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HOT TOPICS IN EMPLOYEE BENEFITS

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April 12, 2023

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Agenda

- Health and Welfare Plan Update
- SECURE Act 2.0
- IRS Proposed Regulations on Forfeitures
- ERISA Litigation Update
- Developments in Requirements Related to Compensation Clawbacks
- PBGC Special Financial Assistance Program Update

Health and Welfare Plan Update

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Periods of Emergency Related to COVID-19

- Two separate emergency declarations:
  - US Department of Health and Human Services (HHS) Public Health Emergency
  - Presidential Declaration of National Emergency

COVID-19 Group Health Plan Requirements

- **HHS Public Health Emergency**
  - COVID-19 Vaccines (including booster shots)
    - Covered without cost-sharing, prior authorization, or other medical management requirements
  - COVID-19 Testing and Related Services
    - Covered diagnostic testing and related services (including over-the-counter tests) without cost-sharing
  - Mental Health Parity
    - Group health plans were able to disregard benefits for COVID-19 diagnostic testing and related services for purposes of MHPAEA

Presidential Declaration of National Emergency

- The US Department of Labor's Employee Benefits Security Administration (DOL's EBSA) 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.

Presidential Declaration of National Emergency (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.

Presidential Declaration of National Emergency (cont.)

- There is also some plan sponsor relief:
  - Extension of timeframes for disclosures of documents required under Title I of ERISA
    - Note electronic disclosure
  - Suspended timeframes for a plan sponsor to provide a COBRA election notice to qualified beneficiaries

Intended End of Emergency Declarations

- Earlier this year the Biden Administration announced the intended end of both the HHS public health emergency and the Presidential declaration of national emergency to be May 11, 2023.
- At the end of March, HHS, DOL, and the US Department of the Treasury issued frequently asked questions to provide guidance to plan sponsors in unwinding the emergency declaration.
- On the same day, the Senate passed a bill to end the national emergency that may go into effect when signed by the President.
- What does this all mean?

HHS Public Health Emergency - What does this all mean?

- COVID-19 diagnostic testing or related services
  - Group health plans no longer have to cover COVID-19 diagnostic testing or related services at no cost-sharing
  - Guidance strongly encourages continued coverage at no cost-sharing
  - HDHP/HSA plans can continue to cover at no cost-sharing without jeopardizing high-deductible status of health plan (until further guidance is issued)
  - Note that a diagnostic test or related service is considered furnished on the date the test is performed or was purchased (not the date the claim comes in the door)

HHS Public Health Emergency - What does this all mean? (cont.)

- COVID-19 Vaccines
  - The HHS public health emergency declaration required vaccines and boosters be covered at no cost-sharing whether in network or out of network.
  - Plans must continue to cover in-network vaccines at no cost-sharing under the preventive care requirements.
  - Out-of-network vaccines no longer have to be covered at no cost-sharing unless the plan doesn’t have a network provider that administers the vaccine (in line with general preventive care rules).
- Mental Health Parity
  - No guidance provided.
  - Plans should be prepared to comply.

Presidential National Emergency – What does this all mean?

- All suspended timeframes begin to count down.
- Assume May 11 is the end of the national emergency.
  - 60 days past that date is July 10, 2023.
  - All suspended timeframes count down effective July 10, 2023.
  - For example, if a participant experienced a COBRA-qualifying event and lost coverage on April 1 2023, the 60-day deadline for the qualified beneficiary to make a COBRA election counts down effective July 10, 2023 (or will have to be made on or before September 8, 2023).
  - What if President Biden ends national emergency sooner?

Next Steps

- ✓ Guidance doesn't require, but strongly encourages, notification.
- ✓ Any change impacting an SBC requires 60-day advance notification.
- ✓ For plan sponsors that updated SPDs to include coverage of testing, vaccines, or suspended timeframes will have to issue SMMs (or plan amendments for those legal plan documents that may have been amended).
- ✓ Decide on how testing and/or vaccines will be covered after the conclusion of the HHS public health emergency.
- ✓ Consider mental health parity.

SECURE Act 2.0

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SECURE Act 2.0

- The SECURE Act 2.0 of 2022 ("SECURE Act 2.0") was signed into law on December 29, 2022, building on the changes to retirement law made by the Setting Every Community Up for Retirement Enhancement Act of 2019 ("SECURE Act").
- SECURE Act 2.0 permits and in some cases requires changes to plan terms and administration.
- The provisions take effect at various times (in some cases retroactively).
- SECURE Act 2.0 also calls for the IRS and DOL to issue additional guidance on various topics.
- Plans generally need not be formally amended until the last day of the first plan year that begins on or after January 1, 2025 (or January 1, 2027 for collectively bargained plans), provided the plan operates in accordance with the applicable requirements of SECURE Act 2.0 when they become effective.

