

# ERISA CONTROVERSY REPORT

## Message From The Firm

One of the perks of practicing employee benefits litigation is that we see many different types of cases that present many different kinds of problems to be solved. The variety keeps it interesting. But we recognize that defendants in litigation rarely think it's a good thing to say "we live in interesting times." Our clients would rather avoid litigation if at all possible.

In this edition of our ERISA Controversy Report, we've included articles that reflect the wide range of cases that we see and issues that we face. More importantly, they point out ways that liability can be minimized or avoided altogether.

Two of the articles involve actual litigation matters that we have handled. The first involves what may be the single most common type of case in the ERISA litigation world—a dispute over whether benefits are payable from a long term disability plan.

The second article is addressed primarily to service providers such as actuaries and third party administrators that provide services for defined benefit pension plans. It focuses on claims by their plan sponsor clients that arise in connection with the termination of those plans.

Finally, Fred Reish points out the problems that can arise when plan sponsors fail to properly obtain bonds for their plans as required by ERISA section 412. As Fred points out, this may not just be a problem for the plan sponsor, but for their advisers as well.

As always, we welcome your questions and comments.

Joe Faucher  
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## The Moving Target – Issues In Terminating Defined Benefit Plans

By Joe Faucher (JoeFaucher@Reish.com)



One of the biggest risk management challenges for retirement plan service providers is effective communication. Service providers—such as third party administrators—often overestimate the level of their clients' understanding regarding the services that they provide. Clients, meanwhile, tend to *overestimate* the range of services that they can reasonably expect to receive.

In recent years, we have handled several cases arising out of the timing of terminating defined benefit pension plans. In most cases, when an employer terminates a defined benefit plan, it must fully fund the plan to pay the present value of the participants' benefits. In those increasingly rare instances when no additional employer contribution is required to fully fund benefits upon termination, the process usually goes smoothly. But, when the plan sponsor has to make a substantial contribution in order to fund the benefits, it is natural that it would ask how that might have been avoided.

In some cases, the timing of the termination can alter the amount of the contribution an employer has to make. This is because the actuarial assumptions for determining the benefits payable may change from year to year. For example, if a key interest rate assumption used in calculating the amount of the

accrued benefits at termination goes down, the dollar amount of the benefits goes up. That, in turn, can mean that a plan sponsor has to make a greater contribution to the plan than it might have had to make if the plan had been terminated in the prior year.

This scenario can result in a client—the plan sponsor—questioning whether the third party administrator or actuary should have advised the plan sponsor to terminate the plan at an earlier date, so that the plan sponsor can avoid having to make a greater contribution to the plan.

There are many problems with that theory. The amount of a contribution that a defined benefit plan sponsor needs to make at termination depends on many factors, not the least of which is the value of the plan's assets. All other things being equal, the greater the value of the plan assets, the lower the plan sponsor's required contribution at termination. Generally speaking, however, third party administrators do not view themselves as being in the business of monitoring the value of plan assets, except when the time comes to prepare required annual reports.

Clients, however, often have only a vague understanding of all of the factors that go into determining the plan's liability on termination and the lengthy process involved. It is not at all unusual

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## IRS Audits and Bonding for 401(k) Plans



By Fred Reish ([FredReish@Reish.com](mailto:FredReish@Reish.com))

The IRS has recently announced the results of two of its LESE (Learn, Educate, Self-Correct and Enforce) audit projects. For both projects, the most common violation was the failure to adequately bond the plan as required by ERISA section 412.

LESE Project #1 was the examination of approximately 50 defined contribution plans with more than \$100,000 in assets, but less than \$250,000 in assets. The most common problem was the failure to obtain bonding, and the second most common problem was the failure to timely amend the plans to comply with the law.

The second report was on LESE Project #4. Project #4 involved examinations of 401(k) plans which were expected to be subject to the top-heavy requirements of Code section 416.

