Episode 21: Pension Risk Transfers and Litigation Risk: What Fiduciaries Need to Know

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Richard Schwartz
Hello. Welcome to Coffee Talk With Benefits, a podcast brought to you by Seyfarth Shaw's Employee Benefits and Executive Compensation department. I'm your host, Richard Schwartz. Join me and members of our national team, along with professionals from across the Employee Benefits space as we talk through the interesting, tricky, and frankly sometimes amusing issues that cross our desks - all over a cup of coffee.

Hello and welcome to Coffee Talk With Benefits. This is your host, Richard Schwartz. Today, we are introducing a new format. My co-host, for the past few years, Sarah Touzalin, is moving on to spend more time in her new position as the vice chair of the ABA employee benefits subcommittee. We all know that she'll be fantastic in that role, and we'll miss her here at Coffee Talk With Benefits. I'm looking forward to having Sarah be a future guest of Coffee Talk With Benefits, where she can tell us all about what she's doing in her new role at the ABA. Moving forward, I'll have a co host each episode until we find a permanent co host. Our discussion today is focused on pension risk transfers and the fiduciary claims that have been the subject of a number of litigations. Joining me as my co host for this episode is my partner, Alan Wilmit, and together, Alan and I will be speaking with our partner, Ada Dolph, an ERISA litigator. So let's start off with Alan introducing himself to the Coffee Talk With Benefits episode. Then we'll have Ada introduce herself. Alan...

Alan Wilmit
Thanks very much, Richard. My name's Alan Wilmit. I am Richard's partner in New York, I've been at Seyfarth now. About 18 months prior to joining Seyfarth, I was at Goldman Sachs in house, where I ran a group in the legal department that covered ERISA and Employee Benefits, and I cover all areas of employee benefits here.

Richard Schwartz
Terrific. Ada, this is also your first time on the podcast, so why don't you say a few things about yourself?

Ada Dolph
Sure, I'm a partner in the Chicago Seyfarth's office. I've actually spent my entire career at Seyfarth, so about over 20 years now at this point, and I've been doing ERISA litigation from day one, and have been following closely all the ERISA class actions and handling many of those during my tenure at Seyfarth.

Richard Schwartz
Terrific. So pension risk transfers. What are we talking about? What is a pension risk transfer?

Ada Dolph
I would say that the best analogy, or the best way of describing it, is that the risk of maintaining a pension plan and paying pension benefits for some people for years and years and years is being lifted out of the pension plan and provided or given to someone who's in the business of managing and assuming risk. So this is a way in situations that it usually has to involve or it usually involves retirees who are no longer employed at the company and are in pay status that are being so called, lifted out to an insurance company that then provides the benefits for them going forward, and it assumes those obligations.

Richard Schwartz
So we're functionally transferring the liability for a group of participants to a carrier and off the plans books, correct? And these are typically people already in pay status or current or retirees who haven't yet commenced benefits.

Ada Dolph
Typically, although there's no limitation on the risk that's transferred. And certainly we have times where employers are terminating an entire plan and transferring that liability to an annuity provider under the same types of rules and circumstances.

Richard Schwartz
Excellent.

Alan Wilmit
Ada, when you when you say they're transferring risk, what kind of risk are you talking about?

Ada Dolph
Well, in contrast to a 401 k plan, where every participant is responsible for their contributions and for the way that those amounts are invested, and it yields what it yields based on the participants oversight. A pension plan is a contract between the employer and the employee guaranteeing a certain amount, a set amount of benefits based on a formula, basically from retirement through the end of their lives. And that is a huge amount to project and to try to figure out how to make sure you're investing the investments in such a way that you'll be able to honor that contract for years and years to come.

Richard Schwartz
You say years and years. We're talking decades. We're talking decades. You could have a 30 year old, 25 year old in a pension plan who might not be drawing benefits for three or four decades or more. Correct? So this is really a transfer of law. Long term risk of all sorts of things, investment, return, interest rate fluctuation, longevity, longevity.

