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Fiduciary Update | November 2018

In this quarter's Fiduciary Update, CAPTRUST's Drew McCorkle provides an update on retirement plans and student loan debt, legacy employer stock in light of the Dudenhoeffer standard, ERISA and bankruptcy, and recent developments in university retirement plan litigation.

Easing the Burden of Student Loan Debt

In a private letter ruling, the Internal Revenue Service approved an employer basing 401(k) non-elective contributions on employees' student loan repayments. The plan sponsor wanted a retirement plan solution for employees who may not be able to defer part of their salary into the 401(k) plan because of their student loans obligations.

The plan originally provided for a matching contribution of 5 percent if an employee contributed 2 percent of his or her salary to the plan. These matching contributions are made on a pay-period-by-pay-period basis. The new student loan feature would provide a 5 percent employer contribution to the 401(k) plan for participants who enroll in the program and pay at least 2 percent of their compensation toward their student loans—or if they make a 2 percent salary deferral to the plan. Participants enrolled in the program must be employed at the end of the year to receive the 5 percent match. The same vesting schedule will apply to the traditional match or the student loan match. IRS Private Letter Ruling 201833012 (2018).

Note that although private letter rulings are informative about the IRS's views, they can be relied on only by the taxpayers to whom they are issued.

Legacy Employer Stock Evaluated Under *Dudenhoeffer* Standard

The Phillips 66 plan was spun off from the ConocoPhillips plan, including investments in ConocoPhillips stock. Although participants could exchange out of the ConocoPhillips stock at any time, more than 25 percent of the new plan's assets remained invested there.

The investment committee of the Phillips 66 Savings Plan was sued for retaining the stock of the former parent company, ConocoPhilips, in the Phillips 66 Savings Plan. Participants argued that the legacy parent company stock was no longer an "employer security" under ERISA and retaining the stock violated ERISA's diversification requirements. They also argued that the legacy parent company stock underperformed, and it was a fiduciary breach to retain it in the Phillips 66 plan.

In a decision of first impression, the court concluded that:

- The legacy parent company stock was no longer an "employer security" under ERISA and exempt from ERISA's diversification requirements. However, plan fiduciaries did not breach the duty of diversification because participants set their own individual asset allocations and were free to reinvest their ConocoPhillips stock holdings among a well-diversified array of options offered in the plan. Additionally, the ConocoPhillips stock fund was closed to new investments and dividends were reinvested according to participants' direction for the investment of new deferrals.
- Retaining the ConocoPhillips stock in the plan was not a breach, because the participants could not establish the special circumstances required by the Supreme Court in *Fifth Third Bankcorp v. Dudenhoeffer* to overcome a presumption that the stock was properly valued at the market price—and not under- or over-valued.

Schweitzer v. Investment Committee of the Phillips 66 Savings Plan, (SD Texas 2018).

Intersection of ERISA and Bankruptcy

Liability for Fiduciary Breach Not Discharged

The company's chief executive officer held full control over the use of corporate assets. The company offered health insurance benefits to its employees, and that insurance was paid for 100 percent by employee payroll deductions. As the company's financial situation deteriorated, monies withheld from employee salaries to pay for health insurance were diverted to other purposes, including paying the CEO. In a suit brought by the Department of Labor, the CEO was found liable in U.S. District Court as fiduciary for improperly diverting $55,000 that had been withheld from employee salaries to pay for health insurance.

The CEO eventually declared bankruptcy and sought to have the $55,000 fiduciary breach liability discharged in the bankruptcy proceeding. The DOL objected to the discharge, arguing that the CEO was a plan fiduciary who misused plan assets. Because the $55,000 liability arose from a fiduciary breach, the bankruptcy court concluded it was not dischargeable in the CEO's bankruptcy proceeding.

The CEO appealed to the U.S. Court of Appeals. One argument on appeal was that the $55,000 health insurance premium debt should be forgiven because he borrowed more than $960,000 from his home equity line of credit, took little salary, and was not reimbursed for his business expenses—all to support the business. The Court of Appeals was unpersuaded. The insurance premiums withheld from employee salaries were required to be used exclusively for the benefit of plan participants, and the CEO breached his duty of loyalty under ERISA by not doing so. The debt was not discharged. *DOL v. Harris*, (8th Cir. 2018).

