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Executive Compensation, Pensions & Benefits Law

The Intelligent Fiduciary Series

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Put it in Writing! Why Your Pension or 401(k) Plan Should have Written Policies

Carol I. Buckmann

ERISA fiduciaries seem to have more and more to worry about. Plan fiduciaries worry not only about being a target of class action lawsuits, but also about the possibility of being selected for an IRS or Department of Labor audit. More and more fiduciaries are coming to realize that memorializing a set of carefully-thought out plan policies and following them can be their best defense in these situations. Written policies allow them to sleep better at night.

Why should we give up flexibility? Plan fiduciaries sometimes think that they have total flexibility to deal with issues if they don't commit their processes to writing, but we have seen that when fiduciaries act without policies that set out good fiduciary processes, they may be missing important issues, such as benchmarking fees regularly, or monitoring the limits on plan loans. Just putting a policy together forces you to focus on how you will do what needs to be done. If you act without written policy guides, you are also risking acting in ways that are not consistent, which makes your decisions harder to defend. Needed flexibility can be built into written procedures if they are properly drafted.

Here are some of the policies that are becoming more common and the reasons to consider them-

- **Investment Policy Statements.** Most plans have these nowadays, though they vary a lot in quality. The worst are provided by advisers who try to draft models to protect themselves by listing every step they take when they review investments and expressing the standards as mathematical formulas that provide no flexibility. Formula policies are especially problematic if there are material changes that may alter future performance, such as a change in fund managers. The best investment policies set forth the criteria for selecting an appropriate investment menu and for monitoring and replacing underperforming funds, but don't lock the company fiduciaries into taking or not taking specific actions.

- **Fee Policy Statements.** Fee review can be part of the Investment Policy Statement, but more and more we are seeing separate fee policies that deal with issues such as revenue sharing and fund classes, regular benchmarking and even regular rfps to compare fees. Given the focus of litigation on allegedly excessive fees, thinking carefully about a fee policy seems like good protection.

- **Internal Controls Policy.** These policies aren't just about preventing plan losses. They list processes to prevent operational violations of the qualification rules, such as making sure there are contribution suspensions after hardship distributions or that those distributions are made only for the proper reasons. They can be very helpful in the event of an IRS audit, which may not dig deeper if the appropriate controls are shown to be in place. They can also decrease the employer's costs of correcting violations by permitting prompt identification and self-correction of violations without having to go through the Voluntary Corrections Program or Audit Cap.

- **Education Policy.** This helps insure that participants understand how the plan works, why they should contribute, and basic investment information. It helps participants accumulate more, but it also helps employers by making it less likely that participants will complain that they haven't received necessary information to make decisions or prepare for retirement.

- **Uncashed Check/Missing Participants Policies.** Fiduciaries need to be doing more to deal with this problem. Both the IRS and the Department of Labor are looking at whether benefits are being distributed at age 70 ½ as required, but the issue is much bigger. Fiduciaries should be making reasonable efforts to find people who are owed vested benefits through actions such as searching public documents and contacting beneficiaries listed for other plans. Often providers are lax about these issues and just want to escheat benefits that haven't been claimed. An appropriate policy should be developed by consulting all parties involved.

Establishing the Policies is Just the First Step. As helpful as having policies may be, not following them is worse than having no written policies at all. The plan's fiduciaries should all be familiar with what the policies require. And you can't set it and forget it. The law and the investment climate are always changing, and all plan policies should be reviewed and updated on a regular basis.

Is Your Pension Plan Auditor Making the Grade? Five Ways to Get a Better Audit

Carol I. Buckmann

Now that the bulk of 5500 filings and related audits are over (most plans filed on October 15), the usual frantic questions from clients who need to respond to their auditors has abated, and everyone is breathing a sigh of relief and moving to concentrate on other matters until the next filing season. That is not the best response, much as we can understand it. Now, when the experience is fresh in your mind, is the best time to evaluate whether your audit was up to snuff, because the consequences of having a bad auditor are about to go up.

Hiring a Bad Auditor Can Be Expensive.

We already know that bad audits are on the Department of Labor's radar. Last year, the Department of Labor issued a highly-publicized report concluding that 39% of audits are deficient. There are possible penalties for a really deficient audit, which could be treated as not satisfying the ERISA requirement at all. However, a more likely consequence of a bad audit is that overlooked operational problems can lead to big penalties, particularly if they are allowed to continue uncorrected for years. A good auditor will find problems when they can easily be corrected, and advise you how to do so. A good auditor can also help you set up controls to minimize the risk of future operational problems.

The Stakes Get Higher.

Now that the Internal Revenue Service has decided to discontinue cyclical determination letters, there is a new risk for plan fiduciaries who don't hire experienced auditors. The plan document will have to be reviewed to determine whether any required amendments are missing and applicable requirements are satisfied, and the prior determination letter is still valid. Cooperation between attorneys advising in connection with the plan and knowledgeable auditors will be required. If a plan document is deficient, the plan's qualified status is called into question.

Finding a Good Auditor.

The regulations don't establish much in the way of requirements for an independent plan auditor, and a common mistake is to hire the company's corporate auditor without inquiring about its ERISA expertise. In addition to reviewing plan finances, ERISA auditors need to be familiar with contribution and compensation limits and understand what a prohibited transaction is. They should be checking compliance items such as benefit and contribution calculations. A good corporate auditor may not have the special expertise to be a good ERISA plan auditor.

Getting a Better Audit.

Here are five ways to have a better audit in 2017:

1. Find out how many ERISA plan audits the firm does. A good way to find a firm that is likely to do a lot of plan audits is to look at its website to see if it

highlights ERISA expertise. If you are told that the firm does one or two ERISA audits a year, find another auditor.

2. No matter how many plan audits your accounting firm says that it does, make sure that the specific people assigned to you have experience doing plan audits on a regular basis. I have often seen major accounting firms assign the most inexperienced people to ERISA plan audits, as is evident by the questions that my clients get asked. For example, a common question that indicates a complete lack of familiarity with existing the determination letter process is: did you get this recent amendment approved by the IRS when you adopted it? Of course, plan sponsors have filed on their five year cycle, and no one routinely filed for each and every plan amendment. The IRS would have put us at the bottom of the pile if we had.

