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Fiduciary Update | February 2019

In this quarter's Fiduciary Update, CAPTRUST Financial Advisor Drew McCorkle provides an update on topics such as fiduciary process controls and liability, affirming the *Chevron* fiduciaries' victory in a fees and investment performance lawsuit, and a few other recent developments stemming from cases of interest to ERISA-qualified retirement plan sponsors.

Good Fiduciary Process Continues to Win

We previously reported on the dismissal of fiduciary breach charges in *White v. Chevron* (N.D. Cal 2016). Plan participants were permitted to refile their complaint with allegations that could survive a motion to dismiss. The updated complaint was also dismissed, and that dismissal upheld on appeal. The appellate court observed that although Chevron could have chosen different investments that performed better or sought lower fees, none of the allegations in the amended complaint made it more plausible than not that there was a breach, which is required for a complaint to survive. *White v. Chevron* (9th Cir. 2018)

The original district court decision dismissing the case included the following observations and guidance for plan fiduciaries:

- Under ERISA, prudence "focuses on a fiduciary's conduct in arriving at an investment decision, not on its results, and asks whether a fiduciary employed the appropriate methods to investigate and determine the merits of a particular investment."
- "A fiduciary's actions are judged based upon information available to the fiduciary at the time of each investment decision and not from the vantage point of hindsight."
- "ERISA does not require fiduciaries to scour the market to find and offer the cheapest possible funds (which might, of course, be plagued by other problems)."
- "The allegation that Plan fiduciaries were required to solicit competitive bids on a regular basis has no legal foundation."

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- "Poor [investment] performance, standing alone, is not sufficient to create a reasonable inference that plan administrators failed to conduct an adequate investigation—either when the investment was selected or as its underperformance emerged—as ERISA requires a plaintiff to plead some other objective indicia of imprudence."
- "ERISA judges fiduciary decision-making as of the time the decisions were made. … Plaintiffs have not alleged that the Plan fiduciaries could predict that the … fund would underperform plaintiff's preferred alternatives during the period [before it] was removed from the lineup."

Who Must Prove a Fiduciary Breach Caused Losses? It Depends…

To win a fiduciary breach case, it must be shown that there was a breach, there was a loss, and that the loss was caused by the breach. Putnam Investments was sued by plan participants for using only Putnam mutual funds in its 401(k) plan without regard to whether they were prudent investment options, violating ERISA's prudence rule. After a trial, the district court found that the Putnam investment committee breached its fiduciary responsibility by automatically including Putnam funds in the plan and failing to monitor those investments. However, the court then concluded that the plaintiffs had not shown a loss to the plan that was caused by the fiduciary breach, and the plan fiduciaries prevailed.

On appeal, the United States Circuit Court for the First Circuit first agreed that there was breach in the failed investment selection and review process. It then reversed the district court decision for the fiduciaries, finding that a loss had been properly set out.

The court then considered who must prove whether the loss was caused by the breach. Joining four other circuits, 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. That is, that their investment decision was objectively prudent, even though there was a breach in their process. The court noted that plan fiduciaries can insulate themselves from liability by utilizing well-regarded index funds and having a sound process in place for selecting and monitoring investments. *Brotherston v. Putnam Investments LLC* (1st Cir. 2018)

Four other circuits have taken the opposite position on proving causation. In those circuits, the suing plan participants must prove that the breach caused the loss. With this split in the circuits, this issue is ripe for consideration by the Supreme Court.

Administrative Staff Can Create Fiduciary Liability

An employee who had been diagnosed with terminal cancer consulted with administrative staff for pension and health benefits as he was planning for his wife's financial security after his passing. Pension staff incorrectly told the employee and his wife that they could secure a 100 percent survivor pension benefit for the wife before the employee retired. Health benefit staff also incorrectly described the retiree and survivor benefits the employee and his wife would be entitled to. Following the participant's death, his wife sued for both pension and health benefits. The district court decided for the plan fiduciaries, (incorrectly) finding that a plan administrator could not be held liable for the misstatements of "ministerial" administrative staff.

On appeal, the court rejected this reasoning, noting that plan fiduciaries are required to provide complete and accurate information to plan participants and their beneficiaries. Plan administrators act as fiduciaries when they communicate with plan participants and their beneficiaries, through both written materials and individual consultations with benefits counselors. *In re: Emily DeRogatis* (2nd Cir. 2018)

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The court of appeals went on to analyze the facts presented and concluded that the pension plan summary plan description (SPD) clearly and accurately specified what was required to elect retirement benefits. Misstatements by the pension staff would not undermine the clear language and meaning of the SPD. The pension decision was ultimately upheld, but for different reasons than the district court decided.