Retirement Distributions – Self-Certification for Hardship Distributions

- Description: Except when the plan administrator "has actual knowledge to the contrary," a plan administrator may rely on an employee's written certification that:
  - a hardship distribution is for an immediate and heavy financial need;
  - a hardship distribution does not exceed the amount required to satisfy the financial need; and
  - the employee has no alternative means reasonably available to satisfy the need.
- Applicability/Effective Date:
  - Optional for 401(k), 403(b), and eligible 457(b) plans for plan years beginning after December 29, 2022.
- Observations:
  - Treasury can provide regulations addressing the exception based on plan administrator knowledge.

Retirement Distributions – Increased RMD Age

- Description: Required minimum distribution age increased:
  - From age 72 to age 73 for distributions beginning January 1, 2023
    - Applies to participants who turn 72 after December 31, 2022 and age 73 before January 1, 2023
  - From age 73 to age 75 beginning January 1, 2033
    - Applies to participants who turn 74 after December 31, 2032
- Applicability/Effective Date: Optional/mandatory for all retirement plans and traditional IRAs for employees who reach age 72 after December 31, 2022
- Observations:
  - Mandatory for determining eligible rollover distribution and excise taxes
  - Technical correction will be required for a participant who is born in 1959 (will turn 73 before January 1, 2033 and 74 after December 31, 2022)

Retirement Distributions – Pre-Death RMDs for Roth Amounts and Removal of Lifetime Income Barriers

- Description Pre-Death RMD: Pre-death required minimum distributions are not required for Roth amounts held in an employer retirement plan.
  - Applicability/Effective Date: Effective for tax years beginning after December 31, 2023
- Description Lifetime Income: Modifies the required minimum distribution rules to eliminate perceived barriers to the availability of certain common lifetime annuity features (e.g., period certain guarantees, guaranteed annual increases of modest amount, etc.) for commercial annuities that are issued in connection with any eligible retirement plan.
  - Applicability/Effective Date: Effective for calendar years ending after December 29, 2022

Retirement Distributions – Cash Out Limit Increase

- Description: The maximum amount that can be automatically cashed out is increased from $5,000 to $7,000
  - Amounts more than $1,000 but not exceeding $7,000 must be rolled over to an IRA unless the participant elects otherwise
- Applicability/Effective Date: Optional for all retirement plans for distributions after December 31, 2023
- Observation:
  - Can help manage lost/missing participants and recordkeeping costs

Retirement Distributions – Federally Declared Disaster Distributions

- Description: Establishes permanent rule permitting "qualified disaster recover distributions" of up to $22,000 (combined from all plans)
  - May be taken into income over three years
  - Can be repaid to the plan within three years
  - Not subject to 10% early distribution penalty
  - Limited to federally declared disaster areas (participant's principal place of abode determination)
  - Maximum loan limit also increased to $100,000 or 100% of the vested balance (if less)
- Applicability/Effective Date: Optional for all retirement plans for disasters occurring on or after January 26, 2021
- Observations:
  - Distributions to purchase a home prior to the disaster can be repaid

Retirement Distributions – Emergency Savings Accounts

- Description: Sponsors of individual account plans (such as 401(k) or 403(b) plans) may create "emergency savings accounts" that permit non-highly compensated employees to make Roth after-tax contributions to a special savings account within the retirement plan.
  - Balances in an emergency savings account must be eligible for distribution at least once per month
  - Contributions cannot be made to an emergency savings account that would cause the balance to exceed $2,500 (adjusted for inflation after 2024), or a lesser amount established by the plan sponsor.
  - Contributions to the emergency savings account must be eligible for matching contributions at the same matching rate established under the plan for elective deferrals (but the matching contributions are not made to the emergency savings account).
- Applicability/Effective Date: Optional for individual account plans for plan years beginning after December 31, 2023
- Observations:
  - Distribution right different from self-certification of hardship and emergency personal expense withdrawals

Retirement Distributions – Emergency Personal Expense Withdrawals

- Description: Plans can permit one withdrawal per year of up to $1,000 for unforeseeable and immediate financial needs relating to necessary personal or family expenses
  - May rely on individual's written self-certification unless actual knowledge to the contrary
  - Not subject to 10% early distribution penalty
  - Can be repaid within three years
  - Additional distributions within the three years are dependent on repayment
- Applicability/Effective Date: Optional for all retirement plans for distributions after December 31, 2023
- Observations:
  - Distribution right different from self-certification of hardship and emergency savings account withdrawals

Retirement Distributions – Other Withdrawal Provisions

- Penalty-Free Withdrawal from Retirement Plans for Cases of Domestic Abuse
  - Lesser of $10,000 or 50%
  - Optional and effective for distributions after December 31, 2023
- Penalty-Free Distribution to Participant Who Is Terminally Ill
  - Requires certification from physician and allowed to be repaid (generally three years)
  - Optional and effective for distributions after December 29, 2022
- Clarification of Qualified Birth or Adoption Distribution (QBAD) Repayment:
  - Clarifies that repayment period following QBAD is three years
  - Optional and effective for distributions after December 29, 2022 (special rule for prior distributions)