3. Find out if the firm is a member of AICPA's Employee Benefit Plan Audit Quality Center. The Department of Labor determined that members produce audits with fewer deficiencies. These firms strive to do the highest quality audits, and a firm peer review system is not a substitute. The Department of Labor did not find that internal peer review had the same correlation with improved audit quality.

4. Ask whether the Department of Labor has had questions about the firm's audits and, if so, how the matters were resolved. (They do not need to identify their clients to respond to this question.)

5. Handle the auditor hiring process like the fiduciary responsibility it is. In fact, the auditor's fees may be coming out of plan assets. Consider an RFP and carefully review fees and service standards of the candidates. (Bear in mind, though, that ERISA does not prohibit paying more for a better audit.) Document the reasons for your choice.

Is Your 401(k) Plan Income "Floating" Away? New Lawsuit Challenges Fidelity's Practices

Carol I. Buckmann

Do you know how your trustee handles cash? 401(k) plan transactions aren't instantaneous, so all plans will have situations in which cash is held pending investment, reinvestment or distribution. These amounts may be held in a short term investment account pending required action, such as waiting for a participant to cash a benefit check. A recent class action suit filed against Fidelity and two plan sponsors, United Airlines and Hewlett-Packard, claims that the income on these accounts should have been credited for the benefit of the plans and that Fidelity committed fiduciary breaches by keeping the float. The suit also names the plan fiduciaries for allowing Fidelity to engage in these practices, which plaintiffs contend are prohibited transactions.

The Department of Labor's Position. In its issued authority on float income, including FAB 2002-3, the Department of Labor treated float as a plan asset and cautioned providers to make disclosures about their float practices to avoid self-dealing and plan fiduciaries to monitor float income. However, this suit comes on the heels of a dismissal of a similar suit (In Re Fidelity Float Litigation) in July by the Court of Appeals for the First Circuit. The First Circuit decision cited other courts that had failed to uphold plaintiffs' contention that use of float income was a violation of Title I of ERISA. It will be interesting to see how plaintiffs fare in this new action, but since retained float may still be considered part of the service provider's compensation, these lawsuits also bring to the forefront some issues plan fiduciaries should be considering in reviewing float practices.

What the Courts Have Previously Held. The cases that upheld the practice of fiduciaries keeping float stated that under normal concepts of property law, float was not a plan asset. Therefore, trustees did not engage in self-dealing when they kept the float. Those decisions might have come out differently if there were different language in the provider's services agreement treating float as a plan asset.

Monitoring Float Practices. If float is not treated as a plan asset, the self-dealing claims in the new lawsuit should be rejected. However, even if the plan sponsor is paying plan fees, it is advisable for fiduciaries to know how much float the trustee or other provider is keeping, and the circumstances under which float arises and is retained. Here are some issues to consider:

- The fact that the trustee will retain float income and relevant details should be disclosed in the services agreement and the Section 408b-2 disclosure. FAB 2002-3 says that relevant information includes the earnings rate and an estimate of anticipated income. However, many providers do not provide estimates in their disclosures, apparently taking the position that the float compensation is not predictable. Fiduciaries may need to ask follow up questions to get the information they need to monitor float, and to have the retained float reported to them.

- The amount of float income is partly a factor of the amount of time the cash is held uninvested or undistributed because a check remains uncashed. Fiduciaries can ask for the trustees' policy or procedures regarding float to make sure that this period is not prolonged unnecessarily. Fiduciaries may want their agreements to specify a maximum number of days in which cash contributions could be held in a cash account prior to investment.

- Even if the provider's fees are paid by the plan sponsor, if the amount of retained float income is consistently higher than expected, it may be appropriate to renegotiate compensation.

- Certain actions or inaction by plan fiduciaries can increase the float. For example, a delay in giving instructions regarding investment of contributions may increase the amount of time the cash is held in the float account. In addition, if plan records are not up to date and many distribution checks remain un-cashed because they are not sent to the current address, that may result in the cash being held in the float account until the check becomes stale. (Finding addresses for these payees will also reduce the risk of audit problems, which was a subject of a prior blog post (click here to read it).)

Regardless of whether plaintiffs prevail in this new litigation, plan fiduciaries can protect themselves if they understand the details of their provider's float policies and practices.

How To Make Your 401(k) or 403(b) Plan a Litigation Target

Carol I. Buckmann

Nobody wants to be sued. Still, writing about plan fee and investment litigation really focuses attention on what plan fiduciaries are doing (or not doing) to come into the sights of the class action lawyers representing plaintiffs. Sometimes it seems as if these defendant fiduciaries were almost asking to be sued, since the practices being described in the complaints are so vulnerable to challenge. These lawsuits keep proliferating, so fiduciaries of 401k and 403b plans would be well advised to learn from what the defendants were alleged to have been doing wrong.

If you want to invite a lawsuit, do the following----

Adopt an Investment Policy Statement, then never consult it again. Outside advisers rightly urge their fiduciary clients to adopt a formal investment policy statement (IPS) setting forth the goals and procedures for selecting, monitoring and replacing investments. Yet adopting a policy and not following it can be worse than not having a written policy at all. The Department of Labor considers the policy one of the instruments and documents governing the plan, which means that mere failure to follow the IPS can be a fiduciary breach. More importantly, failure to follow the IPS will likely result in your participants having a sub-optimum investment menu.

Don't Benchmark Your Fees or Do Periodic RFPs. If you are happy with your current provider, why do this? You need an ongoing reference to determine whether you are overpaying for services and whether other competitors might be providing useful additional services that your current provider doesn't offer. You might find reasons not to be so satisfied with your current provider, but at the least, you will know whether you should be renegotiating your current provider's fees.

Load Your Investment Menu with Proprietary Funds. Recent litigation has focused on providers who put their own funds in their employee plans even though they weren't top performers. Another red flag is the use of the provider's target date funds without investigating whether they are the best in their class.

