersecurity

Engagement with ESG

Plan Sponsor

- ESG funds as designated investment options (and potential engagement with plan participants) or component of DB plan
- ESG explicitly addressed in investment policy statement, such as screens or allocation to specific ESG mandates
- Use of advisers to support ESG consideration
- ESG in brokerage windows

Asset Managers and Advisors

- ESG in investment manager/investment fund guidelines
- Monitoring of manager/fund use of ESG factors
- Delegation of proxy voting and other shareholder rights to investment managers
- Direct engagement of proxy voting advisory firms
- Engagement by managers of proxy voting advisory firms

Corporate ESG Considerations

- Corporate ESG positions and commitments
- Potential use of "tie-breaker" provision to allow for consideration of corporate ESG positions in plan investments
- Proxy battles over ESG offerings in retirement plans
- Consideration of anti-ESG movement risks

ERISA Issues Presented by ESG Factors

- The use of ESG factors in investment **decision-making can implicate ERISA's fiduciary duties**.
  - The Duty of Loyalty: The duty to act for the exclusive purpose of providing benefits to participants and defraying reasonable expenses of administering the plan.
  - The Duty of Prudence: The duty to act with the care, skill, prudence, and diligence under the circumstances then prevailing.
- Consistent DOL view: A fiduciary **may not subordinate the interests of the participants** in their retirement income to other objectives.
- The key difference is the extent to which the DOL believes that ESG factors are:
  - **Part of the economic consideration** of an investment or
  - **Collateral** and instead reflect public policy or political objectives.

Overview of the Final Rule

- The Final Rule confirms that ESG considerations may be considered among the many factors that fiduciaries consider in making investment decisions.
  - **They need not be treated <u>differently</u> from other factors.**
- Rather than focusing on ESG factors specifically, the Final Rule instead sets forth a **principles-based approach** to the fiduciary investment decisionmaking process overall.
- Notably, and contrary to some public statements that have been made, the Final Rule **does *not* require** ERISA fiduciaries to consider ESG factors.
- The DOL emphasizes that the rule is not new, underscoring its attempt to build a **durable "middle-ground"** rule and help alleviate the "chilling effect" caused by uncertainty.

Final Rule Key Takeaways

- Provides more neutral, middle-of-the-road approach to ESG, clarifying that taking into account ESG factors is permissible but not prescribed. Also, no special QDIA rule.
- Allows fiduciaries of participant-directed plans selecting plan investment options to consider participant preference in certain circumstances.
- Reframes the "tie-breaker" test to allow the consideration of collateral benefits in more circumstances.
- Reaffirms the fiduciary duty to vote proxies and exercise shareholder rights.

Overview of the Final Rule (cont.)

Prudence Safe Harbor An investment decision is prudent if the fiduciary has given "**appropriate consideration**" to facts and circumstances **relevant** to the investment and acted accordingly

This requires investment decision making to be relevant to:

- **A risk-return analysis**
  - Which considers *investment horizons*, plan *investment objectives*, and *plan funding policy*, and provides risk of loss and opportunity for gain similar to alternatives in asset class
  - **Risk return factors may include "the economic effects of climate change and other environmental, social or governance factors."**
- The **purposes of the plan**
- (For a DB plan): **Portfolio diversification**, **liquidity,** and cash flow and plan **funding objectives**

Duty of Loyalty

- Cannot subordinate the interests in retirement income or financial benefits under the plan to other objectives
- May not sacrifice investment return or take on additional risk to promote benefits or goals unrelated to retirement income or financial benefits under the plan

Collateral Benefit and **Participant Preference Exceptions** So long as fiduciary duties otherwise met:

- Not prohibited from selecting (between two investments) based on collateral benefits
- In a DC plan, can consider participant preference