As with the first project, the primary problem discovered in these examinations was the failure of the plan to have adequate bonding. The second and third most common problems were the failures to satisfy the top heavy requirements and to timely deposit elective deferrals into the plans.

While the failure to obtain an ERISA bond can be corrected prospectively by purchasing a bond, it cannot be corrected retroactively. However, since the purchase of a bond is not a disqualifying defect, retroactive corrections are not needed for tax purposes. For other purposes, though, the failure to obtain a bond could result in substantial penalties or liabilities.

For example, we have seen penalties imposed where a plan was required to either be audited or bonded because it held more than minimal amounts of non-qualifying assets. In addition, we have seen cases where third party administrators, recordkeepers, fiduciaries and accountants have absconded with

plan assets . . . in other words, they stole the money. Since, in many cases the thief will be bankrupt and in jail by the time the theft is discovered, the Department of Labor and/or the participants will sue the primary plan fiduciaries, such as the officers of the company or the members of the plan committee. In those cases, the primary claim would be the failure to obtain an ERISA bond and thereby to protect the plan and the participants. Since it is an absolute requirement that the plan have a bond, there are few, if any, defenses to those claims.

At that point, in all likelihood, the plan sponsor and fiduciaries will file a claim against their primary 401(k) adviser—who may be the third party administrator, the financial adviser or investment adviser, an attorney or accountant. Essentially, the claim would be that the primary adviser failed to inform the plan sponsor and the fiduciaries about the need for the bond. Depending on the circumstances, and on the communications that can be proven, the primary adviser may be able to prevail in the litigation . . . but that would be after several years of litigation and tens of thousands of dollars in expenses for lawyer fees and court costs (and perhaps even more for settlement purposes).

The morals of this story are:

- Always, but always, recommend that your plan sponsor clients adequately bond the plan. Do that in writing.
- For third party administrators, don't report on the 5500 that the plan sponsor has a bond unless you have written confirmation from the plan sponsor. In other words, a third party administrator cannot properly answer that question without some proof. And, to protect itself, the TPA should have written proof.
- Finally, plan sponsors and fiduciaries can, and will, file malpractice claims

in these cases. Make sure that you have errors and omissions and/or fiduciary breach insurance to protect you from the cost of litigation . . . even if you are right! ❖

### ASPPA 401(k) Summit Conference

Fred Reish and Jason Roberts are presenters at the 2010 ASPPA 401(k) Summit Conference, to be held at the Orlando World Center Marriott & Convention Center on March 14th through 16th. The conference is a unique, interactive environment for retirement professionals who actively sell, market, support or service 401(k) plans.

Fred will present the workshop "Hot Off the Press!" This session will address breaking news and its impact on retirement advisors. Fred will also be moderating a workshop on "Tools for Categorizing and Analyzing Target Date Funds."

Jason is a conference committee member and will present a workshop on "Legal Updates." This session will address recent legislative and regulatory activity and how it impacts service providers. He will also co-present a workshop on "Inadvertent Fiduciary Status: Common Pitfalls for Service Providers and Opportunities for Acknowledged Fiduciaries." This session will explore the various ways one can become a functional fiduciary and provide guidance on how to avoid fiduciary-related pitfalls.

For more information, please visit <http://www.asppa.org/main-menu/knowledge/conferences/2010/the-asppa-401k-summit/overview.aspx>

## The Litigation Benefits of a Self-Funded Disability Plan



By Joe Faucher ([JoeFaucher@Reish.com](mailto:JoeFaucher@Reish.com))

We recently represented the third party administrator of a self-funded disability benefit plan in a federal court litigation matter. A plan is “self-funded” if benefits are funded through, for example, employee contributions to a trust, rather than by a group insurance policy. One of the primary differences is that in connection with an insured plan, the insurance company arguably receives a direct benefit from denying claims, whereas the sponsor of a self-funded plan likely realizes no direct benefit from doing so.