Try to Do Everything In House. Unless you are a very large business with employees who have real expertise about pension investments, and the time to properly review them, you are courting disaster trying to do everything in house. With smaller businesses this is sometimes a result of a reluctance to cede control to an outsider rather than trying to cut costs. However, just about every plan needs professionals advising about investments and fees. And those professionals should acknowledge that they are ERISA fiduciaries, regardless of what happens with the Fiduciary Rule under the new administration. There are many good advisers currently operating under a fiduciary standard to choose from.

Enter into a Revenue Sharing Arrangement, then fail to monitor payments. There are alternatives to paying for plan services through revenue sharing that are more transparent, but if you do enter into a revenue sharing arrangement, make sure that your provider isn't being overpaid or that revenue sharing is not being used to pay for services to the plan sponsor rather than the plan participants.

Use Multiple Recordkeepers and Providers. This has become a big issue in the lawsuits that have recently targeted large universities and health care providers who sponsor 403b plans. Often there may be historic reasons for using multiple providers, but the use of multiple providers to provide the same services seems likely to result in overlapping services, inefficiencies, and a failure to leverage total asset size to get lower fees. The same argument could be made for plans with multiple funds in the same asset class. For example, if these investments were consolidated into one fund, they might become eligible to invest in cheaper institutional class shares.

Set It and Forget It, because nobody is complaining. Just because you picked an appropriate menu years go does not mean that your menu is the best for participants today. Fiduciaries need to monitor performance against benchmarks, and to be aware of new funds and alternatives to regular mutual funds, such as separate accounts and collective investment funds. The U.S. Supreme Court in Tibble v. Edison affirmed that fiduciaries have an ongoing duty to monitor plan investments.

Don't Hold Regular Committee Meetings. Running your business may be a priority, but business priorities shouldn't cause frequent delays or cancellations of Committee meetings. And you should have a committee, or at least specific employees assigned to oversee specific plan operations. Meeting with your outside advisers on a regular basis facilitates monitoring of fees and investments, and also makes sure that the plan's fiduciaries keep abreast of changes in the law. Prepare agendas and keep written Minutes to record what is discussed and the reasons for decisions.

The most important "don't" may be don't assign your plan or plans a low priority. The big lesson of recent litigation is that fiduciaries always need to have the plans on their radar screens.

The Dutiful Fiduciary: What's Really Important About the Supreme Court's Tibble Decision

Carol I. Buckmann

Are there time limits on a participant's ability to challenge imprudent 401(k) investment fund offerings? Can participants challenge an investment fund selected ten or even twenty years ago? If so, will fiduciaries be subject to potential liability for losses going back decades?

The U.S. Supreme Court has just released its long-awaited decision in Tibble v Edison, holding that participants are not prevented from challenging a plan fiduciary's imprudent 401(k) investment choices if the investment was selected more than six years ago. This means that there is not a one-time six year window for challenging imprudent investment offerings.

Since we use these decisions as guides to help our clients avoid being sued, I'll skip the procedural issues of interest to litigators and focus on what this means for plan committees.

The rules set out by the Supreme Court are fairly simple, though their application may not be. The Court said that the duty to prudently select investments and the duty to monitor them are separate. Under traditional trust law and ERISA, a trustee/fiduciary has an ongoing duty to monitor investments and remove imprudent ones. Fiduciary breach claims may be based on positive action or omissions, and suit may be brought within six years of the last act that constitutes a breach or violation, or the last date the fiduciary could have cured an omission, clearly extending the period for challenging failure to remove an imprudent fund from the lineup.

The Supreme Court didn't give us guidance about how to fulfill the duty to monitor, sending the case back to the appellate court for further proceedings. However, some best practices and some limits on the claims that may be brought can be deduced from the decision and the facts.

What was the alleged violation in Tibble? The lower courts had found that the Tibble Committee was imprudent in offering three retail class mutual funds when lower cost institutional funds with virtually the same investments were available. These same claims were raised and erroneously dismissed in connection with three older funds. The Committee met quarterly to review plan investments and to review reports and recommendations from investment staff, but comparing the costs of different share classes was apparently not part of the quarterly review.

Obviously, fund costs should have been part of this review, but if committees prepare and use a review checklist in consultation with ERISA counsel, or have a comprehensive investment policy drafted with the help of ERISA counsel, the likelihood of missing major review items is minimized. Even today, we often see investment policy statements drafted by people who are not lawyers that focus on performance and fail to even mention the importance of reviewing costs and fees. Having regular meetings won't help fiduciaries if they don't focus on the right issues when they meet. And offering the best available investment choices to participants, and not merely avoiding imprudent ones, should be the goal of every committee. That is the best way to avoid investment challenges.

Although not discussed in the Supreme Court decision, in my view it is clear that breaching fiduciaries should not have an open-ended exposure to restore plan losses under the Tibble rules. The Department of Labor in its amicus brief sets forth its position that fiduciaries don't have continuous exposure to restore losses because the losses must have occurred within the six years preceding suit. Further, the plaintiffs in the Tibble case did not try to claim losses for the entire period that the retail funds were in the plan.

At the end of the day, fiduciaries who follow good practices minimize the likelihood that they will ever have to argue that there are specific time limits on restoring plan losses.

The Estopped Fiduciary: When May Participants Rely on Incorrect Calculations?

Carol I. Buckmann

Mistakes happen. Even in the best-run plans, occasional errors in estimating and calculating benefits are inevitable and sometimes they are caught only years after payments commenced. Fiduciaries are required to follow plan terms, so improper payments are typically cut off. Plans may also seek to recoup past overpayments once the mistake is discovered.

In the Mistaken Fiduciary, I described a situation in which Gabriel, a retiree who had never qualified for benefits at all, sued a plan to prevent it from cutting off his benefits. His suit claimed fiduciary breach and sought to estop the plan from applying its terms to him. The retiree also sought other forms of relief for fiduciary breach.

Gabriel lost his estoppel claim at the district court level, and this result was subsequently affirmed by the U.S. Court of Appeals for the Ninth Circuit. The Ninth Circuit decision clearly states that estoppel is not available where relief, as in Gabriel's case, would contradict the written plan provisions. However, we have just had another decision in Michigan in which a retiree named Paul successfully sued to estop a plan from correcting pension overpayments. Why did Paul succeed and should plan fiduciaries be worried about this decision?