Ada Dolph

Right, and they've been occurring more frequently lately, and as we've seen, are in the news more frequently lately, in part because rising interest rates make it less expensive for these annuities to be purchased and to pay for benefits going forward. So there's lots of different as you've noted, Richard economic factors that play into whether a company decides that it's best to transfer that risk out of the plan. And one of those factors is the rising interest rates, which we have seen lately, which is we've had, historically, for a long period of time now, very low interest rates.

Richard Schwartz
And of course, this recognizes the inverse relationship between the pension liability and interest rates. As interest rates increase, the liability goes down, and therefore the cost of an annuity product would go down as interest rates drop. The opposite happens. Everything goes up, the costs and the liabilities go up. So have these been going on for a long time? Is this something new, or has this always been here?

Ada Dolph
These pension risk transfers have basically been allowed since the beginning of ERISA, and there are provisions in the statute that specifically allow for the termination of plans and the transfer of this liability in this way to an annuity provider. In the 90s, there was one particular annuity provider that went bankrupt, and it did, in some fashion impact the benefits that were ultimately paid out to the participants that have been transferred to that annuity provider. In the wake of that the Department of Labor came out with some interpretive guidance, an interpretive bulletin, IB 95-1, and also there were some modifications to the regulations to the regulations and the statute around the factors and pension risk transfers in general.

Alan Wilmit
And when you when you say around the factors, factors that the department put where in 95-1?

Ada Dolph
Right, the only real directive on what is to be considered by a fiduciary for the selection of an annuity provider, is contained right now in an interpretive bulletin 95-1, and that is purely guidance. And as we've seen in some of these cases, the arguments are that, you know, guidance does not equal the statute. And in the wake of the Supreme Court's decision challenging administrative interpretation of statutes. You know, this could be an issue that comes up more frequently, but ib 95 one lays out a few factors that it says need to be considered by the fiduciaries in the selection of the annuity provider. And it does have this language where it says that the fiduciary has to take steps calculated to obtain quote the safest annuity available, unless, under the circumstances, it would be in the interest of participants and beneficiaries to do otherwise. So that language the safest annuity available is only contained in this interpretive bulletin, but has been the focus of and relied upon heavily by plaintiffs who are currently challenging these transactions.

Alan Wilmit
And can we back up just one second? So IB 95-1, it sounds like the plan fiduciaries have to look at something. And then earlier we were talking about the fact that the employer makes the decision about whether to terminate these and get annuities. Like, how does how does that work? Where's the is this all a fiduciary decision? Is this a plan sponsored decision? Like, how does that work for people?

Ada Dolph
Sure, so. And I would say that the current pension risk transfer litigation that challenges these transactions is trying to blur these lines. But as we know in ERISA, there's a division between decisions made by the employer in their settlor capacity versus the fiduciaries in their fiduciary capacity. So for example, a committee overseeing the plan and the decision to engage in a pension risk transfer is one that is reserved to the employer in its settler capacity. And if you think about it, it's part of deciding the plan design, whether to offer a plan at all those are all decisions that have been reserved to the employer. Now the implementation of that decision is a fiduciary task, and the fiduciaries need to consider certain factors and obviously be operating exclusively in the interests of participants in making that decision.

Richard Schwartz
And interpreted both in 95-1 gives the fiduciary some direction and some things to consider?

Ada Dolph
Correct, correct, and those are the qualities, I would say, of the. Annuity provider that are being challenged in the ERISA litigation that we're seeing now. So I'll just list a few of the factors from the interpretive bulletin, the quality and diversification of the annuity providers investment portfolio, the size of the insurer relative to the proposed contract, the level of the insurer's capital and surplus, the lines of business of the annuity provider and other indications of an insurer's exposure to liability, the structure of the annuity contract and various guarantees associated with that, and then finally, the availability of additional protection through state guarantee associations. So each of these factors is being challenged in the current litigation in part because the annuity provider that was selected is involved in and has some investments in private equity, which the plaintiffs in these cases are arguing do not meet the safest available provider requirements of ib 95 one.