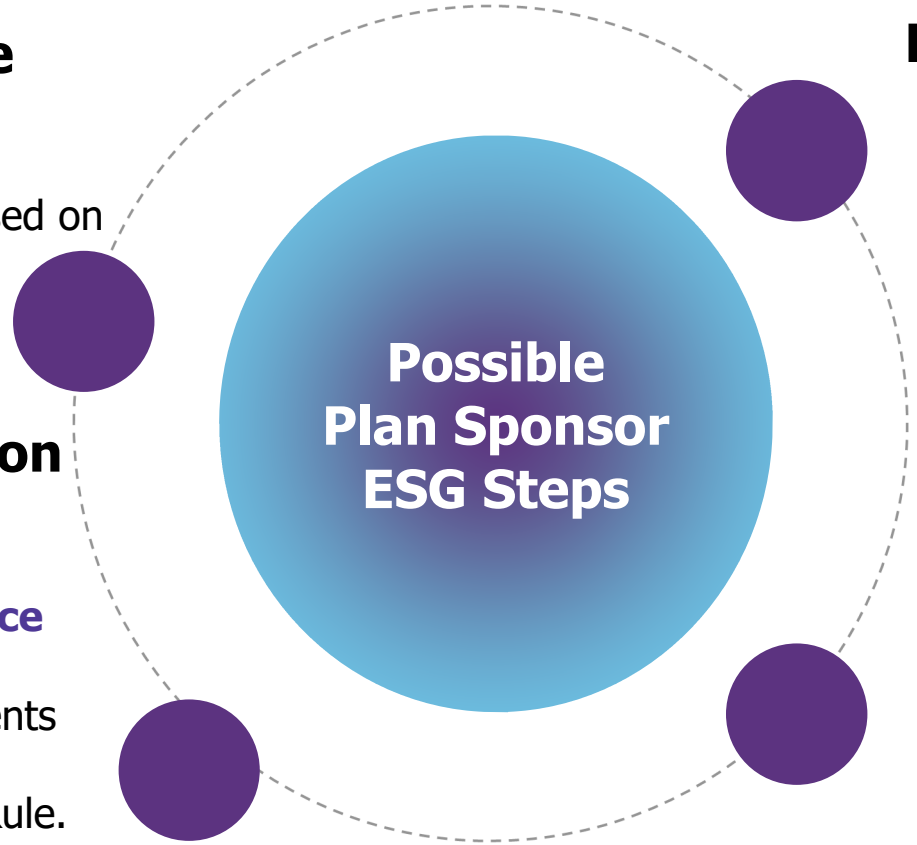
Proxy Voting The fiduciary duties include the management of shareholders rights appurtenant to shares

ESG Due Diligence

For ESG usage (direct and indirect) **develop due diligence processes** based on Final Rule.

ESG Documentation

For ESG usage (direct and indirect) draft appropriate **developing due diligence documentation** (e.g., investment policy statements and committee meeting minutes) based on Final Rule.



ESG External Interest

As needed, address external ESG interest, such as **pro-ESG inquiries** (company ESG commitments, participant ESG requests, proxy voting battles) and anticipate **anti-ESG** initiatives in line with Final Rule.

Other ESG Benefits Issues

Consider other ESG benefit issues such as **compensation and benefits** tied to ESG goals and benefit **"equity audits"** in line with Final Rule.

The Final Rule: Open Questions

Will the Final Rule provide fiduciaries with the comfort they are looking for to incorporate ESG—whether it be as part of investment guidelines or the selection of an ESG fund?

Will fiduciaries take participant preference into account?

How will the current political environment affect the Final Rule?

How much weight will courts give to a fiduciary's consideration of participant preference when the investment is challenged as imprudent?

PBGC Update

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PBGC's Proposed Withdrawal Liability Rule

- September 26, 1980 – The Multiemployer Pension Plan Amendments Act of 1980 is enacted, amending Title IV of ERISA and adding Section 4213 of ERISA
- 2017 – Initial litigation regarding withdrawal liability interest rate
- October 14, 2022 – PBGC publishes proposed rule under 29 C.F.R. Part 4213
- November 14, 2022 – Original close of public comment period
- December 13, 2022 – Extended close of public comment period
- TBD 2023 – Final Rule expected

Withdrawal Liability

- An employer that ceases to contribute to a multiemployer pension plan must pay a proportionate share of the plan's unfunded vested benefits (UVBs) at the end of the plan year before the employer's withdrawal from the plan.
- To calculate the withdrawal liability that an employer owes, the plan actuary determines the present value of all the plan's nonforfeitable benefits using actuarial assumptions and methods.
- One actuarial assumption, the interest rate, is particularly important.