IRS Proposed Regulations on Forfeitures

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Background

- IRS issued proposed regulations on February 27, 2023 that would require plan forfeitures (i.e., unvested benefits) to be used by the end of the year following the year of forfeiture
- The proposed regulations are effective for plan years beginning on or after January 1, 2024, but they may be relied on immediately
- Key focus is on defined contribution plans, but the regulations include some conforming changes for defined benefit plans
- Plan sponsors will have a generous transition period to use forfeitures incurred but not used before 2024 for these purposes
- IRS requested comments by May 30, 2023 on all aspects of the proposed regulations

Defined Contribution Plans

- Under previous informal IRS guidance issued in 2010, "[n]o forfeitures in a suspense account should remain unallocated beyond the end of the plan year in which they occurred."
- Under the proposed regulations, a plan must state that forfeitures of unvested benefits be used no later than 12 months after the close of the plan year in which the forfeitures were incurred.
- The new timeline is intended to "alleviate administrative burdens that may arise in using or allocating forfeitures if forfeitures are incurred late in a plan year."
- The IRS warned that failure to use plan forfeitures in accordance with the plan's terms would constitute an operational failure requiring correction under the IRS's Employee Plans Compliance Resolution System to maintain the plan's qualified status.

ERISA Litigation Update

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Overview of Topics

- Basics and General Lay of the Land
- Recent Waves of ERISA Fee/Expense Lawsuits
- *Hughes v. Northwestern University* (S. Ct. Jan. 24, 2022)
- Post-*Hughes* Decisions and Developments
- Putting the "Target" on Target-Date Funds

Basics and General Lay of the Land

- ERISA litigation can involve various claims and theories, but the heart of most fee/expense class actions is a plan fiduciary's duties of prudence and loyalty.
- ERISA § 404(a)(1):
  - Prudence: Fiduciary must act "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."
  - Loyalty: Fiduciary must act "solely in the interest of the participants" and for "the exclusive purpose of providing benefits to participants and their beneficiaries" and "defraying reasonable expenses of administering the plan."
- Historically, most fee/expense class actions assert several common challenges:
  - Excessive administrative/recordkeeping fees (including challenges to "revenue sharing").
  - Failure to move to lower-cost share classes of the same fund.
  - Failure to use lower-cost vehicles (e.g., CITs or separately managed accounts).
  - Failure to monitor and remove "underperforming" funds, especially actively managed funds.

Basics and General Lay of the Land (cont.)

- ERISA’s duty of prudence focuses on the process used to make plan-related decisions, not the ultimate outcome of those decisions.
- Prudence cannot be judged with hindsight. A fiduciary must act reasonably under the circumstances he or she confronts, which typically means evaluating relevant factors, weighing pros/cons, and making a reasoned decision.
- A motion to dismiss (MTD) is one key battleground in ERISA class actions. Few cases have reached trial—and even fewer have resulted in judgments for plaintiffs.
  - If a plaintiff can survive the MTD, it means full-scale litigation, including classwide discovery, ESI, depositions, etc.
  - This imposes disproportionate burdens on defendants and can create settlement leverage for plaintiffs, who know it will be expensive to get to the next “off-ramp” at MSJ or trial.
  - Defendants have had mixed success in obtaining dismissal of ERISA fiduciary-breach claims since this sort of litigation became common in 2006. While defendants had some early successes, plaintiffs have refined and evolved their theories and increasingly avoided dismissal.

Recent Waves of ERISA Fee/Expense Lawsuits

- As a result of these economic incentives, the steady stream of ERISA fee and expense lawsuits has turned into a deluge over the last 2-3 years.
  - More than 200 new cases have been filed since 2020 (with more than 100 in 2020 alone).
- New plaintiffs' firms have entered the mix, with a few firms filing most of the new suits.
- The challenges have moved "downstream," no longer targeting huge plans.
- The core claims are similar, but the theories of fiduciary breach have evolved as courts, plan sponsors, and the market react.
  - E.g., some complaints allege that a "reasonable" recordkeeping fee should have been as low as $15-$20 per participant. Such complaints may even concede that the plan at issue paid $40 to $50 per participant—but allege that this was still too high.
- The strategy appears to be a volume-based business model - file numerous complaints, hope that a decent percentage survive MTD, then settle for less than the costs of defending the lawsuit through summary judgment or trial.

Hughes v. Northwestern University (S. Ct. Jan. 24, 2022)

- Given the importance of an MTD, many hoped the Supreme Court would clarify the pleading standard for ERISA fiduciary-breach claims. It did not.
- Northwestern was one of 20+ universities sued under ERISA since 2016. The cases involved similar theories, claiming these plans paid "excessive" investment and recordkeeping fees and offered poor investment options, among other claims.
- The Seventh Circuit affirmed a full dismissal, but other circuits allowed some or all claims to proceed to discovery. *See Sweda v. Univ. of Pa.* (3d Cir.) (reversing dismissal and remanding all claims); *Davis v. Wash. Univ. in St. Louis* (8th Cir.) (affirming dismissal of several claims but remanding fee-based challenges).
- A strand of the Seventh Circuit's reasoning found that the claims were not plausible because Northwestern's plan offered numerous low-cost options, including index funds, that participants could select instead of the funds that plaintiffs challenged.