When is a Fiduciary Estopped from Correcting Overpayments?

It seems to require special circumstances, including harm to the retiree from relying on the incorrect calculation, and not just an honest mistake.

When is a Mistake Equivalent to Fraud?

In Paul, the plaintiff began work as a temporary employee and switched from union to non-union positions at the company. He and his wife met with company representatives prior to his retirement and received a pension calculation statement which overstated his benefit service. The retiree was told that the Company reserved the right to correct errors and that he would be notified if final benefit calculations changed the pension amount. The retiree asked the company representative several times to confirm that the service shown on the statement was correct, and was assured that it was. Notice of the error was not sent until two and one half years after retirement, when it was discovered by the sponsor on self-audit.

The court found that Paul was not just the victim of an honest mistake, but that the Company representatives' gross negligence in not investigating the answer to Paul's questions amounted to constructive fraud. Paul claimed that he would not have retired when he did had he known the correct amount of his pension. The court further found that Paul was unaware of the mistake, since he could not calculate his own benefit. The bottom line was that Paul could not be required to repay past overpayments and the plan was estopped from reducing his future payments.

What Can Plans Still Do?

Despite the fact that they didn't help the plan's case against Paul, use of clear disclaimers is still a good practice. Regular self-audits should still permit plan sponsors to correct typical honest mistakes. And this whole lawsuit could have been avoided if the elements of Paul's calculation had been carefully checked when he asked about his service.

Sometimes fiduciaries raise the concern that they are stuck between "a rock and a hard place" if they don't recoup overpayments, because in addition to worrying about equitable remedies such as estoppel, they may have caused a plan qualification error by not following plan terms. There may also be some relief for this concern: the IRS has just "clarified" its position on correcting defined benefit plan overpayments to permit more leeway. It appears that pension plan sponsors will not always have to request a return of overpayments if they are willing to make up the loss to the plan.

IRS has requested comments on what else it should do about correcting overpayments. The U.S. Supreme Court has also accepted a case to determine whether overpayments of disability benefits need to be tracked in order to be recoverable. That future decision may impact other ERISA plans as well. The law in this area is still in flux, so fiduciaries should stay tuned for further development.

The Blindsided Fiduciary: Ignorance is Not Bliss

Carol I. Buckmann

Alliance Bernstein recently released the shocking result of a survey it had taken of plan sponsors: a whopping 37% of those fiduciaries surveyed didn't know that they were fiduciaries.

Obviously, it is unlikely that these individuals are fulfilling their fiduciary responsibilities if they are unaware of their status. And we wonder what will happen if the plans of these oblivious fiduciaries are selected for a Department of Labor audit, though we are sure that it won't be a pretty picture.

It is possible to be an ERISA fiduciary and not know it, because no acknowledgement of fiduciary status is required. ERISA has a functional definition of fiduciary, which means that you become a fiduciary based on what you do. Administration, investment control and giving investment advice for a fee are the activities that trigger fiduciary status. ERISA also provides that there must always be at least one named fiduciary to manage a plan, and this will be the Company and its directors if no other designation is made.

Another form of ignorance can complicate this problem, because it is also possible to believe that your plan service providers are fiduciaries when they are not. Small plan fiduciaries are not the only ones under these misconceptions. Misplaced reliance on what these non-fiduciary vendors are doing can result in avoidable compliance failures and litigation exposure. Here is a short checklist for people who have relationships with employee benefit plans:

- If you are a director, you have some fiduciary responsibilities even if the board has delegated authority to other fiduciaries.
- If you are a plan trustee, you are a fiduciary.
- If you are on a plan committee, including an investment or administrative committee, you are a fiduciary.
- If you have adopted a prototype or other pre-approved plan, your vendor is not a fiduciary unless it has agreed to make decisions and become an administrator as defined in Section 3(16) of ERISA or manages investments.
- If you have appointed an investment manager with the authority to make investment decisions, the investment manager is a fiduciary.
- If you are receiving investment advice from a broker or registered investment adviser, you may not be receiving advice from an ERISA fiduciary as the law stands now. It all depends on factors such as whether the advice is one-time or on a regular basis, or is given with the understanding that it will be a primary basis for plan investment decisions. The Department

> of Labor, with the support of the Obama administration, has been working on a controversial new proposal to extend ERISA fiduciary responsibilities to brokers and others who provide investment advice to plans, but so far, is being close-mouthed about what it says.

Since fiduciaries may be personally liable for losses caused by fiduciary breaches, knowing whether you and your vendors are fiduciaries is essential self-defense against being blind-sided in the pocketbook by a court award, audit penalty or settlement.

The Uninsured Fiduciary: Have You Read the Fine Print in Your Policy?

Carol I. Buckmann

If you are a plan fiduciary and your company has purchased fiduciary liability insurance, you and your board may have simply assumed that the policy would cover any fiduciary breach. You may have even congratulated yourselves on understanding that the plan's ERISA bond provides reimbursement only to the plan, so separate protection for fiduciaries is a good practice. However, a decision just issued by a Pennsylvania court denying coverage to CIGNA is a wakeup call to carefully review such policies to determine what they do and do not cover.

In December, in the probable coda to a lengthy case that went up to the U.S. Supreme Court, the Second Circuit Court of Appeals upheld a district court decision that CIGNA's misleading communications about "wearaway" (a period during which no benefits would be earned by plan participants) were deliberately misleading and fraudulent.

CIGNA had previously filed an action for a declaratory judgment that its policy covered the actions which were the subject of the lawsuit, under a clause that covered "wrongful acts", which were defined as "any actual or alleged…misstatement, misleading statement, act, [or]omission" by the insured. However, the Pennsylvania court agreed with a lower court that the policy needed to be construed as a whole, and that the exclusion for fraudulent or criminal acts overrode the wrongful act provision. CIGNA is now a two time loser; once under the class action and a second time under the policy.

What should you look for when buying fiduciary insurance?

There are differences among policies available in the market. They have different scopes and costs. Among the issues to consider are the following:

1. Does the policy cover only litigation, or will it cover compliance problems discovered on audit or fixed through voluntary correction programs?