Section 4213(a) of ERISA

(a) USE BY PLAN ACTUARY IN DETERMINING UNFUNDED VESTED BENEFITS OF A PLAN FOR COMPUTING WITHDRAWAL LIABILITY OF EMPLOYER

The corporation may prescribe by regulation actuarial assumptions which may be used by a plan actuary in determining the unfunded vested benefits of a plan for purposes of determining an employer's withdrawal liability under this part. Withdrawal liability under this part shall be determined by each plan on the basis of—

(1) actuarial assumptions and methods which, in the aggregate, are reasonable (taking into account the experience of the plan and reasonable expectations) and which, in combination, offer the actuary's best estimate of anticipated experience under the plan, or

(2) actuarial assumptions and methods set forth in the corporation's regulations for purposes of determining an employer's withdrawal liability.

Past Approaches vs. Proposed Rule

- Plan actuaries have used different interest rate assumptions to calculate withdrawal liability:
  - Minimum funding rate under section 431(b)(6) of the IRC and section 304(b)(6) of ERISA
  - PBGC plan termination rate under section 4044 of ERISA
  - Blended rate

29 C.F.R. Part 4213

- The proposed rule permits a plan actuary to use any of the three approaches to choosing an interest rate for purposes of calculating withdrawal liability under section 4213(a)(2).
  - At the upward bound – the rate used for minimum funding purposes
  - At the lower bound – the rate published by PBGC for terminating pension plans under section 4044 of ERISA
- A plan actuary may still choose an interest rate assumption under section 4213(a)(1) so long as it satisfies the statutory criteria.

Impact

- According to PBGC calculations, the proposed rule will increase withdrawal liability obligations of employers by about $804 million to $2.981 billion over 20 years.
- PBGC estimates that the proposed rule will result in an annual savings of $500,000 to $1 million, split evenly between plans and employers.
- The changes in the proposed rule would apply to the determination of withdrawal liability for employer withdrawals from multiemployer plans that occur **on or after the effective date of the final rule**.

Status of the SECURE 2.0 Act, Expanded Determination Program for 403(b) Plans, and IRS Pre-audit Corrrection Program

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Retirement Plan Sponsor

- Status of SECURE Act 2.0
- Triumvirate of agency program updates:
  - Expansion of Internal Revenue Service (IRS) determination letter program to include individually designed 403(b) plans
  - Announcement of IRS pre-examination compliance program
  - Proposed expansion of DOL fiduciary correction program to include a self-correction feature for delinquent participant contributions

Status of SECURE Act 2.0

- First, the background; the Setting Every Community Up for Retirement Act of 2019 (SECURE Act 1.0):
  - Wide-ranging provisions intended to expand retirement plan coverage and participation
  - Loosening and expansion of "multiple employer plan" rules and requirements to make it easier to establish and administer pooled plan arrangements
  - Rules requiring expanded 401(k) plan participation for long-service part-time employees
  - New lifetime income rules and features for defined contribution plans (lifetime income disclosures, lifetime annuity income features, and lifetime income portability)
  - Changes to distribution features (age 72 required beginning date, expanded in-service pension distributions, post-death required minimum distribution rules, etc.)
  - Number of other simplifying provisions and features

Status of SECURE Act 2.0 (cont.)

- SECURE Act 2.0 is shorthand for a number of competing proposals that build off of certain features of SECURE Act 1.0:
  - Securing Strong Retirement Act of 2022 (passed by full House in early 2022)
  - Enhancing American Retirement Now (EARN) Act (approved by Senate finance committee in June 2022)
  - Retirement Improvement and Savings Enhancement to Supplement Healthy Investments for the Nest Egg (RISE & SHINE) Act (approved by the Senate health, education, labor and pensions committee in June 2022)
- Some commonality of provisions between the competing legislative proposals, but also many differences

Status of SECURE Act 2.0 (cont.)

- Key features and provisions of SECURE Act 2.0:
  - Student loan matching contribution for qualified student loan payments
  - Increase in "catch-up contribution limit" for older employees (age 60 and up)
  - Further increase in the required beginning date from age 72 to age 75
  - Further expansion of 401(k) plan participation rules for long-service part-time employees
  - Automatic enrollment/re-enrollment provisions
  - Retirement savings lost and found programs
  - And a lot more!
- Broad bipartisan support for SECURE Act 2.0 generally, but varying degrees of support for each of the three bills and specific provisions
- Possibility of action by lame-duck Congress by year-end, but no guarantees

Determination Letter Program for 403(b) Plans

- IRS recently announced the expansion of the determination letter program to include individually designed 403(b) plans
- First opportunity for individually designed 403(b) plans to obtain:
  - An initial determination letter
  - A determination letter upon a plan's termination
- Determination letter for an initial determination is available on a staggered basis depending on the plan sponsor's employer identification number (EIN):
  - Last digit of EIN is 1, 2, or 3 – June 1, 2023
  - Last digit of EIN is 4, 5, 6, or 7 – June 1, 2024
  - Last digit of EIN is 8, 9, or 10 – June 1, 2025

Determination Letter Program for 403(b) Plans (cont.)

