EMPLOYEE BENEFITS DEVELOPMENTS MAY 2015

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RULINGS, ETC.

DOL Again Proposes Regulations Governing Provision of Retirement Advice. Several years ago, the Department of Labor (DOL) proposed a regulation that would have redefined the term "fiduciary." The proposed regulation received a great deal of criticism, prompting the DOL to withdraw its proposal. In February of this year, President Obama called on the DOL to move forward with the proposed rulemaking to require that retirement advisors be subject to a fiduciary duty. As a result, the DOL reissued the proposed regulation defining and expanding the term "fiduciary" largely in line with the prior proposal and the call of the president. One difference is that the rationale for the regulation is now focused on what the DOL considers a conflict of interest in retirement advice that it claims costs workers and their families billions of dollars every year.

Generally, when we think of guidance issued by the DOL with respect to retirement arrangements, we envision actions that affect qualified retirement plans governed by the Employee Retirement Income Security Act (ERISA). This proposed regulation applies to retirement arrangements far beyond qualified retirement plans. The proposed regulation would consider a person to be a fiduciary under ERISA and the Internal Revenue Code when that person provides investment advice with respect to an employee benefit plan or an individual retirement account-type arrangement. Included in the scope of this proposal are Individual Retirement Accounts (IRAs), Health Spending Accounts (HSAs), and Coverdell Education Savings Accounts -- a much broader group than the typical qualified retirement plan.

With respect to all of these arrangements, the proposed regulation would provide that a person is subject to the fiduciary standards if, for a fee or other compensation, a person provides "covered advice," such as:

- Recommendations as to the advisability of acquiring, holding, and disposing of securities or other property;
- Recommendations to receive a distribution of benefits or to roll over assets from a qualified plan or an IRA;

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- Recommendations as to the management of securities or property, including management of assets to be rolled over to or distributed from an IRA;
- Appraisals or fairness opinions concerning the value of securities or property involving a transaction with a retirement plan or IRA; and
- Recommendations regarding someone who will also receive a fee or compensation for providing the above advice.

Fiduciary status will also apply to those who either 1) directly or indirectly represent or acknowledge their fiduciary status, or 2) provide advice under an agreement or with the understanding that the advice is individualized to the recipient or is to be considered when making investment or management decisions with respect to securities or other property.

The scope as to what type of advice rises to the level of fiduciary advice is much broader than under current regulations. For example, a recommendation about whether to receive a distribution of benefits or roll the amounts over to another plan or an IRA falls within the category of covered advice.

In addition to the proposed regulations, the DOL also proposed two prohibited transaction exemptions and some modifications to other existing prohibited transactions exemptions. Given the expanded definition of fiduciary that would result from the issuance of a final regulation in this form, these exemptions and modifications would be necessary and would allow for orderly business transactions. While described by the DOL as broad and flexible, however, the exemptions have been criticized as narrow in scope by the investment industry.

Because the proposed regulation is similar to the proposal withdrawn in the controversy three years ago, we can expect similarly critical reviews of this proposal. However, given the president's rather uncommon directive to issue this guidance, we can expect that the DOL will feel more empowered to proceed with it this time around.

The type of activities that would be covered as a fiduciary duty by this proposed regulation would seem to encompass activities of individuals who are governed by other regulatory departments such as the Securities and Exchange Commission and FINRA. There have been many suggestions that a coordinated effort involving other federal agencies would be a more appropriate course of action than the DOL individually issuing this guidance. Stay tuned, as we expect there will be many comments issued and further developments in this area. (DOL Factsheet: http://www.dol.gov/ebsa/newsroom/fsconflictsofinterest.html; DOL Proposed Rulemaking and related items: http://www.dol.gov/ebsa/regs/conflictsofinterest.html)

CASES

Plan Must Honor Pension Estimates; Participant May Retain Plan Overpayments. An employee worked for a company from 1984 through 2009 and accrued benefits under the company's qualified pension plans. In late 2007, the employee began considering retirement, so he requested and received a pension calculation estimating his potential retirement benefits from the plans. He also received pension calculations during the summer of 2008, in April of 2009, and at his May 2009 retirement interview. During his retirement interview, the employee and a company representative discussed the lump-sum payment and monthly annuity payment the employee would receive upon retirement. They also discussed the employee's hire date and the calculation of his years of credited service. Because the employee switched between unionized

and non-unionized positions during his employment, he questioned the company representative about the computation of his years of credited service. The employee was particularly concerned with the effect his transfers between union and non-union jobs would have on the accrual of his years of credited service. The company representative indicated that the information on the pension calculation presented at the interview was correct. After reviewing the documents and discussing the matter with the company representative, the employee and his wife signed the pension election form. The employee retired in July 2009, two years before he would have been eligible to receive an unreduced early retirement benefit.