Richard Schwartz
Okay, so what we're looking for, the safest carrier, the safest available annuity, as you mentioned, and these factors are taken into account. How do you know which is the safest? And does it have to be the same, the absolute safest? If you can even identify what that is.

Alan Wilmit
Right, right? Is there even one safest annuity?

Ada Dolph
And that's what's being litigated is, I think just inherently it's a subjective finding. And there is provisions in IB 95-1 as well that say, well, this doesn't mean you have to pay the absolute most money for the annuity provider in exchange to have the safest available annuity. That there's a multitude of factors that should be considered, including the ones I just talked about. And cost can be one of them. If the cost of purchasing the annuity, if choosing one that's a little bit less expensive goes to the benefit of the participants, then it's purely according to IB 95-1 appropriate to take that under consideration.

Richard Schwartz

So the fiduciaries have to consider all of these factors. How do fiduciaries actually as a practical matter, how do they handle this? Do they retain advisors, or are they handling this on their own?

Ada Dolph
And that's another interesting aspect of this ERISA class action we're seeing, which is that the independent fiduciary that has been selected to make the annuity provider decision is also named as a defendant in these cases. So frequently, this is a complicated analysis and selection process, and we do see our fiduciaries relying upon experts for their recommendations about who to select. So we will see in those instances, then that they often are relying upon an independent fiduciary to make recommendations to them about who to select, and that independent fiduciary, you know, is independent of the company and of the committee members who are obviously typically employed by the company. So it removes this concept that they might be conflicted in the selection of the annuity provider.

Richard Schwartz
I see and the annuity provider, the consultants that are retained, the advisors that are retained, are they also being named in these lawsuits?

Ada Dolph
We are not seeing that. It's mostly right now, the independent fiduciaries that are the focus of this litigation, although certainly I wouldn't, you know, rule that out in the future.

Richard Schwartz
So, Ada, we've been talking about independent fiduciaries in the context of these litigations, but can and do plans instead appoint an independent expert to advise the plan's fiduciaries on which annuity meets the 95-1 requirements?

Ada Dolph
Absolutely. You can absolutely use an independent consultant to provide expert advice to the committee on the selection of the appropriate annuity provider. We've been focusing primarily in this discussion about independent fiduciaries, because those have been the focal point of the pension risk transfer litigation thus far.

Alan Wilmit
So are they, are the independent fiduciaries named defendants? Or are they, or is there something else happening, or what role is it that they're playing in the suit other you know, they were there to try and protect the transaction. So are they being sued for breaching their fiduciary duties, or are they challenging independence?

Ada Dolph
They're doing a little bit of both, but the way they get to really a breach of fiduciary duty on their part for the fiduciary duties that were delegated to them, and then, of course, that would also go up to the fiduciary that made the selection of the independent fiduciary, they are going after conflicts of interest.

So they're saying that these independent fiduciaries, you know, are affiliated in some corporate way with either the annuity provider or the company that led them to make the selection that they did.

Richard Schwartz
Ada, tell us about some of the claims that have been filed so far, and how are the courts handling them.

Ada Dolph
So I think we're up to about approximately 15 ERISA class actions challenging pension risk transfers, and there are some well known plaintiffs firms that are sort of leading this charge. Each of these cases are filed in different jurisdictions, and in each of these cases, the defendants, which include the independent fiduciaries, are challenging whether the plaintiff has any harm, any standing that would allow the plaintiff to proceed in federal court on these claims. So what we're waiting for now is we have in most. Of these cases, a motion to dismiss that was filed or is being filed by the defendants, and we're waiting for the outcomes of those decisions.

Richard Schwartz
And you say standing, have standing to raise these claims, tell us about that.

Ada Dolph
Article Three, standing is the doctrine. It's the constitutional doctrine that courts should not spend their judicial resources overseeing cases in which there has been no harm to the plaintiff or the court's ruling would make no impact on the plaintiff's dispute or complaint. So this is a doctrine for ensuring that courts are using their resources as efficiently as needed.

Richard Schwartz
And the standing question is whether or not the plaintiffs are actually harmed, right?