- An expanded determination letter program is generally good news for individually designed 403(b) plans, but some considerations include:
  - Favorable determination letter provides helpful assurances that the form of the plan document satisfies the requirements of Section 403(b)
  - Longstanding 403(b) plans may have outdated or nonconforming plan provisions
  - The scope and details of the determination letter process and the requirements regarding the submission of historical plan documents is not yet clear
- Individually designed 403(b) plan sponsors should work with experienced legal counsel to review plans in preparation for any submission

IRS Pre-examination Compliance Program

- In June 2022, the IRS announced a pre-examination retirement plan compliance program (the Pre-Exam Program)
- Under the Pre-Exam Program, the IRS will:
  - Provide notice to a plan sponsor before starting a plan audit
  - Provide the plan sponsor with a 90-day window to conduct a self-audit
  - Provide the plan sponsor with an opportunity to self-correct certain errors identified in the self-audit
  - Provide the plan sponsor with an opportunity to correct other identified errors (that are not eligible for self-correction) on favorable terms through a closing letter with the IRS
  - Request documentation from the plan sponsor regarding all identified errors and completed or proposed corrections

IRS Pre-examination Compliance Program (cont.)

- Depending on the IRS's evaluation of the plan sponsor's documentation, the IRS may either:
  - Issue a closing letter and take no further action; or
  - Conduct a limited or full scope audit
- **IMPORTANT**: If a plan sponsor fails to respond to the IRS during the 90-day self-audit period, the IRS will commence the audit and the plan sponsor will lose the ability to identify and correct errors through the Pre-Exam Program
- Key considerations for the Pre-Exam Program:
  - Provides a potentially valuable opportunity to avoid a full-scale plan audit
  - Provides a potentially valuable opportunity to identify/correct errors on favorable terms
  - Still very new and some uncertainty as to how the IRS will apply and administer it

Proposed Update to DOL Correction Program

- The DOL sponsors the "Voluntary Fiduciary Correction Program" (VFCP), which permits employers to voluntarily correct certain fiduciary breaches and prohibited transactions
- The most common type of prohibited transaction involves "delinquent" participant contributions to a 401(k) plan (i.e., a plan sponsor is slow to transmit amounts deducted from an employee's pay to a 401(k) plan)
- Under the proposed update to the VFCP:
  - Plan sponsors can self-correct certain smaller errors involving delinquent participant contributions (currently, under the VFCP, all corrections require a filing with the DOL)
  - The DOL clarifies and expands the types of transactions that are available for correction
  - The DOL simplifies administrative and procedural requirements for corrections

Proposed Update to DOL Correction Program (cont.)

- Self-correction of delinquent participant contributions is available for situations in which:
  - The delinquent contributions are remitted within 180 days from the date of withholding
  - The lost earnings on the delinquent contribution is less than $1,000
  - The plan sponsor notifies the DOL of the self-correction and satisfies certain procedural requirements (e.g., to prepare and retain documentation of the error and correction)
- The proposed expansion is welcome, but may only be modestly helpful to plan sponsors given the narrow constraints of the self-correction feature and the procedural requirements
- The proposed expansion of the VFCP will become final after a notice and comment period

Equity Compensation in a Volatile Stock Market

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Equity Compensation Challenges in a Volatile Market

1. Managing Equity Plan Share Reserve
2. Inducement Grants
3. Retention Grants
4. Strategies for Underwater Options
5. New SEC Rules Affecting Public Companies