During an audit in 2011, the pension plan's third-party service provider discovered the years of credited service used to calculate the employee's pension benefit were overstated by approximately three years. The employee was notified of the error in a December 2011 overpayment notice that presented the employee with several options for repaying a total of $17,776.35 in excess benefits plus investment earnings.

In February 2012, the employee filed a claim with the plan in which he objected to the correction of his benefits. The plan committee denied the claim, and the employee appealed. The appeals committee denied the appeal as it related to the correction of his monthly annuity payment, but reversed the decision that would have required him to repay the excess benefits. Under the committee's decision, the employee's monthly annuity payment remained $54.42 lower than before the recalculation, but the employee was not required to repay the excess benefits he received in error. The committee's decision was conditioned on the employee not seeking payment of a special benefit in the amount of $6,884.49 before interest, to which he was apparently entitled at the time.

The employee then filed a lawsuit in which he sought payment of all monies owed to him, as well as $25,000 in costs and damages. The employee alleged he made retirement decisions in reliance on the written pension calculations he was provided, and on the assurances the company representative made at the retirement interview. The court found:

1. The employee was misled when the company representative assured the employee that the years of credited service calculations on the pension calculations presented at the retirement interview were correct, and that his various pensions would be bridged together;
2. The company representative's failure to properly investigate the concern raised by the employee was "grossly negligent," and "was precisely the sort of malfeasance that may give rise to constructive fraud;"
3. The company representative's conduct was sufficient to give the employee a right to believe the company "intended him to act upon their representations in deciding to retire;"
4. The employee was unaware of the true facts; and
5. The employee demonstrated that he suffered an "adverse change in position as a result of his reliance on" the company's representations.

Based on those findings, the court granted the employee's summary judgment motion and denied the company's summary judgment motion. The court ordered that the plan sponsor and the plan are to be "estopped from reducing the employee's retirement benefits" and must return him "to the same position he would have been in had the initial calculations been correct."

It is not uncommon for pension plans to make inadvertent mistakes in performing pension calculations that result in overpayments of plan benefits. Corrective actions by the plan sponsors, based on Employee Plans Compliance Resolution System (EPCRS) guidance, typically have involved a cessation of the excess plan payments going forward and a reasonable attempt to recover excess payments (with an appropriate interest or earnings adjustment) from the affected participants. But when the conduct of the plan sponsor and its representatives in administering benefit payments are indicative of "gross negligence" and "constructive fraud," this case suggests that a court could order the plan *not* to correct the overpayments. That result almost certainly would leave the plan sponsor questioning whether the plan is then vulnerable to IRS sanction or even disqualification for failure to correct an operational error. As we reported in the April 2015 *Employee Benefits Developments*, the appropriate correction under EPCRS for a plan overpayment is changing, and it may be possible for the plan sponsor to correct an overpayment on its own by contributing the overpayment amount (adjusted for earnings or interest) to the plan, rather than requesting the recipient to do so. Nonetheless, a court decision that may force the plan to continue making benefit payments that are inconsistent with the plan terms is difficult to reconcile with the plan sponsor's obligation to operate a plan in accordance with its terms. *Paul v. Detroit Edison et al* (E.D. Mich. 2015)

Plan Document Trumps Summary Plan Description. The U.S. Court of Appeals for the Ninth Circuit vacated a district court's decision to uphold a claim administrator's denial of a plaintiff's long-term disability benefits. The Ninth Circuit held that the district court erred in reviewing the benefits denial under an "abuse of discretion" standard rather than the less deferential "de novo" standard. When a plan confers discretionary authority upon an administrator to interpret its terms and determine eligibility for benefits, a reviewing court will typically give great deference to the administrator's decision (i.e., the "abuse of discretion" standard). In practical terms, this means that when an abuse of discretion standard is used, it is much more difficult for a plaintiff to successfully challenge an administrator's decision to deny a benefit. In this case, although discretionary authority was conferred upon the administrator, it was done through the summary plan description, not the plan document. In an earlier case, the Supreme Court ruled that "the terms of statutorily required plan summaries…may [not] be enforced…as the terms of the plan itself." In this case, the Ninth Circuit similarly reasoned that because the plan document did not confer discretionary authority, the administrator's decision should not benefit from the heightened standard of judicial review. In light of this decision, plan sponsors should confirm that their plans' operative language is contained in the plan document, not the summary plan description. *Prichard v. Metro Life Ins. Co.*, (9th Cir. 2015)

Denial of Severance Benefits Under a Top Hat Plan Entitled to Deferential Review. Affirming a lower court decision, the U.S. Court of Appeals for the First Circuit ruled that the inclusion of a clause providing for administrative discretion in interpreting benefits in an executive severance plan is sufficient for a court to apply a favorable standard of review to the plan administrator's decision. A key factor in the court's approval of the decision by the company to deny severance benefits —to a former executive, in this case—was the standard of judicial review applicable to the plan administrator's decision. As the court noted, when a plan subject to ERISA delegates to the plan administrator the discretion to construe the plan and determine eligibility for benefits under its provisions, a decision made under the plan will generally be upheld unless it is determined to be "arbitrary, capricious, or an abuse of discretion."