Hughes v. Northwestern University (S. Ct. Jan. 24, 2022) (cont.)

- On January 24, 2022, the Supreme Court issued a five-page, 8-0 ruling, reversing the Seventh Circuit's decision.
- The Court first reiterated that a fiduciary has an ongoing duty to monitor <u>each</u> investment option offered in a plan and to remove imprudent funds.
- The Court then framed the Seventh Circuit's holding as focused "exclusively" on "investor choice," insofar as it suggested that a fiduciary could avoid liability merely by offering numerous low-cost or *prudent* funds, even if others were *imprudent*. It held that this "categorical rule" is inconsistent with ERISA's "context-specific inquiry."
- However, the Court concluded by recognizing that:
  - "At times, the circumstances facing an ERISA fiduciary will implicate difficult tradeoffs, and courts must give due regard to the range of reasonable judgments a fiduciary may make based on her experience and expertise."
- The Court did not hold that the *Hughes* complaint stated a plausible claim. Rather, it remanded to the Seventh Circuit to consider that question, given the Court's ruling.

Post-*Hughes* Decisions and Developments

- Initially, *Hughes* buoyed the prospects of an ERISA complaint surviving an MTD. And it certainly did not slow or disincentivize the ongoing wave of new ERISA class actions.
  - E.g., the Ninth Circuit issued two rulings shortly after *Hughes*, reversing dismissal of similar claims *Davis v. Salesforce.com* (9th Cir. Apr. 8, 2022), and *Kong v. Trader Joe's Co.* (9th Cir. Apr. 15, 2022).
- Many courts are predisposed against dismissal at an early stage, particularly if they view the allegations as creating "fact disputes" warranting discovery.

Post-*Hughes* Decisions and Developments (cont.)

- But defendants are starting to find more success in the circuit courts in this recent wave.
  - *Sixth Circuit*: Recently issued two post-*Hughes* rulings, one affirming full dismissal, the other allowing a "share-class" claim to proceed but affirming dismissal of all other claims. *Smith v. CommonSpirit Health* (6th Cir. June 22, 2022); *Forman v. TriHealth* (6th Cir. July 13, 2022).
  - *Seventh Circuit*: Recently affirmed full dismissal of several ERISA theories, interpreting *Hughes* ruling narrowly and reiterating that a fiduciary has no duty to select the cheapest service provider or investment option. *Albert v. Oshkosh Corp.* (7th Cir. Aug. 29, 2022).
  - *Seventh Circuit*: But even more recently reinstated excessive recordkeeping fee and share class claims. *Hughes v. Northwestern* (7th Cir. Mar. 23, 2023)

Standing

- *Boley v. Universal Health Servs., Inc.* (3d Cir. 2022)
  - Plaintiffs have standing
    - Standing for recordkeeping, investment-selection, and failure-to-monitor claims because a common course of conduct affected all plan participants.
  - Courts have typically been finding standing
    - *Thole v. U.S. Bank N.A.*, 140 S. Ct. 1615 (2020) often limited to DB context
- *Driscoll v. Plexus Corp.* (E.D. Wis. Aug. 23, 2022)
  - No standing for recordkeeping fee allegation
    - Named plaintiffs paid less than what they allege is reasonable.
    - Outlier? Way to combat recordkeeping fee allegations that are factually wrong?

Motions to Dismiss: Share Classes

- *Albert v. Oshkosh Corp.* (7th Cir. Aug. 29, 2022)
  - "Inverse share class": a theory rejected?
    - Court rejected idea that a fiduciary must select higher revenue-sharing funds in order to receive rebates.
- *Hughes v. Northwestern* (7th Cir. Mar. 23, 2023)
  - Retail v. Institutional or any claim that a share class cost less?
    - Opinion can be read to suggest that the availability of a lower cost share class is not something that can be resolved on an MTD

Motions to Dismiss: Share Classes (cont.)

- *Forman v. TriHealth* (6th Cir. July 13, 2022)
  - Allegation that fiduciaries should select institutional share classes stated a claim
    - Noteworthy because Sixth Circuit otherwise dismissed investment performance and recordkeeping fee allegations in *TriHealth* and *CommonSpirit.*
  - Opportunity for quick win on summary judgment?
    - "An attentive district court judge ought to be able to keep discovery within reasonable bounds given that the inquiry is narrow and ought to be readily answerable."
- Ninth Circuit decisions (*SalesForce*, *Trader Joe's* also allowed share class claims to proceed)

Motions to Dismiss: Investment Fees

- Mixed bag: will courts scrutinize what is a meaningful benchmark?
  - *Rosenkranz v. Altru Health Sys.* (D.N.D. Dec. 10, 2021)
    - Dismissed investment fee allegations (but not share class allegations)
    - Active to passive comparison irrelevant
    - Looked at glide path of TDFs to determine if plaintiffs pled a meaningful benchmark
  - *Garnick v. Wake Forest Univ. Baptist Med. Ctr.* (M.D.N.C. Sept. 21, 2022)
    - Denied MTD on investment fee allegations
    - Allowed allegation that the "total plan costs" were excessive to proceed
    - Example of court considering analysis of plaintiff's "evidence" to be a question decided after discovery