The distinction has become increasingly significant in recent years, since the decision of the United States Supreme Court in *Metropolitan Life Ins. Co. v. Glenn*. In *Glenn*, the Court held that if a claims administrator is operating under a conflict of interest—for example, if that claims administrator is both deciding whether claims are payable and funding benefits out of its own assets, as an insurance carrier does—that conflict of interest is weighed along with other factors in deciding how much deference the courts will give to the decision maker. That is, even if the plan document confers discretion upon the plan administrator to decide whether benefits are payable, the court will evaluate the conflict of interest (if there is one) along with a number of other factors in deciding the extent to which the court will give the administrator “the benefit of the doubt” about whether it was appropriate to deny benefits.

The analysis, however, is somewhat different, if the administrator has no such “structural” conflict of interest—*i.e.*, if it receives no financial benefit

by denying benefit claims. In that case, the court’s decision essentially boils down to whether a single persuasive medical opinion exists supporting the administrator’s decision. If such an opinion exists, the administrator’s decision should typically be upheld as long as the administrator construes the language of the plan reasonably and explains its decision rationally. In other words, absent a conflict of interest, the administrator’s decision will be upheld as long as the plan grants the administrator discretion and there is a rational basis for the decision, even if the court might have reached a different conclusion had the issue been presented to the court first.

Our client—the administrator of a self-funded plan—benefited from the more deferential standard. During the claim process, it referred the employee claiming benefits for an independent medical examination. The examining physician focused on the fact that, although the employee reported chronic back pain, multiple MRI scans were normal. And, although the employee’s own physician concluded that the employee was “disabled” within the meaning of the plan, his notes indicated that the employee’s subjective reports of pain were somewhat inconsistent with his radiological tests.

The outcome may have been different if the case involved a “fully insured” plan, rather than a self-funded plan. In that case, the court would arguably have been forced to evaluate the decision with a somewhat more skeptical eye.

Self-funded disability plans are certainly not for every employer. Small employers may not be able to absorb the risk (or effectively spread the risk among their

### Employee Benefits Attorney Summer Conley Joins the Firm

We are pleased to announce that Summer Conley has joined the firm as a Senior Counsel in the Employee Benefits practice.

Summer has 12 years of experience at a major national law firm and specializes in all aspects of employee benefits issues, including qualified and nonqualified deferred compensation plans and executive compensation. She also has in-depth knowledge and experience in the health and welfare practice, including COBRA, HIPAA, cafeteria plans, and medical plans.

Summer is the President of the Los Angeles Chapter of the Western Pension & Benefits Conference and is an active member of the Los Angeles Employee Benefits Group. She was a Fringe Benefit Subcommittee Junior Liaison for the Taxation Section of the American Bar Association.

small workforce) of paying benefits to an employee with an extended and severe disability. However, medium-sized and larger employers may benefit from offering a “non-insured” disability plan, since they may be able to effectively offer a reasonable disability benefit at little cost to themselves and still obtain the benefit of a favorable standard of review by a court.

Employers with self-funded plans may even be able to insure themselves against the cost of potential litigation. Although fiduciary liability insurance policies likely would not cover the benefits payable under a self-funded disability plan, some policies would cover the attorneys’ fees and other litigation costs incurred if an employee challenges

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## PLANSPONSOR's 15 Legends of the Retirement Industry

This is our 11th installation of the 15 "Legends." In our future newsletters and bulletins, we will be featuring the other Legends that were selected by PLANSPONSOR. Fred Reish was selected as one of the 15 "Legends of the Retirement Industry." These "Legends" are individuals who have, in the past decade and a half, made a lasting contribution to the nation's retirement security.

Denise Nappier was named one of the 15 Legends. As described by PLANSPONSOR:

Nappier has proved as adept a steward of the state's pension fund as she is a politician—and she is a formidable politician, winning three consecutive elections as state treasurer, and establishing herself as a considerable force in Hartford.

Perhaps that was to be expected—less predictable is how effective she has been in bringing Connecticut's pension fund into the top rank of state pension funds.

