Berkshire Hathaway Specialty Insurance

Fiduciary Liability Ledger

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So much has been written about the raft of suits brought against corporate and university plan sponsors alleging imprudent charging of excessive fees, that we may have lost focus on the many other issues impacting plan sponsors. In this first installment of the Ledger for the new year, we primarily address non-fee matters, although we do touch on the final outcome of Tibble, the excessive fee case decided in 2015 by the Supreme Court. Our guest authors are Paul Ondrasik, Gwen Renigar, Tom Veal, and Eric Serron, all of Steptoe & Johnson LLP.

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The Continuing Saga of DOL's Fiduciary Rule

The Department of Labor's "Fiduciary Rule," enacted under the Obama administration and ostensibly designed to protect retirement savers from conflicted investment advice, continues along its bumpy road. Courts are pondering attacks on its validity, while the new DOL leadership has taken steps toward mitigating its impact, though without repudiating its essence.

Background of the Fiduciary Rule

In brief, the Rule exposes financial institutions to liability if they make investment recommendations to their retirement market customers without complying with the terms of an applicable exemption. Accompanying the new Rule were amendments to previously granted exemptions, and two new exemptions (the "Related Exemptions"). The Related Exemptions require adherence to "Impartial Conduct Standards" (summarized as "give prudent advice that is in retirement investors' best interest, charge no more than reasonable compensation, and avoid misleading statements"), extensive disclosures of potential conflicts of interest, and, for non-ERISA retirement plans such as IRAs, a contractual agreement to be bound by ERISA's fiduciary standards.

The Rule encountered resistance from the financial services industry, including lawsuits challenging the DOL's authority to promulgate it. Shortly after taking office, President Trump directed the DOL to review the Rule and the Related Exemptions to determine whether they were, in fact, in the best interests of their intended beneficiaries.

Interestingly, the DOL continued to defend the Rule in court against challenges by industry groups. To date, district courts in the District of Columbia, Texas and Kansas have upheld the Rule and the Related Exemptions. The Fifth Circuit heard oral argument in the Texas case, *Chamber of Commerce v. Acosta*, on August 1, 2017. To allow time for the Fifth Circuit to issue a decision in the Texas case, the DC Circuit has since granted a continuance of oral argument in the District of Columbia case, *NAFA v. U.S. Dept. of Labor*, and ordered that the appeal be held in abeyance until further notice.

Opponents of the Rule have effectively prevailed on one issue, though. In its latest court filings, the government has declined to defend the two new Related Exemptions' prohibition against arbitration agreements in which the customer waives the right to participate in class action litigation. In a Field Assistance Bulletin issued on August 30, 2017, the DOL affirmed their position, announcing that the DOL will not pursue a claim against a fiduciary based on failure to satisfy the above-mentioned exemptions if the sole failure to comply with the exemptions "is a failure to comply with the Arbitration Limitation...of the exemptions."

Also, after initially delaying the applicability date of the Rule and the Related Exemptions by two months, to June 9, 2017, and amending the two new Related Exemptions to drop all conditions except adherence to the Impartial Conduct Standards through the end of 2017, the DOL on November 29, 2017 published a Federal Register notice extending the transition period relief provided by the two new Related Exemptions through June 30, 2019.

As of this writing, it appears likely that the DOL will modify the requirements of the two new Related Exemptions to make them less burdensome, without rejecting the Rule's sharp expansion of the types of communications that are treated as fiduciary investment advice. Less clear is the likely outcome of litigation challenging the Fiduciary Rule's very existence.

Wrapping Up Tibble

In December 2016, the Ninth Circuit sent *Tibble v. Edison International* back to the district court for, at long last, a decision on whether the defendant fiduciaries fulfilled their duty to monitor the continued prudence of the investment options available to 401(k) plan participants. On August 16, 2017, the court handed down its verdict: that offering retail mutual fund shares, rather than lower fee institutional shares, to participants was so clearly imprudent that the fiduciaries should have made changes to the plan's investment menu as soon as institutional shares became available. The judge summarized thus:

> *Certainly, reasonable fiduciaries are not expected to take a daily accounting of all investments, and thus the reasonable discovery of an imprudent investment may not occur until the systematic consideration of all investments at some regular interval... However, the facts of this particular case present an extreme situation.*

Less extreme cases will no doubt arise. What we know at this point is that, as the Supreme Court held in its Tibble opinion, fiduciaries have a duty to monitor investments, whether or not any special circumstances provide a reason to reevaluate them. The implication is that reviews should be conducted periodically, but how often and to what extent are questions not answered by the Court.

How Does the Fiduciary Rule Affect Plan Sponsors?

While the Fiduciary Rule has its greatest impact on the financial services industry, it also has ramifications for plan sponsors, as communications with plan participants may now fall within the Rule's expansive definition of "investment advice." Employees who discuss plan provisions with participants in the ordinary course of their duties could be deemed ERISA fiduciaries under the Rule. Of particular concern are responses to participants' questions about distribution elections.

Reversing prior law, the Rule states that recommendations about the amount or form of distributions or rollovers constitute "investment advice."