Motions to Dismiss: Investment Performance

- Mixed results, but tide turning?
  - Appellate courts have dismissed investment fee and performance claims
- Dismissing investment performance claims:
  - *Smith v. CommonSpirit Health* (6th Cir. June 22, 2022)
    - Active to passive not a meaningful benchmark (following Eighth Circuit)
  - *Forman v. TriHealth* (6th Cir. July 13, 2022)
    - Underperformance must be long term, sustained
- Not dismissing investment performance claims:
  - *Garnick v. Wake Forest Univ. Baptist Med. Ctr.* (M.D.N.C. Sept. 21, 2022)
    - Example of court finding it inappropriate to assess reasonableness of benchmarks on an MTD

Motions to Dismiss: Recordkeeping Fees

- Dismissing excessive recordkeeping fee claims
  - *Albert v. Oshkosh Corp.* (7th Cir. Aug. 29, 2022)
    - Dismissed more robust recordkeeping claim: complaint contained chart with so-called comparator plans
  - *Hughes v. Northwestern* (7th Cir. Mar. 23, 2023)
    - Reinstated excessive recordkeeping fee claim that contained allegations of a failure to consolidate recordkeepers, examples of other plans that paid less
    - Alleged other recordkeepers are "equally capable" of providing same services
  - *Smith v. CommonSpirit Health* (6th Cir. June 22, 2022)
    - Opinion focused less on recordkeeping fees, but there was an allegation that the plan's fees, including recordkeeping fees, were too high
  - *Matousek v. MidAmerican Energy Co.* (8th Cir. Oct. 12, 2022)
    - Upheld dismissal of recordkeeping fee claim, needs a meaningful benchmark

Takeaways

- MTDs continue to be a viable strategy for trying to trim or eliminate claims early
- Without clear guidance from the Supreme Court, decisions are all over the place
- No signs yet that complaints are decreasing
- Share class and recordkeeping fee allegations are harder to dismiss
- Increasingly tough standard to bring investment performance claims
  - And these claims have greater liability
- Many plaintiffs' firms are just looking to survive an MTD, then settle

Putting the "Target" on Target-Date Funds

- TDFs are increasingly popular litigation targets in recent years. Plaintiffs may claim that they are too expensive, perform poorly, or both.
  - Not entirely surprising, as TDFs often are a plan's default investment option and hold substantial plan assets.
  - Plaintiffs have challenged TDFs from numerous large fund managers.
- TDFs can be more difficult to monitor, as there are more variables to consider.
  - Active vs. passive. Glide-path strategy. Overall performance. Differences in vintages across a TDF series. An appropriate benchmark? Asset allocations and classes. All this and more.
- In late July/early August 2022, a single plaintiffs' firm filed 11 new ERISA class actions challenging the BlackRock LifePath target-date series.
  - These claims truly push the boundaries of ERISA's fiduciary duties and what facts will state a plausible fiduciary breach under ERISA.
  - To date, claims have not survived an MTD.

Summary Judgment Decisions

- *Pizarro v. Home Depot* (N.D. Ga. Sept. 30, 2022)
  - Summary judgment for defendants
  - Genuine issues as to fiduciary process, but plaintiffs hadn't shown loss causation
- *Falberg v. Goldman Sachs* (S.D.N.Y. Sept. 14, 2022)
  - Summary judgment for defendants on claims that Goldman selected its own poorly performing proprietary investments for the plan
    - Lack of IPS not a barrier to summary judgment
- *Vellali v. Yale* (D. Conn. Oct. 21, 2022)
  - Summary judgment denied on recordkeeping fee, share class, and investment monitoring allegations
  - Summary judgment for defendants on prohibited transaction, monitoring claim

Developments in Requirements Related to Compensation Clawbacks

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Recent Developments in Compensation Clawbacks

US Securities & Exchange Commission (SEC) Final Rule 10D-1 (and Applicable Exchange Standards)

- New regulation implemented by SEC, directing stock market exchanges to establish listing standards requiring companies to implement "clawback" policies providing for the recovery of incentive-based compensation in the event of a required accounting restatement, and requiring companies to provide related disclosure
- Covered on remainder of slides
- See here and here for additional details

US Department of Justice (DOJ) Pilot Program to Incentivize Compensation Clawbacks

- On March 2, DOJ announced the launch of a 3-year pilot program on compensation incentives and clawbacks
- Companies will be able to reduce criminal fines by attempting in good faith to claw back compensation from individual wrongdoers—even if those efforts are unsuccessful—and the companies will be able to retain any recovered funds
- Additionally, DOJ will require every company that reaches a criminal resolution to restructure its compensation and bonus programs to incentivize compliance
- See here for additional details