Ada Dolph
That's been the focus of the challenges in these cases, where the participants in all of them have been receiving their benefits as they have been contracted to be provided to them, and no one's you know, been shorted or missed a benefit payment at all. The challenge is really to whether the annuity provider selected was the safest by a participant's account.

Alan Wilmit
So what is the argument that even if a fiduciary breached its fiduciary duties, no harm, no foul, so you don't get your day in court?

Ada Dolph
Well, I mean, that's part of it, Alan, but it's complicated, and it's the main argument that is being focused on in these cases. Harks back to a Supreme Court decision in an ERISA class action context called Thole, and Thole took a look at a plaintiff's claim in the context of a pension plan where the plaintiff argued that the employer, in that instance, not the annuity provider. So there's someparallels here. The employer had breached his fiduciary duties in how it had invested the investments underlying the plan, thereby jeopardizing they asserted their future payments of benefits. And the Supreme Court in that

case, again, we had a participant in that case who had received all of their benefits was continuing to receive all of their benefits due, and had not really pled that there was a sufficient or a significant risk of imminent harm, and the court said here, we don't have enough harm for this case to proceed in court, and dismissed the case for lack of Article Three standing.

Alan Wilmit
So that's been a real issue for plaintiff's firms you know, finding defined benefit cases like generally, right? Yeah, defined plaintiffs that have standing.

Ada Dolph
Well, and we've seen a number of runs at pension plans that have failed for this very reason. What's interesting about full is there is some suggestion that had the plaintiffs proceeded in a different way, or made different allegations, that they could have reached that level of harm that would allow them to proceed in the case. So there's in particular, a footnote in the case where it says, even if they had somehow pleaded that there was this risk of imminent harm, then you would also look at sort of the second level, or the backing behind the benefits. And here the PBGC would cover those benefits, and that may be enough to wipe out any harm and to ensure that these participants, or this plaintiff does not have Article Three standing to proceed.

Richard Schwartz
So, Ada, there have been a couple of decisions that I know I read about. What are we seeing so far from the courts? What decisions are we seeing?

Ada Dolph
We've had two rulings come out, and they came out on the same day in March, and of course, they came out in opposite directions. So one of the courts concluded that the plaintiff in the case had sufficiently pleaded imminent harm and could proceed with the case. Had established Article Three standing. And in the other case, the court concluded that there was not sufficient harm. There was not sufficient allegations to demonstrate that the risk was imminent, and therefore the participant there, the plaintiff there, did not have Article Three standing.

Alan Wilmit
Did somebody not get paid? What, was an insurance company not going to pay? Or why was there risk in one place and not the other? Or what? What's the risk that they thought they saw?

Ada Dolph
Well, the opinions really show the different perspectives on a court's responsibility in overseeing a motion to dismiss. So in one of the opinions, the opinion where they found that the plaintiff had Article Three standing, the court felt that it had to take all of the complaint allegations as true, and the complaint allegations contain a whole host of allegations about corporate con. Conflicts between the independent fiduciary and the other defendants in the case that would cause it to be predisposed to select the annuity provider at issue. They also allege that the annuity provider at issue was heavily invested in private equity, such that it was not as financially stable as it should have been so. The other court, though, I think critically, looked at those allegations and concluded that even with all of them,

there was still, for example, a state guarantee association that could back up the benefit as well as, if not better than a PBGC. And concluded that there was no standing. So it's, I think it's driven by really a perspective on what the obligations are for a court at the motion to dismiss stage and the nature of the allegations made by the plaintiffs. I will say, In the one case where the court concluded that the plaintiff had established standing. The court seems to have some misgivings about that, or at least understands what a borderline decision it has made, because it specifically called out that subject matter jurisdiction like standing can be challenged at any point in the case, and suggested that that may be something that occurs later on in the case, when there's been discovery and when the court feels it's not tied to the complaint allegations.

Richard Schwartz
So it sounds like the court that ruled that there was, or at least there was, the potential for imminent harm, hasn't really made a firm decision. They're just kicking the can down the road so that they can get more discovery.

