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Fiduciary Update | August 2019

In this quarter's Fiduciary Update, CAPTRUST's Drew McCorkle touches on the state of cybercrime and the heightened need for proper control and diligence in evaluating and approving retirement plan participant distributions. McCorkle also provides a synopsis of the retirement plan cases on the Supreme Court's docket, a status on the ongoing flow of fee cases, and a report on allegations of incorrect actuarial assumptions made by pension plans.

Case to Recover Missing 401(k) Balance Proceeds

A small law firm established a 401(k) plan with the help of a third-party administrator (TPA), and the plan was set up with Nationwide Trust Company. Both the TPA and Nationwide were involved in the ongoing operation of the plan. Plan operations apparently went smoothly until 2016.

In December 2015, one plan participant withdrew $15,000 from his account. The appropriate form was emailed to the TPA who processed the distribution with Nationwide and the money was deposited in the participant's bank account. Thereafter, the withdrawal process was allegedly duplicated by unauthorized persons, and the remaining approximately $400,000 was distributed from the participant's account—but into a different bank account, not belonging to the participant. According to the claim, emails that appeared to originate from the plan sponsor's office administrator forwarding apparently legitimate withdrawal requests from the participant were sent to the TPA and processed by Nationwide.

Various fiduciary breach allegations were made against the TPA and Nationwide, claiming that they did not exercise proper control and diligence in evaluating and approving the distributions. It appears that the TPA and Nationwide disagree on who is responsible. The TPA's and Nationwide's initial defense was that they were not acting as plan fiduciaries, so the fiduciary breach claim should be dismissed. The judge disagreed, and the claims will proceed. *Leventhal v. The MandMarblestone Group LLC* (D ED PA 2019).

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Plan and participant data security becomes a higher priority to plan sponsors every day. As providers launch new capabilities that make plan information more accessible, they also increase the threat of a cyberattack. When new tools or processes are introduced, plan sponsors should understand the important role they play in safeguarding participant information and retirement assets.

Retirement Plan Cases Crowd the Supreme Court's Docket

The Supreme Court of the United States has agreed to hear four retirement cases during its 2019-20 term that begins in October. Unlike other courts, with few exceptions, the Supreme Court decides what cases it will hear. Out of 7,000 to 8,000 requests, the Supreme Court agrees to hear only about 80 cases each term. The last ERISA case decided by the Supreme Court was in 2017. Following is a synopsis of cases on the Supreme Court's upcoming docket and one that the court declined to hear:

- *If a pension plan becomes fully funded after a breach, is there a basis for a fiduciary breach claim? Was anyone harmed?* Following the financial crisis in 2008 and 2009, U.S. Bank was sued for breaching its fiduciary duty managing its pension plan investments, resulting in large losses. The pension plan was underfunded when the lawsuit was filed. However, as a result of employer contributions and market performance, the plan became overfunded in 2014. As a result, the alleged injury—inability of the plan to pay benefits when due—has been eliminated. Consequently, the case was dismissed as moot. *Thole v. U.S. Bank, Nat'l Ass'n* (8th Cir. 2017).
- *After a fiduciary breach is established, is the claimant required to show that losses resulted from the breach, or does the burden shift to the fiduciaries to show that no losses resulted?* To win a fiduciary breach case, it must be shown that there was a breach, there was a loss, and the loss was caused by the breach. In *Brotherston v. Putnam Investments LLC* (1st Cir. 2018), the court held that, after a breach and loss are established, it is the responsibility of plan fiduciaries to prove that the loss was not caused by the breach. Four judicial circuits have taken this position, and four other circuits have taken the opposite position.
- *When does a participant have "actual knowledge" of an alleged breach that starts the statute of limitations clock running?* Intel created its own target date funds that included alternative investments. After performance of the target date funds lagged, a participant sued. Intel asked to have the case dismissed because it was filed more than three years after the participant had knowledge that alternative investments were being used. The district court dismissed the case, but the court of appeals reinstated. Simply having knowledge that alternative investments were used does not constitute "actual knowledge," and legal knowledge that there was a breach of ERISA's rules was too much to require. The court settled on a middle ground that to have "actual knowledge" sufficient to begin the running of the statute of limitations, there must be knowledge of the facts and a knowledge that the fiduciaries' actions were imprudent. *Intel Corp Investment Policy Committee v. Sulyma* (9th Cir. 2018).
- *For plans with employer stock, what allegations are needed to support a stock-drop fiduciary claim?* Five years ago, the Supreme Court's decision in *Fifth Third Bank v. Dudenhoeffer* (S. Ct. 2014) struck down lower court decisions finding a presumption that it was prudent to offer employer stock in a retirement plan. The court established a new pleading standard for suits alleging that fiduciaries should have avoided losses from a dramatic drop in the employer's stock. Since then, no cases have met the new standard with all being dismissed. The Supreme Court will consider the new standard in Jander v. IBM (2nd Cir. 2018).
- *Excessive fees and investment performance claims must allege an insufficient fiduciary governance process to avoid dismissal.* It is sometimes important to note cases the Supreme Court does not accept and allows the lower court opinion to stand. We have previously reported on the decision in *White v. Chevron* (9th Cir. 2018), in which plan fiduciaries allegedly breached their fiduciary responsibilities by using a money market fund rather than a stable value fund; paying excessive investment management fees; paying excessive pan administration fees; and