The Long Road to Final Rule 10D-1

- ✓ **July 21, 2010 –** the Dodd-Frank Wall Street Reform and Consumer Protection Act became effective, and included Section 954, which added Section 10D of the Securities Exchange Act and required the SEC to implement rules to direct exchanges to require listed companies to (i) disclose compensation clawbacks and (ii) implement clawback policies
- ✓ **July 1, 2015 –** the SEC issued a proposed rule under Section 954 of the Dodd-Frank Act
- ✓ **October 14, 2021 –** the SEC announced the reopening of the comment period for the proposed rule
- ✓ **June 8, 2022 –** the SEC again reopened the comment period with additional information on increased use of clawback policies without a final rule in place and a discussion of costs and benefits of the proposed rule
- ✓ **October 26, 2022 –** the SEC issued Rule 10D-1 (the "**Final Rule**") directing listing exchanges to adopt new listing standards
- ✓ **November 28, 2022 –** SEC's Final Rule was published in the Federal Register
- ✓ **February 22, 2023 –** The NYSE and Nasdaq publicly submitted proposed listing rules related to the implementation and disclosure of clawback policies to the SEC

The Long Road to Final Rule 10D-1 (cont.)

✓ **March 13, 2023 –**

- The NYSE and Nasdaq proposed clawback listing standards were published in the Federal Register
- The public has until **April 3, 2023** to submit comments for the SEC to consider in approving both listing standards
- Once the comment period has concluded, the SEC must approve both proposals within the timeframe below

❑ **Date TBD**, but must be on or before November 28, 2023

- Per the SEC's final rule, the deadline for the national exchanges to finalize their listing standards for clawback policies is November 28, 2023; however, either or both listing standards may be adopted at an earlier date, which would accelerate the compliance date

❑ **General compliance date, TBD**, but will be within 60 days of the date above

- Within 60 days of the applicable listing standards becoming effective, public companies must adopt compliant clawback policies
- If the listing standards become effective on November 28, 2023, then the 60-day deadline for companies to adopt compliant clawback policies is January 27, 2024; however, as noted above, this could be accelerated

Overview of Final Rule 10D-1 (and Applicable Exchange Standards)

Final Rule requires **each issuer** to develop and implement a **required policy** providing for the recovery, in the event of a **required accounting restatement**, of **incentive-based compensation** received by **current or former executive officers** during **the coverage period** where that compensation is based on the erroneously reported **financial information**.

- **Covered Issuers:** Broadly applicable to any company listed on a national exchange, including smaller reporting companies (SRCs), emerging growth companies, and foreign private issuers
- **Required Clawback Policy:** A written policy to recoup incentive-based compensation in the event of an accounting restatement
- **"Big R" Restatement:** A restatement that corrects errors that are *material* to previously issued financial statements
- **"Little r" Restatement:** A restatement that corrects errors that are not material to previously issued financial statements, but would result in a material misstatement if (a) the errors were left uncorrected in the current report or (b) the error correction was recognized in the current period

Overview of Final Rule 10D-1 (cont.)

- **Incentive-Based Compensation:** Broadly defined as any compensation that is granted, earned, or vested based wholly or in part upon the attainment of any "financial reporting measure"
- **Financial Reporting Measure:**
  - A measure determined and presented in accordance with the accounting principles used in preparing the issuer's financial statements, any measure derived wholly or in part from such measure, and stock price and total shareholder return (TSR)
  - A financial reporting measure need not be presented within the financial statements or included in a filing with the SEC
  - Includes TSR and share price, which present challenges as to how to calculate what constitutes excess compensation
- **Excess Compensation:**
  - The excess over what would have been paid giving effect to the accounting restatement
  - Recoverable compensation is calculated on a pre-tax basis
  - Under the Internal Revenue Code, it is generally possible for an executive to recoup the taxes previously paid on recovered/clawed-back compensation, but only through somewhat complicated tax provisions

Overview of Final Rule 10D-1 (cont.)

- **Covered Executive:**
  - Any *current or former* executive officer who received erroneously awarded incentive-based compensation (including stock-based compensation)
  - Final Rule applies to covered executives, without regard to whether the covered executive is “at fault”
- **Covered Period:**
  - Incentive-based compensation is deemed to be received, and therefore recoverable, in the fiscal period when the financial reporting measure specified in the incentive-based compensation award is attained
  - The three completed fiscal years, during which any performance measure was attained, immediately preceding the date on which the company determined *or should have determined* that a restatement would be required (actual payment date is irrelevant)
  - Application of the clawback policy will be triggered before the accounting restatement is actually filed