On the other hand, the court found that the health plan SPD did not clearly communicate to participants the benefits that the participants widow was suing for. Lack of clarity in the health SPD coupled with the misrepresentations by health benefit staff would permit the case to proceed. Among other factors the court considered about the health SPD were: the SPD was 156 pages long, its language was in relevant places "almost impenetrable," it did not have a table of contents or index, and the typeface used as headings made it difficult to identify various important sections and topics. Finally, the SPD said, "Read this book in its entirety," and "When in doubt …….. ASK!" The case was sent back to the district court on the health plan issue.

This case is a good reminder of both the importance of clear and complete summary plan descriptions and that administrative staff can create fiduciary liability.

Harder for Fiduciaries to Win on Statute of Limitations Grounds

Because a plan participant did not have "actual knowledge" of allegedly improper investments by plan fiduciaries, the statute of limitations did not begin, and the participant was permitted to proceed with his lawsuit. A former employee of Intel, Sulyma, who worked there for two years, was a participant in Intel's 401(k) plan. The investments available to participants were constructed by the Intel investment committee's adoption of asset allocations and combining various different investments to fulfill those allocations. Sulyma used the Target Date 2045 Fund. When this fund was established, it did not include significant exposure to alternative investments like hedge funds. Over time Intel increased the use of alternative investments in the fund, which came at the cost of higher fees and lower returns during periods of strong equity performance. Between 2010 and 2012, during the recovery from the Great Recession, the fund lagged compared to index funds and comparable portfolios. Sulyma sued the investment committee and others at Intel for imprudent use of alternative investments in the fund.

Use of alternative investments in the fund was disclosed in fund fact sheets that were made available to participants. However, Sulyma testified that he was unaware of the use of alternative investments like hedge funds and private equity. Intel asked to have the case dismissed because it was filed more than three years after Sulyma had knowledge that alternative investments were being used in the fund. The district court agreed and dismissed the case. However, the court of appeals reversed, finding Sulyma did not have "actual knowledge" that the investments were imprudent.

The court explained that mere knowledge of the alternative investments was not enough to create 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*. Sulyma v. Intel Investment Policy Committee* (9th Cir. 2018)

This case applies to courts in the 9th Circuit, which noted that its decision is inconsistent with at least one other circuit's view. This decision will make it more difficult for fiduciaries to have suits of this type dismissed in the early stages of litigation.

Pension Lawsuits Challenge Benefit Calculation

American Airlines, PepsiCo and Metropolitan Life have been challenged in three separate lawsuits alleging that their pension plans paid low benefits to some pensioners and their survivors by using incorrect actuarial assumptions. It is alleged that a combination of outdated mortality assumptions and interest rates used to calculate "joint and survivor" benefits resulted in understated benefits in violation of ERISA.

With this form of benefit, the amount paid to the participant is reduced and payments continue to the survivor after the participant dies. The suits allege that by using the incorrect assumptions, the joint and survivor benefits were not actuarially equivalent to a single life pension for the participant. The suits were filed by the same law firms within a few days of each other. This area has received little attention, and these cases present a potential new area for legal challenge.

Fiduciaries Win Life Insurance Conversion Suit

Following her husband's death, a participant sued for his supplemental life insurance benefits. Although she received her husband's basic life insurance benefit, she did not receive supplemental life insurance because it was not converted to individual coverage. The court of appeals upheld dismissal of the claim because there was no evidence that the employer failed to accurately respond to the participant's questions, and there was no evidence that the employer knew that its silence might be harmful. *Vest v. Resolute FP US Inc.* (6th Cir. 2018)

This is unlike the situation we previously reported in which a terminally ill participant requested information to make financial arrangements for his wife after his passing. The participant and his wife had three separate meetings with benefits staff and although life insurance was discussed at some length, the need to convert life insurance to individual coverage was not mentioned. Plan fiduciaries were found to be liable for the value of the missed conversion because under the circumstances they had a duty to provide information on conversion.

Benefit Interference Claim Proceeds

Wrongful discharge employment suits frequently include a claim that the employee's discharge was motivated by the employer's objective of interfering with the employee's retirement or health benefits. These claims are frequently dismissed early in the litigation process because it is challenging to show that the discharge was intended to prevent the employee from receiving benefits. A recent case illustrates a situation that appears to be headed for trial. An employee took extended leave for multiple inpatient alcoholism treatments. When he returned to work, he was unable to return to his prior position and was given other less skilled work. Following a relapse, he was fired. However, before he was fired, his boss made a number of comments about how much his health care had cost the company. This was enough for the suit to survive for further consideration*. Norrell v. Jeff Foster Trucking, Inc.* (W.D. Wisc. 2018)

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