2. What actions are excluded?

3. Are there time limits on the coverage based on when the acts occurred?

4. Who selects counsel to defend legal actions?

5. Does the policy cover all of your internal fiduciaries or is it limited to employees in certain positions? Are riders necessary to cover the right people?

Further Tips

Your policy typically will not cover third party vendors such as investment managers or third party administrators. It is advisable to determine that they have their own fiduciary liability insurance in place, and to get a representation that they will maintain it. However, the best advice for those in the market for fiduciary liability insurance is to carefully review it with the assistance of experts before signing on the dotted line.

The “Reformed” Fiduciary: Another Cautionary Tale About Explaining Your Plan Amendments

Carol I. Buckmann

“We are pleased to inform you about new improvements to our plan.” How many times have you sent out notices like this (perhaps drafted by your vendor) without thinking about whether they are incomplete or misleading?

We have just had another reminder from the Second Circuit Court of Appeals of the potential consequences of inaccurate plan communications. This came on December 23, 2014 in the form of a decision upholding class relief to participants who challenged CIGNA’s conversion of its defined benefit pension plan to a cash balance plan. The relief in effect rewrote the plan to eliminate “wearaway”, a technical term referring to the period when a participant might accrue no benefits because future accruals were less than the minimum benefit that had been earned under the plan before its conversion.

Why the Plaintiffs Won. The basis for the relief was not that the plan violated any plan qualification rule then in effect by providing for wearaway, but that participants had not been adequately warned about it in CIGNA’s communications and the summary plan description. In fact, they had been told that “your benefit will grow steadily throughout your career” and that the new plan would “significantly enhance” CIGNA’s retirement program.

The Case History. The CIGNA participants challenged the wearaway and plan conversion on multiple grounds, including age discrimination, when they initiated their suit, but lost on all of the issues except misleading communications. The United States Supreme Court decided in 2011 that lower courts erred in finding that participants could recover benefits calculated without wearaway under ERISA Section 503(a)(1) (authorizing suits for benefits payable under the terms of the plan), or that the SPD could modify the terms of the plan. (See our prior post and Osler Update.) The Supreme Court went out of its way in its decision to outline the forms of equitable relief that might instead have been awarded under Section 501(c)(3) of ERISA based on misleading communications. The lower courts took the hint.

The New Decision. The Second Circuit affirmed a district court decision awarding class relief and reforming the plan to match what was communicated by giving participants the sum of benefits earned prior to and after the conversion. The court went out of its way to point out other instances in which the new plan design was inferior to the pre-conversion plan, including loss of certain subsidies and exposure to interest rate risk under the new design.

Grounds for Reformation. The Second Circuit found that all that was required for reformation was either a mutual mistake (which was not claimed in the case) or a showing that “defendants committed fraud or similar inequitable conduct and that such fraud reasonably caused plaintiffs to be mistaken about the terms of the pension plan.” Those requirements were satisfied.

Lessons for Administrators. Regular readers of our blog know that the decision to redesign a pension plan is made by the plan sponsor in a settlor, not a fiduciary capacity. However, like most plan sponsors, CIGNA wore “two hats” here, because at the time of the conversion, it was also the fiduciary responsible for ERISA-required plan communications. Had CIGNA properly communicated the challenged plan changes, more realistically and with less puffery, it could have avoided liability for unintended benefits. Companies that adopt prototype plans need to be especially alert when distributing plan communications, because in almost all cases their vendor has not assumed legal responsibility for administration or the communications it sends out. These documents should always be carefully reviewed before they are distributed to avoid a potential lawsuit.

The Inattentive Fiduciary: When Supervisors Don't Supervise

Carol I. Buckmann

The United States Department of Labor recently commenced legal action against a plan investment manager who failed to diversify plan investments, then sold the portfolio and left the proceeds uninvested for a period of two months, causing $7 million in losses. The complaint also named members of the Retirement Committee that retained the manager, and particularly cited them for failing to monitor the investment manager and take action to correct this problem. In addition to seeking restoration of plan losses, the complaint asks the court to remove the committee members and appoint an independent fiduciary in their place.

This complaint serves as a forceful reminder to plan committee members that their responsibilities to monitor investment managers are ongoing and don't end when the hiring process is completed.

What Happened Before?

The Department of Labor filed its suit in Pennsylvania, but there is existing litigation in New York involving these same parties and plans. In that case, a lawsuit was initiated by the plan's Retirement Committee after it had fired the adviser in 2009, alleging the same fiduciary breaches as the recent Department of Labor complaint.

Earlier this year, the New York court issued a key ruling that the adviser was functioning as an ERISA fiduciary with respect to the plans, and a trial was held over the summer. We are awaiting a decision on the merits in New York. If the New York court orders the manager to make up the $7 million in losses and it does so, it may affect the relief sought by the Department of Labor, as the plans should not have a right to a double recovery.

Asleep at the Switch?

Despite the fact that the Retirement Committee woke up and attempted to address past wrongs, the lawsuit did not protect these Committee members from being investigated and ultimately sued by the Department of Labor.

Committees need to meet regularly and establish procedures for regularly monitoring the service providers they hire. These plans apparently had an investment policy requiring proper diversification. A regularly scheduled review process would have brought the manager's inaction to the committee's attention. But too often, pension plan committees have irregular meetings without formal agendas, and as a result are taking huge risks by demonstrating lack of accountability. The lawsuit also revealed the fact that the retirement committee gave the manager authority before the agreement defining the manager's obligations was actually finalized, which is another red flag that this committee was not following good fiduciary practices.

Who Else Could Be Liable?

Members of the board of directors of the plan sponsor have a residual fiduciary responsibility to prudently appoint and monitor the named fiduciaries, including committee members, that they hire. Although they were not named in the Department of Labor's complaint, as we discussed in our recent webinar on "The Intelligent Fiduciary", the board can never shed all of its fiduciary responsibility by delegation to a pension committee or hired advisors. We can conceive of situations in which the members of the board would also be named as defendants in actions such as this because they failed to adequately supervise the committee.