Managing Equity Plan Share Reserve

- Significant drop in stock price can lead to dwindling share reserve
  - Volatile stock market can lead to discrepancies in number of shares covered by awards that are meant to deliver similar value
  - Shareholder approval is required to increase share reserve
- Strategies for managing equity plan share reserve
  - RSUs instead of stock options (except for plans with fungible share counting)
  - Determine the number of shares subject to equity grants based on a trailing average stock price that includes a prior trading period when prices were higher
  - Increase cash compensation or use awards payable in cash
  - Grant options with 5- to 7-year terms to reduce future overhang
  - Grant equity awards outside the shareholder-approved equity compensation plan as "inducement grants" for newly hired employees

Inducement Grants

- NYSE/NASDAQ listing rules generally require shareholder approval of equity plans
  - NYSE/NASDAQ rules permit equity awards to be granted to newly hired employees as an inducement to employment without shareholder approval if certain requirements are met
- Inducement grants help reduce depletion of equity plan share reserves
  - Not "free" shares and will be taken into account by ISS and Glass Lewis as outstanding equity grants when an equity plan is next submitted to shareholders for approval
- For more information: Inducement Grants Enable Companies to Avoid Depletion of Equity Plan Share Reserves – Publications | Morgan Lewis

Retention Grants

- Retention grants have become popular as one-time enhanced or supplemental grants to support retention
- Companies may want to use retention grants to indirectly replace unearned performance-based compensation
- Retention grants raise significant shareholder/ISS/Glass Lewis scrutiny
  - Off-cycle retention arrangements are generally viewed negatively
  - Performance-based retention awards are viewed more favorably than time-based retention awards
- Consider whether an 8-K Form should be issued at time of retention grant
- Prepare for shareholder scrutiny through advance shareholder outreach

Strategies for Underwater Options

- The biggest hurdle for any type of option repricing or exchange is usually the need for shareholder approval
- Alternatives for underwater options:
  - Option Repricing
  - Option Exchange
  - Option Buyout
- NYSE/NASDAQ rules
  - Require shareholder approval of option repricing/exchange programs unless the equity plan specifically permits option repricing without shareholder approval
  - Do not require shareholder approval of cash buyouts of underwater options
- Public companies seeking shareholder approval of option repricing programs must comply with the proxy solicitation requirements, including the disclosure requirements of Item 10 of Schedule 14A

Strategies for Underwater Options (cont.)

- ISS/Glass Lewis considerations
  - Recommend a vote against an equity plan that permits option repricing without a shareholder vote
  - Recommend a vote against members of the compensation committee if options are repriced without shareholder approval, even if such repricing is allowed under the plan
  - Option repricing proposals reviewed on a case-by-case basis
- Design considerations
  - Who is eligible? Which options are eligible?
  - Tender offer implications
- Disclosure considerations
- Taxation
  - Does the repricing/exchange cause a taxable event?

New SEC Rules Affecting Public Companies

- Pay Versus Performance Rules
  - Should be addressing now!
    - For more information: SEC Finalizes Pay Versus Performance Disclosure Rules

- Clawback Rules
  - Expect to address in early 2023!
    - For more information: SEC Adopts Compensation Clawback Requirements – Publications | Morgan Lewis

Transparency in Coverage Final Rules and COVID-19 National Emergency Relief

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Transparency in Coverage: Final Rule

- Establishes two requirements for the disclosure of cost-sharing and pricing information:
  - Public disclosure requirements via machine-readable files
  - **Required disclosures to participants and beneficiaries via an internet self-service tool**
- Applicability
  - Applies to non-grandfathered health plans
  - Does NOT apply to grandfathered plans, HRAs, health FSAs, excepted benefits, and short-term, limited-duration insurance
  - Operates in tandem with (and does not supersede or alter plan's and issuer's responsibilities under) existing federal and state laws governing data privacy, security, and accessibility (e.g., HIPAA/HITECH)

Required Cost-Sharing Disclosures to Participants

- Group health plans and health insurance issuers must provide participant-specific cost-sharing information upon the request of participants, beneficiaries, or enrollees of a group health plan/insurance coverage (collectively, participants)
- This disclosure will take the form of an **online self-service tool** that allows participants to search for certain cost-sharing information
  - Information must be accurate at the time the request is made
  - Provided free of charge without a subscription
  - "Plain language" requirement
  - Paper copies provided upon request (or disclosed over the phone or via email)
  - Seven content elements

Cost-Sharing Disclosure Contents

1. Estimated Cost-Sharing Liability
   - Includes deductibles, coinsurance, and copayments
   - Does not include premiums, balance billing amounts charged by out-of-network providers, or costs of non-covered items and services
2. Accumulated Amounts
   - The amount of financial responsibility incurred by a participant at the time of request with respect to the applicable deductible or out-of-pocket limit
   - includes how many visits/items/days the participant has used within a cumulative treatment limitation, regardless of any obligation to determine medical necessity for future visits

Cost-Sharing Disclosure Contents (cont.)

