BAD TIMES FOR ERISA FIDUCIARIES:

MORE EXPOSURE, LESS DEFERENCE AND INCREASED REPORTING

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Introduction

- General Overview of ERISA Fiduciary Duty Provisions
  - ERISA Sections 404 and 406
  - Enforcement through ERISA Section 502
  - Special duties of Plan Administrators

Introduction (continued)

- 2008 Supreme Court decisions directly affecting fiduciaries and their decisions
  - *LaRue v. DeWolff, Boberg & Associates*, 128 S.Ct. 1020 (2/20/08) – expands causes of action for individual recoveries for fiduciary breach
  - *Metropolitan Life Insurance Co. v. Glenn*, 128 S. Ct. 2343 (6/19/08) – less deference for fiduciary decisions in the presence of any "conflict of interest"

Introduction (continued)

- U.S. Department of Labor actions to increase the reporting and disclosure burdens on fiduciaries regarding the receipt and payment of fees and other consideration
  - DOL requirements for reporting of direct and indirect compensation received by insurance companies and other service providers on Form 5500
  - DOL Proposed Rules regarding reasonable compensation paid to service providers under Section 408(b)(2)

LaRue and Section 502(a)(2) Causes of Action

- Supreme Court revisited the issue of whether an individual participant can sue for damages under ERISA section 502(a)(2)
  - Historical reliance on *Russell* – relief only for plan as a whole
  - Change in the "landscape" of employee benefits field, in particular the advent of individual account pension plans, individual participants should be able to sue under 502(a)(2) when a fiduciary breach has caused a loss to the value of the participant's account
  - Chief Justice Roberts' concurrence – the interplay between Section 502(a)(1)(B) (individual suit for claim of benefits under a plan) and the Court's new interpretation of Section 502(a)(2)

LaRue (continued)

- *LaRue* has been applied in only limited situations
  - Standing for former employees to sue for various fiduciary breaches:
    - *Wangberger v. Janus Capital Group, Inc.*, 529 F.3d 207 (4th Cir. 2008) (market timing)
    - *Rogers v. Baxter International Inc.*, 521 F.3d 702 (7th Cir. 2008) (stock drop)
    - *Harris v. Finch, Pruyn & Co.*, 44 Emp. Ben. Cases [BNA] 2206 (N.D.N.Y. 2008) (tax losses due to mistakes in roll-overs from 401k plan)
    - *Maxwell v. RadioShack Corp.*, 43 Emp. Ben. Cases [BNA] 2059 (N.D.Tex. 2008) (investment losses)

LaRue (continued)

- Non-pension plan context:
  - *Nichols v. Alcatel USA Inc.*, 44 Emp. Ben. Cases [BNA] 1001 (5th Cir. 2008) – *LaRue* does not apply in the case of a self-funded plan (no loss of or diminution in the value of plan assets) but could apply to an insured or funded health care or disability arrangement
  - *Crider v. Life Insurance Co. of North America*, 44 Emp. Ben. Cases [BNA] 2289 (W.D. Ky. 2008) – relied on Chief Justice Roberts' concurrence to hold that where a case can be brought under Section 502(a)(1)(B) for a claim for benefits under a plan, the participant would be foreclosed from suing for damages under Section 502(a)(2).

Glenn and Decreased Deference to Fiduciary Interpretations

- Supreme Court addresses the extent to which a fiduciary's plan interpretation in a claims context is entitled to deference when the fiduciary acted in the presence of a conflict of interest.
  - Factual Background – Insured long term disability plan with a Special Security offset
  - Court broadly defines conflict of interest -- Any interest of the claims fiduciary at odds with the interest of the claimant
    - All justices agree that an insurance company that both insures and administers a plan has such a conflict
    - Conflict also results when an employer administers its own self-funded plan.

Glenn (continued)

- Divisions in delineating the effect of such a conflict
  - Five Justice majority (Breyer, Stevens, Souter, Ginsburg and Alito) agreed that such a conflict was one factor to be weighed when determining how much deference to accord a fiduciary decision. Essentially adopted a totality of the circumstances test.
  - Roberts (concurring in judgment) and Thomas and Scalia (dissenting) – conflict relevant only if it played an actual role in the decision or was evidence of an improper motive.
  - "Walling Off" and other procedures to preserve deference.

Glenn (continued)

- The effects of *Glenn* are already being seen in court decisions:
  - *White v. Coca-Cola* (No. 07-13938, 11th Cir. 9/10/08) – Eleventh Circuit considers abandoning "heightened standard of review"
  - *Wakkinen v. UNUM Life Insurance Co. of America*, 44 Emp. Ben . Cases [BNA] 2172 (8th Cir. 2008) – Use of conflict as a "tie-breaker"
  - *Crowell v. Shell Oil Co.*, 44 Emp. Ben. Cases [BNA] 1909 (5th Cir. 2008) – Court abandon deference in favor of a "totality of circumstances" approach

Glenn (continued)