The Bottom Line

Plan participants suffer most when the supervisors fail to supervise, but the supervisors are also exposing themselves to material liability for losses and lost profits when they fail to review what their service providers are doing. Establishing and following good plan governance practices is the best way to protect everyone involved. Those practices should include requiring all investment professionals who manage plan assets to acknowledge fiduciary status in their service agreements. Establishing a pre-determined schedule to meet with advisors is also a good idea, although it doesn't relieve the fiduciaries of their duty to review advisor activity between meetings.

Note: *On August 10, 2015, the district court found that WPN and its principal, Ronald LaBow, had breached their fiduciary duties in their handling of the Severstal plan assets, and ordered them to pay $9.6 million in damages for losses to the plans, $5.3 million in pre-judgment interest, and $110,438 to refund investment management fees previously paid. It will be interesting to see whether the U.S. Department of Labor pursues its suit against the Severstal Committee now that the plan has been made whole.*

The Ambushed Fiduciary: Does Authority over a Corporate Account Cross the Line?

Carol I. Buckmann

Corporate officers can wear two hats under ERISA: the corporate officer hat or the ERISA fiduciary hat. Actions taken wearing the corporate officer hat are traditionally not fiduciary functions.

The courts recognize that ERISA's protections were not intended to apply to business decisions such as whether to adopt, merge or terminate plans or set the level of benefits. However, a recent decision from Florida, Perez v. Geopharma, Inc., crafted an interesting but flawed argument that mere authorization to sign on a corporate bank account could make an officer a fiduciary. It followed that the officer could be liable for fiduciary breach for not transmitting employee contributions from the account to the Geopharma Group Welfare Plan.

This decision could have a chilling effect on corporate officers routinely doing their jobs.

A major problem with this decision is that as a policy matter, officers need to know when they are assuming a fiduciary role and risking possible personal liability for their actions. There should be bright lines and officers shouldn't learn only after the fact that they were fiduciaries. (For another example of a court extending fiduciary status retroactively to persons not thought to be fiduciaries, see my prior blog post, The Inadvertent Fiduciary.)

A second problem is that this officer had nothing to do with running the plan, and ERISA contemplates that a fiduciary (other than an investment adviser) is someone with discretion or control over plan administration or plan assets. This officer had neither in the common understanding of those terms simply because he was a signer on a corporate account, though the court accepted the Department of Labor's argument that the unpaid employee contributions were plan assets. In fact, since it required two signatures to act for the account, this officer was unable to unilaterally even direct the contributions.

Basis for the Lower Court Decision.

The lower court rejected a motion to dismiss, claiming that the unpaid contributions were plan assets in the corporate bank account, and that those with signatory authority over the account were co-fiduciaries with control over plan assets because they controlled the account. The court claimed to be following an earlier 11th Circuit decision, but in fact its decision was not required by the 11th Circuit decision and conflicts with decisions in other circuits on unpaid plan contributions.

This lower court's decision should not be applied to employer contributions. Most authority holds that employer contributions are not plan assets until contributed to the plan unless an agreement between an employer and the plan indicates otherwise (which would be unusual). For example, in July, a federal district court in Michigan declined to find that corporate officers of a troubled company acted as fiduciaries when they prioritized the other company obligations over unpaid plan contributions. Further, even the U.S. Department of Labor set out the general rule that unpaid employer contributions are not plan assets in Field Assistance Bulletin 2008-1.

Are Other Remedies Available?

With respect to employee contributions, if there is no plan committee but the plan says simply that "the Company" is the administrator, it may be reasonable to hold Board members or officers who have the most connection with the plan responsible, rather than to assign fiduciary status simply on the basis of co-signing authority.

The better analysis seems to be that the plan has a breach of contract claim against the company for unpaid employer contributions. In the case of multi-employer plan contributions, Section 515 of ERISA even establishes a specific cause of action for unpaid contributions. These alternatives may have influenced the many decisions declining to find corporate officers liable for unpaid contributions under ERISA's general fiduciary liability rules.

It remains to be seen whether the Geopharma decision will be appealed or other courts will follow it, but if they appreciate the risk the Geopharma decision imposes on ordinary corporate officers, they will not do so. In the words of the 11th Circuit Court of Appeals, from the same decision cited by the Geopharma court: "Preservation of the purposes of ERISA does not require that we ambush corporate officers with stringent fiduciary duties and personal liability..."

The Reckless Fiduciary: When Are Imprudent U.S. Fiduciaries Liable For Plan Losses?

Carol I. Buckmann

"A pure heart and an empty head are not enough." This is a quote from an early case defining the scope of ERISA fiduciary liability. However, ERISA has always made fiduciaries responsible only for losses caused by their breaches of fiduciary responsibility. It doesn't make fiduciaries insurers of plan assets.

A recent Fourth Circuit Court of Appeals case has established its own gloss on the ERISA rules to determine when fiduciaries who follow imprudent procedures will have to make up plan losses. The Fourth Circuit rule is based on what a hypothetical prudent fiduciary, who I will call the "prudent shadow", would have done in the same situation.

Like the recent "Teflon Fiduciary" decision of the Fifth Circuit Court of Appeals, discussed in a prior blog post , the lower court decision seemed to exonerate fiduciaries in situations that may not have been intended by the drafters of ERISA. We will have to see how the new rule is applied in order to determine whether the Fourth Circuit rule does so and whether it is workable.

What Happened?

After the spinoff of Nabisco businesses from RJR Nabisco, the RJR 401(k) plan held blocks of Nabisco stock in two frozen funds. A working group that was not authorized under the plan documents decided after a short discussion to divest the stock in these frozen funds within six months. It did so at a time when the stock price had declined, because it was concerned about fiduciary liability for violating the rule that employee plan investments must be diversified and thought continuing the Nabisco funds was illegal.

The group didn't consult an outside investment adviser or hire an independent fiduciary to determine the best time to divest. Nor did it seek the advice of an outside ERISA attorney about what the ERISA diversification rule, which actually provides that investments be diversified "unless it is prudent not to do so," required.

The plan ended up selling its stock at a time when outsiders rated the stock a "buy" due to forecasts of improving company prospects, and the stock did, in fact, rebound. However, the appellate court decided that even though the decision-making process wasn't prudent, there might not be any damages – it all depended on whether the prudent shadow would have sold the stock in the fund at that time.