The former executive in this case, however, argued against such deferential review. Pointing out that the plan at issue is a "top hat plan," he urged the court to follow the lead of the Third and Eighth Circuits in applying a *de novo* standard of review that is less favorable to the plan administrator. Both parties agreed that the plan is a top hat plan—that is, an

unfunded plan maintained by an employer primarily for the purpose of providing deferred compensation for a select group of management or highly compensated employees. Nevertheless, the First Circuit declined to decide in this case whether top hat plans are categorically subject to *de novo* review, because the plan explicitly grants the administrator discretion to interpret the plan. Applying the deferential standard of review here, the court found that the plan administrator exercised its discretion reasonably in deciding that the former executive's retirement was not the result of an involuntary termination entitling him to severance under the plan.

A different standard of review applied to the executive's benefit interference claim under ERISA. Ruling that the lower court applied the wrong standard when it ruled in favor of the company on this claim, the First Circuit reinstated the claim and returned it to the lower court for reconsideration under the proper legal standard. On balance, this case illustrates the importance for employers of including in their top hat plans a provision granting the plan administrator discretion to interpret the plan. *Niebauer v. Crane & Co.* (1st Cir. 2015)

Requirement to Hold Plan Assets in Trust Does Not Require Document With Express Words of Trust or Trustee. ERISA Section 403(a) requires, with certain limited exceptions, that an employee benefit plan's assets be held in trust by one or more trustees. The trustee is required to either be named in a trust instrument or the plan document, or appointed by the plan's named fiduciary. Unless the trustee is a directed trustee or an investment manager has been appointed, the trustee has the exclusive authority and discretion to manage and control the plan's assets. ERISA does not define the terms "trust," "trustee," or "trust instrument."

The California Association of Professional Firefighters (CAPF) served as the manager of an ERISA-covered long-term disability plan. The plan was funded solely from participants' contributions, and benefits were paid solely from these contributions and any related earnings. The assets were held in a checking account with Wells Fargo, for which officers of the California Administration Insurance Services, Inc. (CAISI), the Plan's administrator, were signatories. CAPF was charged with supervising CAISI under the plan document.

Under the plan's document, all funds, property, and additional assets held by the plan were to be maintained exclusively in the name of CAPF for the benefit of plan participants. However, there was no document expressly using the words "trust" or "trustee."

After tracing through the history of the common law of trusts, the U.S. Court of Appeals for the Ninth Circuit concluded that ERISA Section 403(a) does not require the creation of a document including express words of trust; rather, all that is required under ERISA is that a person (legal or natural) must hold legal title to the assets of an employee benefit plan with the intent to deal with the plan's assets solely for the benefit of plan participants and beneficiaries. The Ninth Circuit then held that since the plan document required CAPF to hold legal title to the plan's assets for the benefit of plan participants, ERISA's trust requirement was satisfied.

The court also summarily rejected the plaintiff's argument that, because CAISI was administering the plan, CAPF failed to maintain exclusive authority and control over the plan's assets. According to the court, this argument failed because the plan document required CAPF to supervise CAISI. Somewhat strangely, the court did not devote any analysis to the administrative services agreement with CAISI, which appears to have warranted some attention in view of the fact that CAISI's officers were the sole signatories for the Wells Fargo checking account.

The plaintiff also alleged that the defendants had breached their fiduciary duties by failing to distribute a summary annual report (SAR). However, the Ninth Circuit held that defendants were entitled to rely on an exemption from distributing a SAR for plans under which benefits are paid solely from the general assets of the employer or employee organization maintaining the plan. The court's holding on the plaintiff's SAR claim is directly at odds with its holding that the plan's assets were held in trust.

Notwithstanding the conclusions reached by the Ninth Circuit, it is strongly recommended that a plan's assets be held by a trustee pursuant to a formal trust instrument, if ERISA's trust requirement must be met. Although not at issue in the case, among other potential issues, there could be adverse tax consequences associated with plan assets being held under an informal trust arrangement. *Barboza v. California Association of Professional Firefighters* (9th Cir. 2015)