Ada Dolph
Yeah, and I think the judge there, as I said, took its responsibility as having to take us through the complaint allegations and is essentially inviting defendants to put into evidence information that that undermines or shows that those allegations are incorrect.

Alan Wilmit
Yeah. And it sounds, it sounds like maybe, on a practical level, they're more concerned with cutting off the case at an early stage than they are about getting this exact decision right. Because it sounds like they're saying, we can make this decision later. We don't have to, we don't have to cut it off right now. We could wait, wait this out a little bit and see, let the facts develop a little better. That's important, though, right? Because for if you're a defendant, the longer it goes, the longer it goes, right?

Richard Schwartz
And the more it costs to defend.

Ada Dolph
Right? I would say so. Obviously, defendants want to prevail right out of the gate. A main factor in the ERISA class actions that we've seen over the last 15 years or so is the cost of defense. So often, these cases come down to a battle of experts, as they would in the pension risk transfer context, and they're very, very expensive to defend and to prosecute, even on the other side, so often, a ruling like a denial of a motion to dismiss would precipitate settlement discussions from a cost of defense perspective.

Richard Schwartz
You mentioned earlier that there are a lot of these cases out there, and we have these two differing decisions so far. What does that bode for the cases that are out there?

Ada Dolph
I think if you look at both of the opinions, the common thread is that standing is a difficult question in these cases, that it's not an airtight yes or no type of decision. So I think we're going to see similar

thoughtful decisions come out from the courts if there's any bent. I mean, even in the instance where they found there was Article Three, standing to proceed if the defendant is able to bring forth facts that undermine those asserted allegations that the annuity was unsafe. There the court saying, we'll dismiss this case because we won't find any harm that's happened or imminent. So I think we'll see thoughtful rulings, as we always do, but they'll be very focused on this standing component, and there's going to be different perspectives. But again, I think all will recognize that this is really on the borderline of whether there is the harm or not.

Richard Schwartz
Are you seeing any ... ERISA litigation over the last 15, 20 years has been exploding, and it just seems to be exponentially more recently. Is there any relation, or can you tie this in any way to the fee cases, the ERISA fee cases that we used to see and still see?

Ada Dolph
Well, certainly we actually have some of the same players in the ERISA class action fee context, as we do here in the pension risk transfer context. But overall, we've seen over the last 20 years, just an immense amount of scrutiny on the fiduciaries, every part of the fiduciary process that really wasn't there previously. So there was certain lines of case law where the Court said, well, we don't really care how you got there, if you got the right decision, there's. Breach of fiduciary duty here. And then that perspective changed when they started looking at the process carefully. So no longer is it a bad process that results in the right selection. Is a defense against liability. Now we really have to have a very airtight, thoughtful process in place to defend against whatever decision is made.

Richard Schwartz
What are the takeaways? What are we learning from this? And what should sponsors, plan sponsors and plan fiduciaries, who are responsible for selecting the annuity provider? What should we be advising them to do?

Ada Dolph
I think the advice is very similar to what we've been giving in the ERISA class action fee context, which is make sure you have a really good process. And although independent fiduciaries are identified here as defendants, and you know, imputed with some liability or some wrongdoing, the selection of an independent fiduciary really should and does, in most cases, take away any questions about whether the fiduciaries were acting exclusively in the interests of participants, because in the independent fiduciary context, that is their job. They've been hired to think exclusively in the interest of participants and to make the best decision in the interest of participants. So this is a long way of saying I would continue to do use independent fiduciaries, even though they are being challenged in these cases, because of that inherent removal of the conflict of interest question from the decision makers. I also would say, as in these ERISA class action fee cases, it's not enough to have a good process. Now we have to start thinking, because of all the legal challenges, how to prove that you had that process, how to prove that it was careful, how to prove that it was without conflict. The law, of course, says you only need to have a good process and make good decisions and act in the interests of participants. But now, because of these legal challenges, there's this extra layer of documentation that is really necessary to try to protect the fiduciaries against claims in the future.