What Did the Lower Court Decide?

The district court had ruled in favor of RJR, even though it concluded that an imprudent process had been followed, on the ground that the breach of using an imprudent process didn't cause plan losses if the prudent shadow COULD have divested the stock at the same time that the imprudent fiduciaries decided to do so.

Note the difference between the "could have" standard and the "would have" standard applied by the Court of Appeals. The smallest probability may satisfy the "could have" standard, whereas the "would have" standard seems to require that it be more likely than not that the prudent shadow would have divested at the same time.

Where Do We Go From Here?

The case was remanded to the district court to determine whether there were losses under the "would have" sold standard. Presumably, the district court will find liability if it determines, for example, that the prudent shadow would have sold the stock later. However, the implications of this rule seem to be that if a bumbling fiduciary somehow stumbled on an appropriate sale date, or blundered into a good investment, there may be no way in the Fourth Circuit for participants to hold the fiduciary accountable for failing to act prudently. In this case, the court might instead, for example, have determined that damages would be based on the most favorable sale date or an average of the most favorable sale dates over a defined period.

What Fiduciaries Should Do?

The lesson for fiduciaries is clear. Fiduciaries can be sued for not selling stock as well as for selling at what plaintiffs allege is the wrong time. And now that the Supreme Court has eliminated the so-called "Moensch presumption" that decisions involving employer stock are presumptively prudent, fiduciaries of plans with employer stock funds need to be particularly diligent.

However, courts do not apply 20-20 hindsight in reviewing whether investment decisions were prudent. Had the correct RJR fiduciaries followed a prudent process, the issue of damages might never have been reached. Written documentation of a prudent process by the correct plan decision makers is essential, and that prudent process often involves consulting the right expert advisers.

The Mistaken Fiduciary: Can You Correct Overpayments to U.S. Retirees?

Carol I. Buckmann

Even the best run pension plans occasionally pay retirees the wrong amount due to errors in employee classification, or calculating participant service or compensation. Correcting underpayments is easy enough – though it is important to remember that interest is required –but what happens after a pension plan discovers an error after paying the retiree too much or even a benefit to which a retiree was never entitled?

The United States Court of Appeals for the Ninth Circuit recently confronted this issue when a retiree, who was found never to have had enough qualifying service to have vested in his pension, sought to enjoin the plan from cutting off his payments. In Gabriel v. Alas. Electrical Workers' Plan, the retiree claimed that he would never have stopped working if he had known he had not qualified for a pension. He sought equitable relief under the U.S. Supreme Court's CIGNA v. Amara decision, finding that participants could obtain traditional equitable relief for certain violations by plan fiduciaries.

The Ninth Circuit rejected the retiree's claims under each of the three forms of equitable relief discussed by the Supreme Court in its decision.

- The court rejected the retiree's estoppel claim that the plan couldn't discontinue what it had been doing because it found that there could be no estoppel based on oral statements when the plan language was clear. To recognize such claims might jeopardize the actuarial soundness of a plan and the benefits of legitimate participants. The court noted that the retiree was also ineligible to rely on estoppel, because he was aware that he had failed to qualify for the pension.

- The court refused to reform the plan to require it to provide the pension, because there was no mistake in the plan document.

- A surcharge was denied, because there was no loss to the trust to be reimbursed by the continuing payments and the trustees were not unjustly enriched.

In effect, the court rejected the retiree's efforts to use CIGNA v. Amara in an action that was not to the benefit of the trust.

While the court upheld the plan's suspension of the unearned pension, it did not comment on whether the plan had an obligation to recover the improper payments it had previously made. The plan had apparently dropped its lawsuit to recover those payments, but was that appropriate?

The IRS correction procedures in the voluntary correction program in Rev. Proc. 2013-12 require a plan sponsor seeking a compliance statement to demand repayment plus interest when overpayments have been made. However, they also indicate that if the participant does not make the repayment, the plan sponsor must make up the difference to place the plan in the same position as if the overpayment had not been made. It does not appear that the IRS requires that the plan sue the participant to recover.

An Ounce of Prevention.

There are a number of decisions in which participants attempted unsuccessfully to keep overpayments that had been communicated in erroneous benefit statements. See, e.g., Stark v. Mars Inc., 879 F. Supp. 2d 752 (S.D. Ohio 2012, affd by the Sixth Circuit Court of Appeals).

These cases underscore the importance of using warning language stating that the amount shown on the benefit statement is only an estimate, and that the final amount of a pension must be determined by the plan's actuaries. But by the time a participant applies for a pension, as the participant in this case did, every plan needs to do a final careful check of eligibility and every element relevant to the pension calculation to avoid this type of litigation and the need to make retroactive corrections. The plan might also want to notify new retirees that it still retains the right to correct mistakes. Playing catch-up later could lead to expensive legal action even if the plan fiduciaries win.

The Inadvertent Fiduciary: Mass Mutual Crosses the Line

Carol I. Buckmann

Plan fiduciaries are held to the highest performance standards and can be personally liable for breaches of fiduciary responsibility. Because of this potential liability, there should be clear and rational rules enabling those who provide services to plans to know when they have crossed the line.

I recently wrote a post called the "Teflon Fiduciary" in which I argued that the U.S. Court of Appeals for the Fifth Circuit had permitted investment advisers functioning as fiduciaries to avoid responsibility for imprudent or inappropriate advice. By looking to the manner in which the adviser in question was paid rather than whether he was functioning as a fiduciary, that court set the line in the wrong place. The rule may have been clear, but it wasn't rational and it excluded too many advisers.

We have now had a decision from a federal district court in another part of the country that seems to err in the opposite direction by including as fiduciaries people who the drafters of ERISA probably never intended to cover.

The case is Golden Star, Inc. v. Mass Mutual Life Insurance Company.

Mass Mutual marketed 401(k) investment and recordkeeping services to two 401(k) plans sponsored by Golden Star, and plaintiffs challenged (among other practices) Mass Mutual's receipt of revenue sharing payments from investment providers in connection with plan investments. The ERISA self-dealing provision, that plaintiffs claimed, had been violated applied only to fiduciaries. Their claims would fail if Mass Mutual was not a fiduciary.