Congratulations to Denise Nappier for restoring "a sense of ethics and moral purpose to a fund desperately in need of it."

## Self-Funded Disability

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the administrator's benefit decision. Before proceeding with a self-funded approach, employers would be wise to consult with reputable employee benefit and insurance consultants. They should also have the documents governing their plan carefully reviewed by employee benefits counsel. ❖

## Moving Target

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for the process of plan termination to take a year or more. But, depending on the facts, if the actual termination occurs just weeks or days earlier or later it can materially impact the plan sponsor's contribution obligation.

This makes it critical for third party administrators and other service providers to manage their clients' expectations. For example, third party administrators who provide services for defined benefit plans should make it clear—in writing—that the process of terminating a defined benefit plan is lengthy and involved and that the third party administrator will not be held responsible for any additional contributions owed as a result of any alleged delay in the process. The client should also acknowledge, in writing, that the service provider will not undertake any responsibility for consulting with the client about the timing for terminating a plan. Service providers who wish to undertake that responsibility should consider doing so only in exchange for a separate fee and pursuant to a separate written agreement.

The defined benefit plan termination process sometimes gives rise to disputes. Those disputes can arise when the agreement about the services to be provided by actuaries and third party administrator is unclear or incomplete. Forewarned is forearmed—service providers should anticipate those disputes and draft their contracts accordingly to minimize the likelihood of litigation and reduce their exposure. ❖

## Pre-Conference Session at ASPPA 401(k) Summit

The ASPPA 401(k) Summit Conference is nearly upon us. Join Fred Reish, Bruce Ashton and Jason Roberts as they present a pre-conference session, entitled "The Government's Focus on Accumulation and Distribution of Benefits: Target Date Funds and Guaranteed Payments". The session will be aimed at financial services professionals and will address issues and guidance surrounding target date funds and the emerging issue of guaranteed lifetime benefits. The session will be held at 9:00 am on Sunday, March 14, in the Canary room, section 2. It is open to all registrants at the Summit.

For more information, please visit <http://www.asppa.org/main-menu/knowledge/conferences/2010/the-asppa-401k-summit/overview.aspx>.

## Super Lawyers

Super Lawyers is a listing of "outstanding lawyers from more than 70 practice areas who have attained a high degree of peer recognition and professional achievement." Congratulations to Bruce Ashton, Joe Faucher, Jon Karp, Lee Reicher, Fred Reish, Mark Terman and Mike Vanic for their inclusion in the "2010 Southern California Super Lawyers." The listing is published in the February 2010 issue of Los Angeles magazine.

For the 2010 Super Lawyers listing, visit [www.superlawyesrs.com](http://www.superlawyesrs.com)

## Around the Firm

**Speeches:** At the ASPPA Los Angeles Benefits Conference, held on January 20th-22nd, **Fred Reish** co-presented a session on “Benefit Survival in Hard Times” and **Bruce Ashton** co-presented a workshop on “Service Agreements in the (New) Disclosure Environment.” At the NTSAA National Conference, held on January 27th-29th at Indian Wells, **Bruce** presented “Fixing a Broker Plan.” On February 3rd, **Jason Roberts** co-presented “Legislative Update” to the Compliance Roundtable at La Canada. He also co-presented “Compliance and Risk Management” at the NSCP West Coast Meeting on February 22nd at San Francisco. At the Bolton & Company School Benefits Forum, held on February 11th at Glendale, **Bruce** presented “403(b) Update: What You Need to Know Now.”

**Quotes:** On January 20th, **Jason** was quoted in the article “VALIC Sued Over Annuity Product,” published on *FundAction.com*. He was also quoted in the article “Senate Bill Stirs Retirement Plan Lobby,” published on *InvestmentNews.com* on February 21st.

**Articles:** In the January and February issues of *Plan Sponsor* magazine, **Fred** wrote the columns entitled “Document ‘Ed’” and “Analyze This,” respectively.

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