3. In-Network Rates
   - Composed of negotiated rate and any underlying fee schedule rate
     - Negotiated rate must always be disclosed with cost-sharing liability estimates, even if such rate is not used to determine the reported cost-sharing liability
     - The underlying fee schedule used to determine the cost-sharing liability should also be disclosed (if different from the negotiated rate)
   - Must be expressed as a dollar amount
4. Out-of-Network Allowed Amount
   - The maximum amount a group health plan or health insurance issuer will pay for a covered item or service furnished by an out-of-network provider
   - Alternatively, can disclose any other calculation that provides a more accurate estimate of the amount that the plan pays (e.g., UCR charge)

Cost-Sharing Disclosure Contents (cont.)

5. Items and Services List (for bundled payment arrangements only)
   - "Bundled payment arrangement" is defined as a payment model under which a provider receives a single payment for all covered items and services provided to a participant or beneficiary for a specific treatment or procedure
6. Notice of Prerequisites of Coverage (if applicable)
   - Includes concurrent review, prior authorization, and step-therapy or fail-first protocols related to covered items and services that must be satisfied before a group health plan or health insurance issuer will cover the item or service
   - Does not include medical necessity determinations generally or other forms of medical management technique

Cost-Sharing Disclosure Contents (cont.)

7. Disclosure Notice
   - Plain language requirement
   - Must include:
     - A statement that out-of-network providers may engage in balance billing and that the estimated cost-sharing liability may not capture such additional charge (Note: provide this statement only if balance billing is permitted under state law);
     - A statement that actual charges may be different from the estimated cost-sharing liability;
     - A statement that the estimated cost-sharing liability is not a guarantee that coverage will be provided for the requested item/service;
     - A statement disclosing whether the plan counts copayment assistance or any third-party payments when calculating the participant's deductible and out-of-pocket maximum;
     - A statement that certain in-network items/services may not be subject to cost-sharing if billed as a preventive service; and
     - A statement including any other disclaimers or information that the plan/insurer deems appropriate.

Implementation Timeline

- Two phases:
  - With respect to the 500 items and services specified by the Departments, the information must be available for plan years beginning on or after January 1, 2023
  - For all other items/services covered under the plan, for plan years beginning on or after January 1, 2024

COVID-19 National Emergency: EBSA Disaster Relief

- The US Department of Labor's Employee Benefits Security Administration and the Internal Revenue Service (IRS) issued the following guidance suspending certain ERISA deadlines for employee benefits plans, participants, and beneficiaries affected by the COVID-19 outbreak:
  - EBSA Disaster Relief Notice 2020-01
  - Joint Final Rule
  - EBSA Disaster Relief Notice 2021-01
  - IRS Notice 2021-58
- Collectively, the guidance provides that certain deadlines under ERISA that occur on or after March 1, 2020 generally extend for one year. However, the extension may be less than one year if the government declares an end to the COVID-19 National Emergency, in which case the extension will end on the 60th day following the end of the National Emergency.
- **The end of the National Emergency has not been announced as of the date of this webinar! This means the COVID-19 extension is still in effect.**

COVID-19 National Emergency: EBSA Disaster Relief (cont.)

- As a reminder, the COVID-19 extension applies to certain deadlines related to the following events:
  - HIPAA Special Enrollment
  - Claims, Appeals, and External Review
  - COBRA Coverage Continuation*
    - the date by which the Plan must be notified of the occurrence of certain qualifying events and a disability;
    - the date by which eligible individuals must elect COBRA coverage; and
    - the date by which the COBRA premium must be paid.