Alan Wilmit
So it seems like when fiduciaries are documenting their process, one of the things that they ought to do is document why they determined that a fiduciary that they're hiring is an independent fiduciary, since that's part of the cases now and being challenged. And so even though they may think there's no doubt that the fiduciary they're hiring is independent, but they should be ready to defend that choice, and should write down what it was that made them independent, so that they're ready to defend it.

Ada Dolph
I think that's right. Just as with anything, given the legal challenges, it is prudent for fiduciaries to document that they've examined that issue and concluded there are no connections, corporate affiliations, or anything that would drive a conflicted decision by the independent fiduciary. We're almost getting to the point where we're going to have to have an independent fiduciary, bless the independent fiduciary selection.

Alan Wilmit
So, infinite loop limit.

Richard Schwartz
So, you know, it sounds to me like, you know, we've never committees generally don't focus, and haven't really focused on the independence of their selected advisors and fiduciaries. Is this going to affect the way committees work with their contracted fiduciaries advisors? I mean, if they continue to use the same advisor, which we've all seen, is that going to feed into this litigation?

Ada Dolph
Well, I think part of the issue is that there are very few entities willing to take on fiduciary responsibility in these situations for the very reasons we're seeing now in terms of the very expensive litigation and challenges to the fiduciary decisions. So there really aren't that many players in this sphere, and there's just a handful that will take on the responsibility and put the parameters in place with the fiduciary to do the best they can, obviously, to make an independent decision of the selection of the annuity provider. I can see if you use the same independent fiduciary for every fiduciary obligation that you delegate out someone trying to allege that there was a conflict there or some interest in continuing to compensate the same party. I also think with the new rise in the prohibited transactions, we could see these challenges more as well, where they're starting to point to an existing relationship between the parties as a reason why there needs to be more independent review of future contracts. So I could see that argument being made. But again, I feel like we're getting to sort of the end of the road in terms of how much independent review can be required over fiduciary decisions.

Richard Schwartz
So, Ada, it just. It seems like really a newer focus is on independence of the designated fiduciary. And it also feels to me like it's a bit of a moving target. So we have to figure out what's independent.

Alan Wilmit

Yeah, and maybe Ada, interesting to hear what you think. But I think one place that maybe people can look when they're, you know, making this decision is in the Department of Labor's, you know, recently changed procedures for getting an exemption. They had kind of an extensive conversation about independence, because they require independent, independent fiduciaries or independent appraisers, and maybe that's a place that plan sponsors and plan fiduciary should look to try and show that you're at least following those rules in determining independence as a way to establish, establish that you've had a good process and you've got a truly independent fiduciary or, or even just exemptions that the department's granted where they've required independent, fiduciary and defined independence.

Richard Schwartz
And these exemptions you're referring to are prohibited transaction exemptions, right, right, right. Got it. Well, this is fascinating, Ada, this is like a whole new area unfolding right before our eyes.

Ada Dolph
I think that's right. I think this this type of intense focus on process and fiduciary decisions is going to continue, as we saw with the rise in the ERISA class action fee litigation. Those are now very prevalent. If you haven't been sued yet, you will be over the decision making in terms of the investment options being offered in your plan to plan participants. So I see this trend certainly continuing. Pension risk transfer litigation is just one piece of what we'll continue to see going forward.

Richard Schwartz
Well, this has been very, very interesting. Ada. And thank you very much for your time and for your thoughts. I also want to thank Alan for being the initial co host, and Alan want to tell you, you did such a great job. I may be tapping you again in the future.

Alan Wilmit
Excellent. Thanks, Richard. Thanks, Ada.

Richard Schwartz
Okay.

Ada Dolph
Thank you.

Richard Schwartz
Thank you for listening to Coffee Talk With Benefits, brought to you by Seyfarth Shaw. We invite you to subscribe and follow on your favorite podcasting platform. If you have any questions you'd like us to discuss on the podcast, please send us an email at S-coffeetalkwithbenefits@seyfarth.com. Learn more about the podcast at coffeetalkwithbenefits.com.