WINSTON & STRAWN LLP

BLOG

January 2026 Forfeiture Litigation Update

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This summary addresses recent legal developments regarding the use of forfeitures by 401(k) plans and related compliance issues raised under the Employee Retirement Income Security Act of 1974, as amended (ERISA). While ERISA has historically permitted the use of forfeitures to offset employer contributions to a plan, plaintiffs' attorneys have recently raised a novel theory of liability that challenges such use as a fiduciary breach and/or a related violation of ERISA. Matters of plan design (both establishment and amendment) are not subject to ERISA fiduciary requirements—so they are not subject to challenge as a fiduciary breach—but plaintiffs have instead suggested that when interpreting plan terms regarding forfeitures, plan fiduciaries should have allocated them differently.

USE OF FORFEITURES UNDER ERISA

When 401(k) plan participants terminate employment before becoming fully vested in employer-funded contributions, those unvested benefits are deemed "forfeited," and the associated funds become "forfeitures." ERISA and related Treasury regulations under the Internal Revenue Code impose certain requirements for the use of forfeitures. In general, Treasury regulations permit the use of forfeitures to pay reasonable administrative expenses, reduce or offset future employer contributions, and/or increase participants' benefits, assuming such uses are consistent with the plan's terms and ERISA's fiduciary obligations. Establishing and amending the forfeiture-related provisions of a 401(k) plan are matters of plan design that are "settlor" (i.e., nonfiduciary) in nature and, thus, outside the scope of ERISA's fiduciary requirements. Conversely, matters of plan administration—including interpretation of plan terms governing use of forfeitures, such as discretion regarding forfeiture allocations—are fiduciary in nature, and therefore subject to ERISA's fiduciary duties of loyalty and prudence.

RECENT LEGAL CHALLENGES TO USE OF FORFEITURES

Over the past two years, plaintiffs' attorneys have filed approximately 80 or more cookie-cutter class-action lawsuits challenging the use of forfeitures under ERISA. These lawsuits allege that plan fiduciaries breach their fiduciary duties under ERISA by using forfeitures to reduce future employer contributions rather than to pay the plan's administrative costs. Plaintiffs' attorneys have coupled forfeiture-related claims with other ERISA causes of action (e.g., fiduciary-breach claims based on allegedly excessive fees or imprudent investments), and the forfeiture-specific challenges are often styled as their own fiduciary breaches, "prohibited transactions" under ERISA, and/or violations of ERISA's anti-inurement provision.

While the number of forfeiture challenges continues to grow, some employers have successfully obtained dismissals of these claims at the pleading stage. As of the date of publication:

- Where district courts have ruled on motions to dismiss forfeiture-related claims, to date they have largely sided with defendant-employers and granted dismissal of the claims more than 80% of the time. In total, forfeiture claims have been dismissed in at least 25 cases and have been allowed to survive in at least six cases.
- At least six of these dismissals have been appealed, but federal courts of appeal have yet to rule on these challenges. Appeals are currently pending in the Third, Eighth, and Ninth Circuits, and Bank of America recently requested permission for a Fourth Circuit appeal. The Ninth Circuit is poised to be the first to rule.

Courts remain largely unreceptive to any categorical argument from plaintiffs that, regardless of plan terms, ERISA's fiduciary duties of loyalty and prudence require forfeitures to *always* be (i) allocated as increased benefits to participants or (ii) used to offset participant-borne plan expenses. Dismissing courts generally reiterate that ERISA does not mandate particular benefits or require the creation of additional benefits beyond those provided for under the plan terms—whatever those may be (including no employer contributions)—as established through the settlor (i.e., nonfiduciary) process of plan design. They explain that ERISA protects those benefits promised under the plan but otherwise requires fiduciaries to *follow* plan terms, as long as the terms do not themselves violate ERISA. Plaintiffs have therefore seen fiduciary-based forfeiture challenges dismissed where they fail to allege either (a) a deprivation of some benefit promised under the plan or (b) a violation of plan terms. Where plan terms do not permit the allocation of forfeitures in plaintiffs' desired manner, courts have dismissed plaintiffs' corresponding forfeiture challenges as attempts to create a benefit beyond those provided for in the plan. Likewise, where plan terms confer discretion regarding forfeiture allocations and no order of priority for allocations is prescribed, dismissing courts have rejected plaintiffs' suggestion that a particular order is categorically required by ERISA because no such order is promised under the plan. Dismissing courts have also cited the decades-long understanding of Congress and the Treasury Department that forfeitures may properly be used to reduce future employer contributions.[1]

Plaintiffs have attempted to avoid these plan-language limitations by citing plan terms that confer discretion regarding forfeiture allocations and alleging that, in the exercise of such discretion, defendant-employers failed to act in participants' best interests (in violation of ERISA's fiduciary duty of loyalty) and/or failed to use adequate decision-making processes (in violation of ERISA's fiduciary duty of prudence). Certain courts have still dismissed these challenges by reasoning that, without factual allegations suggesting otherwise, they amount to an already-rejected categorical approach to ERISA liability and impermissible attempt at creating new benefits. Others have permitted such challenges to proceed past the pleading phase—in particular, where plaintiffs provide factual allegations that suggest that they are not taking a categorical approach to liability. Of course, surviving dismissal at the pleading stage does not ensure an ultimate liability finding but provides defendants with an incentive to settle,[2] and plaintiffs' attorneys will presumably take note of potentially viable channels to discovery and tailor future pleadings accordingly.

KEY TAKEAWAYS—RISK-MITIGATION OPTIONS

To mitigate potential exposure (regardless of the merits), a plan sponsor could consider the following:

1. Amending the plan to eliminate the discretionary use of forfeiture language challenged by plaintiffs and require the use of forfeitures to either (a) offset employer contributions or (b) pay plan expenses before offsetting future employer contributions.
2. Paying all plan expenses from the plan sponsor's general assets.
3. Amending the plan to (a) 100% vest employer contributions, which would eliminate most forfeitures, or (b) require the reallocation of forfeitures as additional contributions to participants' accounts.

In general, we recommend that plan sponsors review their plan provisions and consider amending the plan to reflect their intended plan design (Option 1 above). In addition, we are seeing some plan sponsors consider Option 2 above if financially feasible.

[1] The U.S. Department of Labor (DOL) recently filed three amicus briefs in support of the plan sponsor in three pending appeals from dismissed forfeiture challenges, and it likewise rejected any such categorical approach to ERISA liability for forfeitures.

[2] Defendants have settled forfeiture challenges in at least three cases.

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