Although the Rule includes provisions intended to forestall the placement of ERISA fiduciary responsibilities upon such employees, the precise boundaries of this relief are uncertain at this point.

In addition, some service providers will wish to take advantage of a provision that negates fiduciary status for parties who deal with plan fiduciaries who possess investment expertise. That category includes registered investment advisors and other fiduciaries who are independent of the service provider and are responsible for the investment of at least $50 million of plan assets. Plan investment committees and their outside investment managers can expect to receive requests for confirmation that they satisfy that criterion.

Supreme Court Grants Relief – Perhaps Only Temporary – to Church-Affiliated Pension Plans

Handing a victory to church-affiliated hospitals, colleges and welfare agencies, the Supreme Court held on June 5, 2017 that their retirement plans are entitled to the "church plan" exemption from the burdens of ERISA. The decision, *Advocate Health Care Network v. Stapleton*, reversed three Circuit Court decisions that had barred the exemption for most plans established by church-affiliated employers. It may not, however, have ended this "church plan" litigation.

The lower court decisions came in response to a wave of nearly 40 lawsuits, urging courts to reject the longstanding IRS, DOL and Pension Benefit Guaranty Corporation position that a plan falls within the definition of "church plan" if it is (i) established by an employer that is controlled by or shares common religious bonds and convictions with a church and (ii) is overseen by a committee whose principal purpose is plan administration. The plaintiffs contended that the church itself must establish the plan; one established by a related organization should not qualify. The majority of lower courts, including the Third, Seventh and Ninth Circuits, agreed, holding that the agencies had been misreading the statute for over 30 years.

These decisions had potentially enormous repercussions for plan operations. The church plan exemption frees employers from ERISA's fiduciary standards, minimum funding requirements and PBGC premiums and greatly softens the Internal Revenue Code's "nondiscrimination" standards.

It also eliminates many reporting requirements and allows greater flexibility in plan design and in disclosures to participants. The sudden imposition of ERISA burdens, retroactive to the enactment of ERISA or the inception of the plan, would have opened up the prospect of enormous liabilities and administrative costs.

The Supreme Court, however, rejected the plaintiffs' view. Its unanimous opinion, authored by Justice Kagan (Justice Gorsuch not participating), found that the text of the statute unambiguously provided that a plan maintained by a church-related employer is to be deemed "established and maintained" by a church and therefore a "church plan," regardless of who actually established it. The only discordant note was Justice Sotomayor's concurring opinion, which agreed that the meaning of the statute was clear but expressed a wish that Congress had chosen differently.

Despite this definitive victory on the question of statutory construction, church-related employers may face further travails. The Court did not address three additional arguments that plaintiffs have put forward, namely, that the relationships of hospitals and schools to churches are, in a great many instances, purely nominal, that the statutory language limits church plans to those administered by independent boards rather than employer-appointed committees, and that the church plan exemption contravenes the Establishment Clause (the First Amendment provision that prohibits the government from establishing a religion).

Another possibility is that states may take up the regulation of church plans. A corollary of exemption from ERISA's burdens is the loss of its benefits, in particular the preemption of state laws relating to employee benefit plans. If plaintiffs' lawyers or state attorneys general focus their attention on plans set up by church-related employers, the latter may prefer to elect ERISA coverage (which they have the right to do) rather than risk being subject to the often vague and plaintiff-friendly laws of the several states.

"Could" or "Would": What Is the Fiduciary Standard?

Looking at *Tatum v. RJR Pension Investment Committee* for the third time, the Fourth Circuit Court of Appeals held on April 28th that it was objectively prudent for the fiduciaries of RJR's 401(k) plan to eliminate Nabisco stock from the plan's investment options after RJR spun off Nabisco in 2001, even though the fiduciaries had not followed a prudent process in making their decision.

Earlier Fourth Circuit decisions found that RJR's decision making process fell short of ERISA's fiduciary standards and that the defendant fiduciaries could avoid liability only if they could show that a prudent fiduciary would have made the same decision (so-called "objective prudence"). A dissenting judge maintained that it should be sufficient to show that the decision was within the range of those that a prudent fiduciary could have made.

On remand, the district court concluded, largely on the basis of expert testimony, that RJR's decision was, in fact, objectively prudent in the sense that it was one that a prudent fiduciary would have reached under the same circumstances. The Fourth Circuit affirmed that decision on appeal, while also reiterating the "would have" standard.

Tatum indicates that the "would have" standard of objective prudence is not insurmountable in those jurisdictions which, like the Fourth Circuit, shift the burden of proof on the issue of loss causation to the defendants. It is far from certain, however, that other Circuits applying that burden-shifting approach will follow the Fourth Circuit's lead. In fact, a Supreme Court decision handed down shortly before *Tatum – Fifth Third Bancorp v. Dudenhoeffer,* 134 S. Ct. 2459 (2014) -- suggested that "could have" was the proper benchmark, though the Tatum court regarded that case as distinguishable. Regardless of its ultimate fate, Tatum reinforces the wisdom of paying close attention to procedural prudence. The best way to avoid fiduciary liability is to examine all of the pertinent facts with care and to make sure that the bases for decisions are accurately recorded. If that is done, no need will arise to fall back on "objective prudence" as a defense.

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