In a recent ruling denying summary judgment to Mass Mutual, the court found that Mass Mutual was a "functional fiduciary" because it had the discretion to unilaterally set fees up to a maximum and it actually exercised that discretion. Specifically, Mass Mutual determined its own compensation, took fees out of separate accounts, and had discretion to offset some or all of the revenue sharing payments against management fees. The same decision rejected plaintiffs' claims that Mass Mutual was also a fiduciary because it had contractual authority to add, delete or substitute mutual funds available on the plan menu-and therefore influence the amount of revenue sharing it was paid- because Mass Mutual had never exercised its authority to change funds on the menu during the limitations period. This is consistent with the position taken by most courts that have addressed this issue. (See, e.g., Leimkuehler v. Am. United Life Ins. Co., 713 F. 3d 905 (7th Cir. 2013))

In its amicus briefs filed in other recent cases, the Department of Labor has asserted the same positions taken by plaintiffs in Golden Star, but is this a rational and clear basis for determining fiduciary status? It would appear to be more logical to find that the person must first be determined to be a fiduciary based on other actions it took with respect to the plan, and then examine whether a breach of fiduciary duty occurred in setting the level of fiduciary compensation.

If setting its own compensation level is what makes a vendor a fiduciary, then almost any plan record-keeper could be held to be a fiduciary under the reasoning adopted by the Golden Star court because most form contracts we see permit plan vendors to change at least some rates for service, by simply providing advance notice. However, under longstanding ERISA authority, Reg. 2509.75-8 on fiduciary responsibility provides in Q&A D-2 that those who maintain plan records and prepare plan reports “who have no power to make any decisions as to plan policy, interpretations, practices or procedures” are not fiduciaries.

These recent decisions make a clear case for establishing more consistent standards so that plan service providers know in advance whether they have fiduciary responsibilities and exposure.

Amidst much controversy, the Department of Labor is undertaking to update its 1975 regulations on the definition of “fiduciary.” We don’t know when we will see a new proposal or what it will say. However, if the new proposal does not establish rational distinctions that help prevent service providers from inadvertently assuming fiduciary status, perhaps it is time for Congress to revisit this issue, as the court cases in this area don’t seem to be t advancing that goal.

The Teflon Fiduciary: Could Your U.S. Adviser Avoid Responsibility For Bad Advice?

Carol I. Buckmann

Ronald Reagan was referred to years ago as "the Teflon President" because voters never seemed to hold him responsible for his administration's missteps. A significant decision on fiduciary status has just been issued by the Court of Appeals for the 5th Circuit. Tiblier v. Dlabal which created what I call the "Teflon Fiduciary."

Why is this Important?

This decision deserves lots of attention because it provides a blueprint for investment advisers to avoid responsibility for self-dealing and bad advice. The decision also constitutes a persuasive argument why the U.S. Department of Labor needs to continue its controversial efforts to update its regulations on when giving investment advice makes a person a fiduciary.

What Actually Happened?

In the view of the appellate court, the facts were so straightforward that summary judgment in favor of the adviser - without a trial on the facts - was warranted. A careful reader of the decision may well disagree.

- Dlabal was a doctor and former colleague of Tiblier.

- Dlabal was licensed as a broker and investment adviser to act in affiliation with a firm, but could not act individually.

- In affiliation with the now-defunct CACH Capital Management, Dlabal advised Tiblier regarding his medical practice's plan investments. He recommended an investment in bonds issued by a risky start-up company and received a $2500 share of the broker's commission in lieu of a fee when the plans invested.

- The issuer stopped paying interest on the bonds, and Tiblier sued Dlabal for numerous fiduciary breaches. (Under ERISA, a fiduciary may be personally liable for losses caused by fiduciary breaches.)

The appellate court found that although Dlabal recommended this investment, he was not a fiduciary because he had no discretion over plan investments and had disclosed his compensation and the risks of the investment to the fiduciaries who authorized it. Further, he declined a fee in favor of a share of the broker's commission on the trades, so the court found that he did not receive a "fee" from the plan for his advice.

The DOL Supports Plaintiffs.

The Department of Labor filed an amicus brief in this case arguing that the district court was applying liability standards under the securities laws - which look to whether adequate disclosure of the risks was made - instead of those under ERISA. The Department of Labor also reminded the appellate court that ERISA contemplates that there can be co-fiduciaries and even if the company fiduciaries made a bad decision, and should have read the offering materials more carefully, that did not mean that the adviser was off the hook.

What is Wrong with this Picture?

Dlabal seems to have been functioning as a fiduciary as defined in ERISA, although the appellate court did not reach the issue of whether his advice was based on the particular needs of the plans.

Section 3(21) of ERISA and related regulations provide that giving investment advice, such as making recommendations regarding the investment of plan assets for direct or indirect compensation makes an adviser a fiduciary, provided that the advice is given on a regular basis pursuant to an understanding that it will form a primary basis for plan investment decisions and is based on the particular needs of the plan. (Emphasis added)

The appellate decision adds a requirement of discretion or control, and a second requirement that compensation have been paid by the plans, even though these requirements appear nowhere in the ERISA authority. It is clear that Dlabal was compensated for his advice regarding plan assets, albeit indirectly, in the common understanding of that term. It should not matter that the adviser elected to forego a direct fee in favor of a different method of compensation. In a sense, Dlabal was in "constructive receipt" of the fee.

Company Fiduciaries Beware.

There are lessons here for company fiduciaries who want advisers who take responsibility for their advice and understand the fiduciary duties of prudence and loyalty.

First, make sure that you hire advisers who are experienced in dealing with ERISA plans and competent in their purported field of expertise and not simply people that you know already.

Second, hire only advisers who will acknowledge in writing that they are providing advice to you as an ERISA fiduciary, which subjects them to the highest standards of conduct. Otherwise, you run the risk that they will run in the other direction and maintain that they are not fiduciaries if their bad advice results in losses. Dlabal even had the audacity to try to get the plaintiffs to pay his attorney's fees, but even the district court drew the line at that!