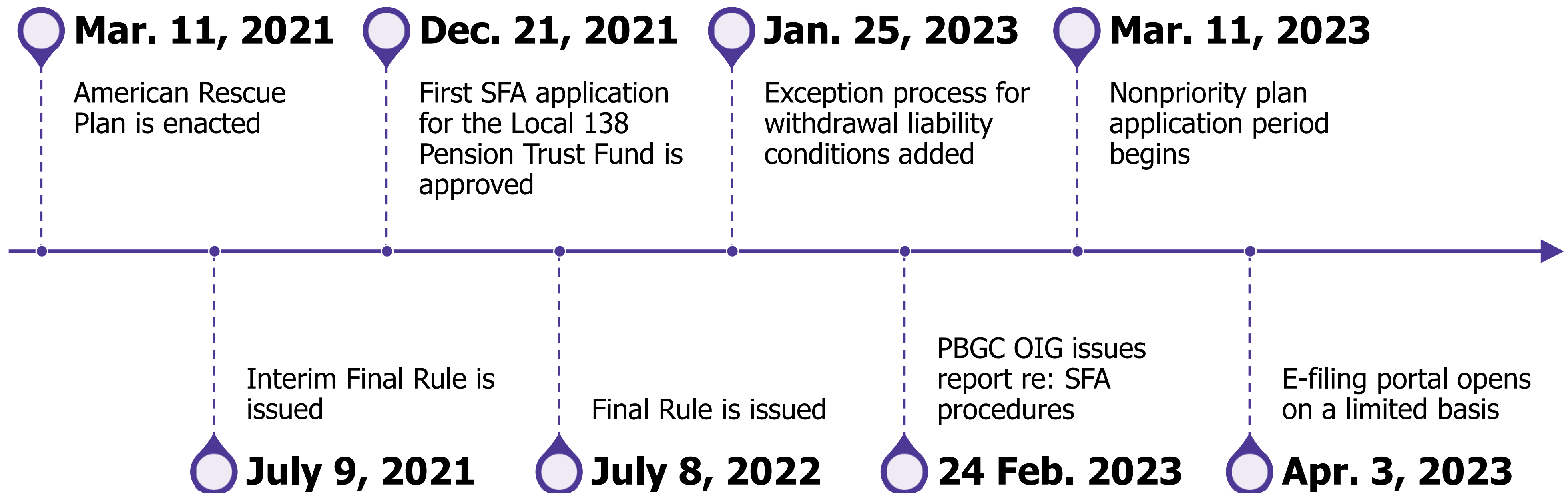
Disclosure Requirements of Final Rule 10D-1

- The listing standards must mandate recovery (not discretionary)
  - Very limited exceptions (violation of home country rules or impracticality)
- Final Rule includes additional disclosure requirements and form changes
  - New annual report cover page (with box to check for whether report includes error corrections)
  - Companies must disclose “recovery” policies and actions taken to recover erroneously awarded executive compensation during or following the end of the most recently completed fiscal year
  - Policy must be an exhibit to annual filing
- Potential consequences
  - Listed companies that do not adopt, disclose, and comply with an applicable exchange’s listing standards and the related recovery policies will be subject to delisting from that exchange

PBGC Special Financial Assistance Program Update

Morgan Lewis

PBGC SFA Program Timeline



SFA Applications: By the Numbers

- **41** applications under review
- **70** applications approved
  - 19 initial applications
  - 22 revised applications
  - 29 supplemented applications
- **1** denied application
- **47** withdrawn applications
- **99** lock-in applications
- **104** plans on the waiting list

OIG Report: “PBGC Should Improve Its Special Financial Assistance Review Procedures”

- OIG faulted PBGC for failing to:
  - formally assess and document fraud risks,
  - sufficiently define risk tolerances,
  - establish review procedures for exceptions,
  - formalize final review procedures,
  - design a control that would ensure timely review of SFA applications, or
  - identify additional procedures are needed as the priority group period ends.

SFA Approved, So Far

- PBGC has approved about $45.8 billion in SFA.
  - $19 billion in full (initial or revised) applications
  - $451 million in supplemented applications

- Participants affected: about 553,000

- Priority windows have closed. Non-priority groups may apply via a waitlist and metered application process.

SFA Application Waiting List

- The SFA application review process is extensive and must be completed within a short review time frame (120 days within filing), therefore PBGC is limited in the number of applications it can review at a time.
- PBGC does not have the capacity to accept new applications en masse.
- PBGC created a waiting list for eligible non-priority plans.
- Plans will be picked, in order, from the waiting list. A plan has 7 calendar days to submit an application.

SFA Application Waiting List (cont.)