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taking too long to replace an underperforming fund. It was not also alleged that these breaches resulted from failed or insufficient fiduciary processes, so the claims were all dismissed. The disappointed plan participants petitioned the Supreme Court to reinstate their claim. However, the Supreme Court declined.

Flow of Fee Cases Continues
As the flow of fee cases continues, here are some recent developments:

- The U.S. Department of Labor sued City National Corporation for receiving improper compensation in administering its own 401(k) plan. ERISA is clear that plan sponsors may receive only reimbursement for the direct cost of providing services to their retirement plans. In this case, it appears that City National treated its own plan much like the 200 or so other plans it administered, retaining revenue sharing from plan investments to pay for its services. Because City National set its own fees for its plan and did not track actual costs of providing services to its plan, the court found that it had committed a prohibited transaction under ERISA. The total fees paid for plan services was determined to be $4.6 million. Missed earnings brought the amount to approximately $8 million. Because City National could not demonstrate the actual cost of services provided for its own plan, the entire amount less a few offsets for fees paid to outside parties, was found to be due to plan participants. *Acosta v. City National Corporation* (9th Cir. 2019).
- MFS was accused of using primarily its own investments in its plan without investigating alternatives, not using the least expensive share classes, and not removing poorly performing funds. A proposed settlement of $6.9 million has been filed. *Velazquez v. Massachusetts Financial Services Company* (D. MA).
- BB&T was sued for using only its own funds until 2009 and later using proprietary funds that allegedly underperformed and were expensive. The case settled for $24 million. *Sims v. BB&T Corporation* (M.D. NC 2019).
- Suit has been brought against a 401(k) plan with approximately $200 million in assets, alleging fiduciary breaches in overpayment of administrative and investment fees and not using enough passive investments. The case is proceeding and is worth highlighting as this plan is meaningfully smaller than the typical plan being targeted by plaintiff's attorneys. *Torres v. Greystar Management Services LP* (W.D. TX).

More Pension Lawsuits Challenge Benefit Calculation
Additional lawsuits have been filed alleging that pension plans paid improperly low benefits to some pensioners and their survivors by using incorrect actuarial assumptions. Generally, these cases allege that outdated mortality assumptions or interest rates used to calculate joint and survivor benefits resulted in understated benefits in violation of ERISA.

One of these suits was filed against U.S. Bancorp, which filed a motion to dismiss the claim. The motion was denied in late June, and the case will proceed. Denying the motion, the judge focused on "actuarial equivalence." He indicated that if a pension benefit is paid at any time or in any form other than a single life annuity at normal retirement age, it must be worth as much as that annuity. This language will undoubtedly be viewed positively by the plaintiffs. *Smith v. U.S. Bancorp* (D. MN 2019).

One legal commentator recently suggested that plan sponsors who evaluate this issue may want to consider utilizing legal counsel to avoid having the analysis find its way into future litigation.

This Isn't an ERISA Pension Plan…. Is It?
In September of 1947, Mary Chichester DuPont created an "employee pension trust." The trust was

established to pay an annual pension equal to 60% of wages to retired domestic employees and any employees who provided secretarial, accounting, or other assistance to DuPont family members. Two grandchildren of Ms. Dupont have domestic employees who they claim are entitled to benefits under the trust. At least 13 other former employees of DuPont family members have qualified for and are receiving pensions. Apparently, until the filing of this suit, the trust and its provisions had not been treated as a pension plan covered by ERISA.

The two grandchildren sued, seeking determinations that the trust is covered by ERISA and their employees are entitled to pension benefits. Applying ERISA's criteria, the court concluded that the trust and program to pay pensions to DuPont family employees is a pension plan covered by ERISA. Although ERISA was signed into law in 1974, nearly thirty years after the trust was established, the court noted that ERISA was designed to cover plans and arrangements that were in place at the time ERISA was passed. ERISA's substantive rules did not begin to apply until January 1, 1975. *Wright v. Elton Corporation* (D. DE 2019).

This case is a good reminder that benefits provided by employers to employees may be covered by ERISA even if that is not immediately apparent.

Author(s)

Drew McCorkle

https://captrust.com/people/drew-mccorkle/

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