  ** The extension period for electing COBRA and the extension period for making initial and subsequent COBRA premium payments generally run concurrently.*

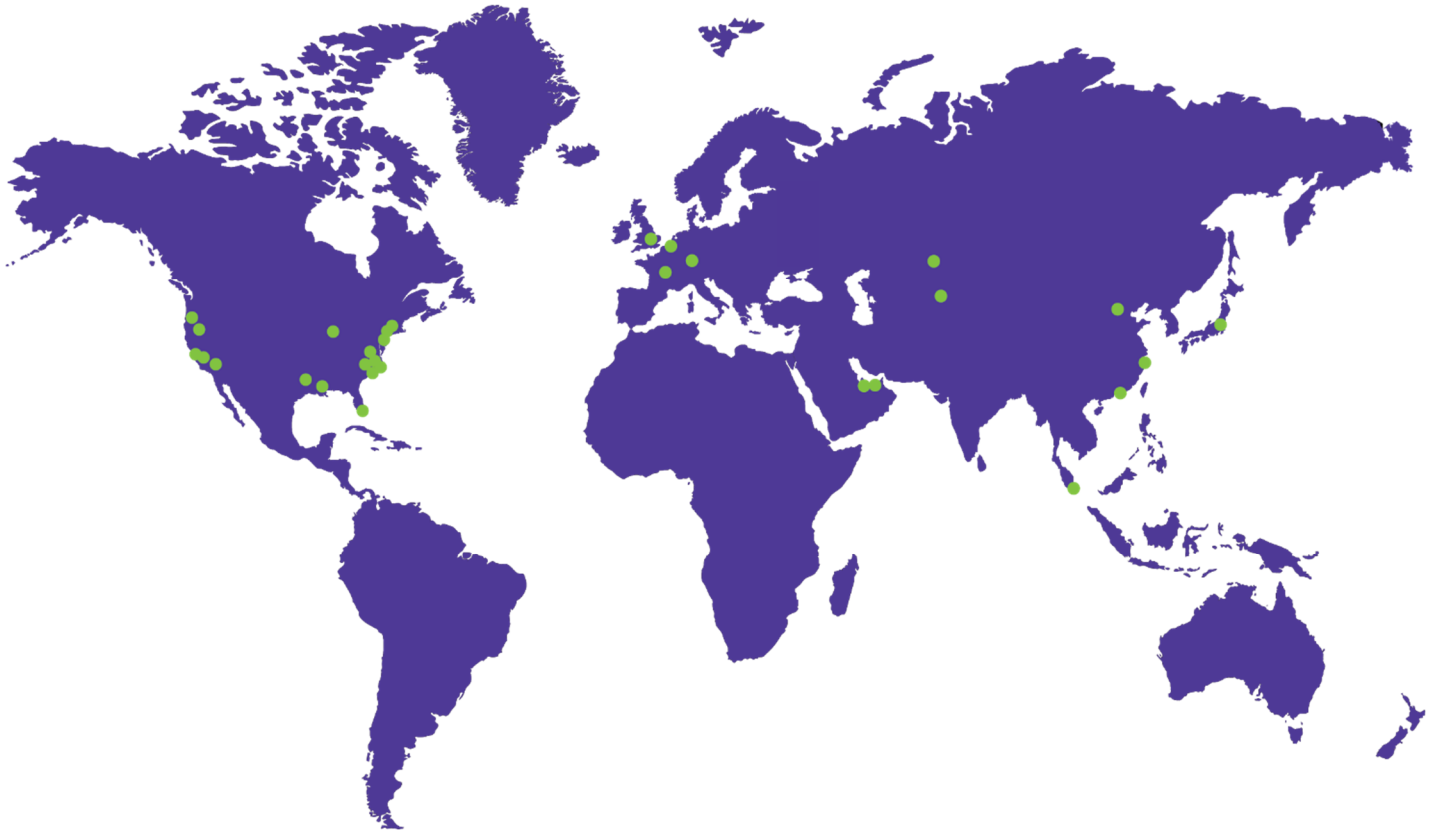
Questions?

Our Global Reach

Africa
Asia Pacific
Europe
Latin America
Middle East
North America

Our Locations

Abu Dhabi
Almaty
Beijing*
Boston
Brussels
Century City
Chicago
Dallas
Dubai
Frankfurt
Hartford
Hong Kong*
Houston
London
Los Angeles
Miami
New York
Nur-Sultan
Orange County
Paris
Philadelphia
Pittsburgh
Princeton
San Francisco
Shanghai*
Silicon Valley
Singapore*
Tokyo
Washington, DC
Wilmington



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THANK YOU