Divorced Spouse's Portion of 401(k) Plan Not Protected

Retirement assets held in 401(k) plans and individual retirement accounts (IRAs) are usually shielded from creditors in bankruptcy proceedings—but not always. The former spouse of a 401(k) plan participant declared bankruptcy. Earlier, the former spouse, Lerbakken, had divorced from his wife and, in that proceeding, was awarded a portion of her 401(k) plan and an entire IRA. By the time of the bankruptcy, Lerbakken had not submitted the divorce documentation to the 401(k) plan administrator, to be verified as a qualified domestic relations order (QDRO), nor had he established a separate account in his name in the 401(k) plan.

The U.S. Supreme Court recently decided that an IRA inherited by a daughter from her mother was not protected in a bankruptcy proceeding. *Clark v. Rameker* (2014). This was because the mother's IRA was set aside for her retirement, but not for her daughter's retirement. Following that reasoning, the U.S. Bankruptcy Appellate Panel for the 8th Circuit found that Lerbakken's interest in his ex-wife's 401(k) plan account and the IRA awarded in the divorce were not protected in his bankruptcy. *In re: Brian A. Lerbakken* (8th Cir. Brcy App Panel 2018).

Employment Termination Does Not Stop Executive's $400,000 Incentive Payment

An executive was hired with the promise that, if he was still employed at the end of five years, he would receive a long-term incentive payment equal to 5 percent of net margin on sales under his supervision. At the end of the five-year period, that amount was $429,000. The five-year period ended on January 18, 2015. However, in 2014, the company that employed him was sold, and the executive was fired without cause before January 18, 2015. The employee sued for the long-term incentive payment. He lost in U.S. District Court, which found that he had not met the condition for the payment that he be employed after January 18, 2015.

The executive got a better result in the U.S. Court of Appeals for the Fifth Circuit. Applying Texas law, the court found that, under the notice requirements in the executive's contract, he was likely employed after January 18, 2015. Regardless, the court found that the condition of being employed after January 18, 2015 was either deemed to be fulfilled or waived. This is because the new employer's termination of the executive without cause made it impossible for him to fulfill the condition for the payment of being employed after January 18, 2015. *Sellers v. Minerals Technologies Inc.* (5th Cir. 2018)

Suits Against Universities: Developments

As previously reported, several suits have been filed against universities, alleging fiduciary breaches. These cases are working their way through the courts. A few have survived initial motions to dismiss, and are proceeding, while others have reached full or partial conclusions.

Two cases have recently concluded, finding no fiduciary breaches. Breaches were alleged in the following areas, among others:

- Not using the least-expensive funds available
- Overpaying for plan record-keeping
- Retaining underperforming funds

In *Davis v. Washington University in St. Louis* (ED Missouri 2018), the judge dismissed the case before trial. Notable highlights from the case include:

- Plaintiffs started with the false premise that—just because the plan's investment and record-keeping fees could have been lower—the court should conclude that defendants breached their fiduciary duties. There were no allegations of a failed process or of conflicts of interest that influenced the fiduciaries' actions.
- There is no cause of action in ERISA for "underperforming funds." No authority requires a

fiduciary to pick the best-performing fund. The prudence of each investment is not assessed in isolation, but rather, as the investment relates to the portfolio as a whole.

In *Sacerdote v. New York University* (SD New York 2018), following a trial, the judge decided in favor of plan fiduciaries. Notable aspects of the case include:

- The fiduciary committee held regular quarterly meetings and considered detailed investment review information provided by an independent advisor.
- The plan had an investment policy statement that was periodically reviewed by the committee.
- The plan's fiduciaries periodically reviewed and renegotiated administrative record-keeping fees.
- The court observed that ERISA does not require a fiduciary to take any particular course of action—so long as the fiduciary's actions meet ERISA's prudent person standard.

Tidbits

- *More State Fiduciary Rules Coming*—Along with other states reported here, New Jersey's governor has announced plans to issue stricter standards requiring investment professionals to act in their customers' best interests. He noted that this was, in part, a result of the DOL fiduciary rule's demise. Similarly, in New York, new regulations have been adopted pertaining to the sales of life insurance and annuities.
- *Multiple Employer Plan Guidance from the White House and DOL*—Following an executive order directing action, the DOL has issued proposed regulations that could make it easier to establish multiple employer plans (MEPs). The aim of the regulation is to make it more cost-effective for smaller and nontraditional employers to provide retirement plan benefits for their employees. The DOL's proposal came just short of supporting the concept of *open MEPs*, in which no commonality requirements exist. If finalized, the proposal would expand access to ☐☐☐MEPs by allowing association retirement plans ☐(ARPs) and professional employer organizations (PEOs) to sponsor MEPs for their members.

Author(s)

Drew McCorkle

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

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