- Effects of *Glenn* in court decisions (continued …):
  - *Jobe v. Medical Life Ins. Co.*, 44 Emp. Ben. Cases [BNA] 2410 (W.D. Mo. 2008) – Follows *Wakkinen* tie-breaker approach, but notes that conflict can be considered only if it is shown to have actually influenced the determination
  - *Scrugs v. ExxonMobil Pension Plan*, 44 Emp. Ben. Cases 2122 (W.D. Okla. 2008) – Conflict of interest given little effect if there is no other evidence of any discrepancies in the decision-making process

Increased Fiduciary Obligations Regarding Reporting of Fees and Other Compensation

- Form 5500 Schedules A and C
  - DOL Advisory Opinion 2005-02A (2/24/05) – Requirement to include reporting of any compensation "directly or indirectly attributable to a contract or policy [of insurance] placed with or retained by" an ERISA-covered plan

Form 5500 Schedules A and C (continued)

- Same standard now included in Instructions to Revised Form 5500, Schedule A of 2007 plan year
  - Must report all compensation paid directly or indirectly in connection with an insurance contract or policy
  - Includes fees, commissions (whether specifically related to one contract or to any entire book of business), reimbursement of expenses, and non-monetary awards
  - Requires two-step process –
    - Identify all compensation direct or indirect;
    - If not related to a single contract or policy, adopt a reasonable allocation procedure (disclosed to the plan)

Form 5500 Schedules A and C (continued)

- Payments made by plans to service providers not in connection with an insurance policy or contract must be reported on Schedule C of Form 5500.
  - Only service providers receiving $5,000 or more of direct or indirect compensation in connection with the provision of services to a plan must be specifically named.
  - On July 14, 2008, DOL issued a series of Q & A's relating to the revisions for the 2009 Form 5500 Schedule C indicating that indirect compensation such as rebates, discounts, etc. must be disclosed on Schedule C.

Proposed Reasonable Compensation Rules under ERISA Section 408(b)(2)

- Background
  - Statutory Exemption for Services
    - Prohibited Transactions - Section 406(a)(1)(c)
    - Exemptions – Section 408(b)(2) exempts certain service contracts
      - To qualify for the exemption, the following requirements must be met:
        - » The contract or arrangement must be reasonable;
        - » The services must be necessary for the establishment or operation of the plan; and
        - » Reasonable compensation must be paid for the services.

Section 408(b)(2) (continued)

- Proposed Amendment to Regulations Under ERISA Section 408(b)(2)
  - Scope of the Proposed Amendment
    - Applies only to contracts or arrangements for services to employee benefit plans
    - Applies to the following categories of service providers:
      - » Fiduciary service providers;
      - » Service providers of banking, consulting, custodial, insurance, investment advisory, investment management, record keeping, securities or other investment brokerage, or third party administration services; or
      - » Service providers who receive any indirect compensation in connection with accounting, actuarial, appraisal, auditing, legal or valuation services.

Section 408(b)(2) (continued)

- Basic Requirements
  - Contract or arrangement must be in writing
  - Terms of the contract or arrangement must require the service provider to disclose, in writing, to the best of the service provider's knowledge, the information described below and that all such information was provided to the plan fiduciary.

Section 408(b)(2) (continued)

- Disclosure of Compensation and Services
  - Service provider must disclose the following:
    - » All services to be provided to the plan
    - » All compensation, direct or indirect, it will receive in connection with the services

      a. Compensation or fees include "money or any other thing of monetary value (for example, gifts, awards, and trips) received, or to be received, directly from the plan or plan sponsor or indirect (i.e. from any source other than the plan, the plan sponsor, or the service provider) by the service provider or its affiliate in connection with the services to be provided pursuant to the contract or arrangement or because of the service provider's or affiliate's position with the plan."

      b. Formula Permitted

      c. Bundled Services Rule
    - » The manner of receipt of compensation

Section 408(b)(2) (continued)

- Disclosure Concerning Conflicts of Interest
  - Service provider must disclose and provide details regarding the following:
    - » Whether the service provider will provide services to the plan as a fiduciary
    - » Any financial or other interests in transactions in which the plan will enter pursuant to the contract or arrangement
    - » Any material relationships with various parties that creates or may create a conflict of interest
    - » Any compensation the service provider may receive that it can affect without the prior approval of an independent plan fiduciary
    - » Any policies or procedures that address actual or potential conflicts of interest and how the policies or procedures address potential conflicts of interest

Section 408(b)(2) (continued)

- Ongoing Reporting and Disclosure Obligations
  - During the term of the contract or arrangement, services providers must disclose any material changes to the information that was disclosed within 30 days of the service provider's knowledge of the material change.
  - Service providers must disclose all information requested by the plan fiduciary or plan administrator in order to comply with the ERISA's reporting and disclosure requirements.

Section 408(b)(2) (continued)

- Compliance
  - Compliance includes not only requiring the contract or arrangement to include the disclosure requirements but that the service provider actually provide all the required disclosures.
  - DOL Proposed Class Exemption – No prohibited Transaction where a plan fiduciary enters is a contract or arrangement that is not “reasonable” through no fault of the plan fiduciary but because the service provider failed to comply with its disclosure obligations.
- Effective Date