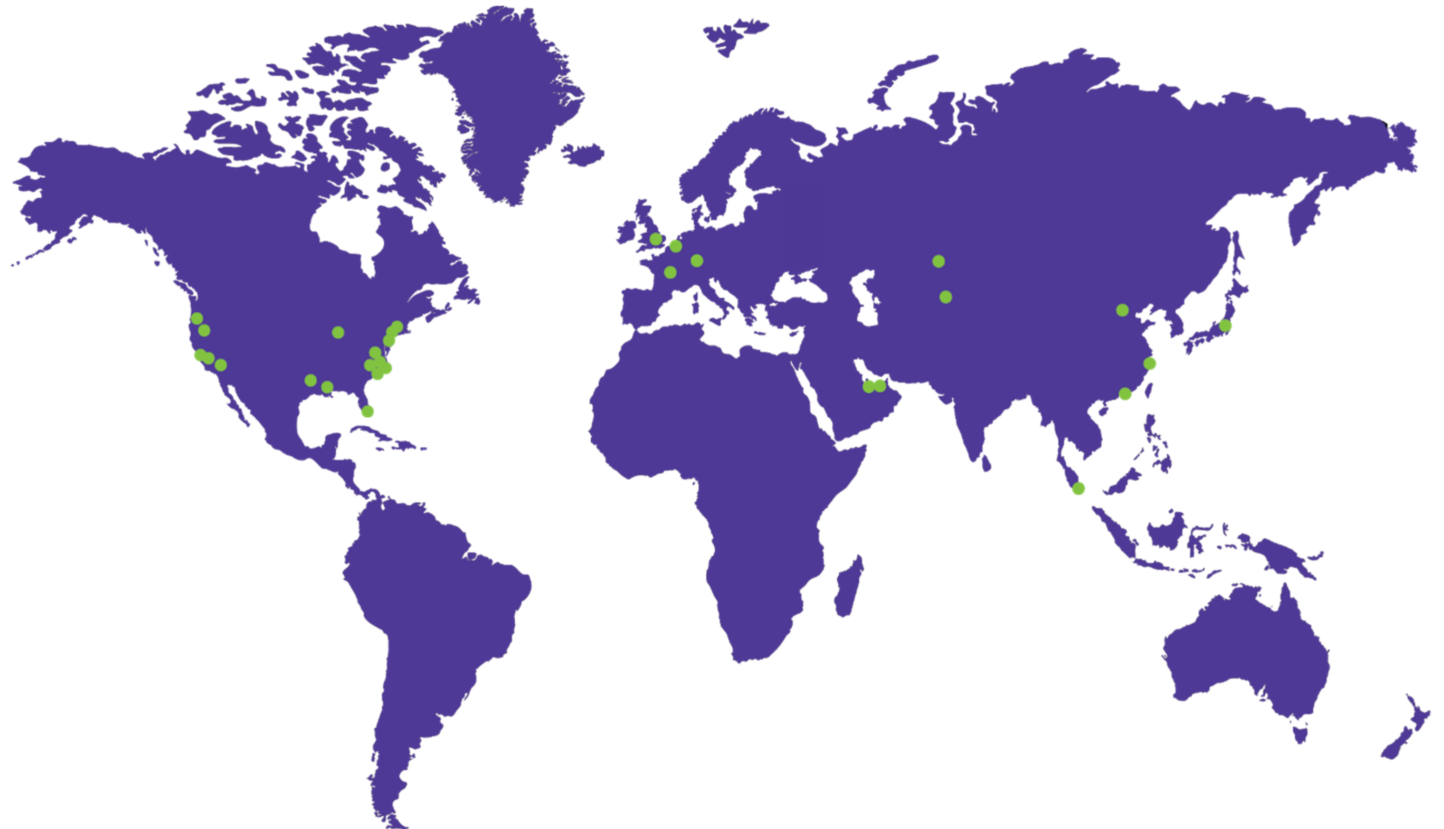
Waiting List Number	Name of Plan	EIN/PN	Date Email Request Received	Time Email Request Received
1	Laborers' International Union of North America Local Union No. 1822 Pension Fund	16-6147773/001	3/13/2023	9:00 AM
2	Teamsters Local 11's Pension Plan	22-6172223/001	3/13/2023	9:00 AM
3	UFCW Regional Pension Fund	16-6062287/074	3/13/2023	9:00 AM
4	IUE-CWA Pension Plan	22-6250252/001	3/13/2023	9:00 AM
5	Newspaper Guild International Pension Plan	52-1082662/001	3/13/2023	9:00 AM
6	CWA/ITU Negotiated Pension Plan	13-6212879/001	3/13/2023	9:00 AM
7	UFCW Northern California Employers Joint Pension Plan	94-6313554/001	3/13/2023	9:00 AM
8	Retirement Benefit Plan of the Newspaper and Magazine Drivers, Chauffeurs and Handlers Union Local 473	34-6514567/001	3/13/2023	9:00 AM
9	Retail Food Employers and UFCW Local 711 Pension Trust Fund	51-6031512/001	3/13/2023	9:00 AM
10	Central New York Laborers' Pension Plan	15-6016579/001	3/13/2023	9:00 AM
11	Teamsters Local Union No. 73 Pension Plan	51-0149915/001	3/13/2023	9:00 AM
12	Twin Cities Bakery Drivers Pension Fund	41-6172265/001	3/13/2023	9:00 AM
13	Employers' – Warehousemen's Pension Trust Fund	95-2238031/001	3/13/2023	9:00 AM
14	United Food and Commercial Workers Union Local 152 Retail Meat Pension Plan	23-6209656/001	3/13/2023	9:00 AM
15	Pacific Coast Shipyards Pension Fund	94-6128040/001	3/13/2023	9:00 AM

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
Munich
New York
Nur-Sultan
Orange County
Paris
Philadelphia
Pittsburgh
Princeton
San Francisco
Seattle
Shanghai*
Silicon Valley
Singapore*
Tokyo
Washington, DC
Wilmington



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