# FIDUCIARY AND PLAN LIABILITY ISSUES ASSOCIATED WITH COVID-19

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# BACKGROUND

- COVOID-19 has afflicted the world.
- In the United States, social distancing is recommended through May 1.
- Unemployment claims surged to nearly **10 million** in the last two weeks, with **more than 6.6 million** new claims filed in the last week of March.
- The St. Louis Fed is predicting that the economic freeze forced by the coronavirus will ultimately put 47 million Americans out of work, spiking the unemployment rate to 32%, exceeding the Great Depression.
- Equity markets have declined, with the **S&P down 11%** and the **Dow down 12%** as of March 31 **(down 20% & 23.2% for Q1 2020)**.
- These unprecedented economic and social conditions raise challenges for plan administrators and fiduciaries.

# DEFINED CONTRIBUTION PLAN ISSUES

- Stock Drop Litigation
- Recordkeeper Crashes
- 401(k) Plan Litigation Alleging Imprudent Menu Options
- Target Date Fund Litigation
- Stable Value Fund and Money Market Issues
- Bond Funds
- Administrative Fee Issues
- Partial Terminations Due to Employee Layoffs
- Administrative Issues, including hardship distributions and plan loans
- Coronavirus Aid, Relief, and Economic Security Act ("CARES Act")

# DEFINED CONTRIBUTION PLAN ISSUES—STOCK DROP ACTIONS

- Under ***Fifth Third Bancorp v. Dudenhoeffer***, 573 U.S. 409 (2014), and ***Amgen Corp. v. Harris***, 136 S.Ct. 758 (2016), a plaintiff has to demonstrate:
  - A plausible alternative action that would have been consistent with the securities laws; and
  - That a prudent fiduciary in the same circumstances would not have viewed it as more likely to harm the fund than to help it.

- The Court recently reaffirmed that standard in ***Retirement Plans Committee of IBM v. Jander***, 140 S. Ct. 592 (2020).
  - Court vacated the Second Circuit decision reinstating the complaint
  - Remanded the case to the lower court to consider two briefed issues that it had not addressed.



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# DEFINED CONTRIBUTION PLAN ISSUES—STOCK DROP ACTIONS (CONT'D)

- While difficult to allege a viable stock drop complaint under this case law.
  - A plausible claim may lie in a factual pattern where plan fiduciaries refused to act, or even consider their options,
  - or the securities have fallen so drastically because the company is verging on insolvency.

- Risk of increased stop drop litigation.
  - If the equity markets remain in negative territory for the year,
  - and some companies become insolvent.

- Claims are expensive to defend and resolve.

# DEFINED CONTRIBUTION PLAN ISSUES—STOCK DROP ACTIONS (CONT'D)

- Proactive defensive steps for fiduciary committees.
  - Engage in **robust procedural prudence** that is **documented**.
  - More **frequent meetings**
  - Appropriately seeking and **evaluating independent investment advisors' advice**.

- Fiduciary committee considerations
  - **Freeze plan investments in company stock**,
  - **Limiting participant contributions**,
  - or even **liquidating the stock fund**.

- Plan investment in company stock assets
  - Carefully consider **appointing an independent fiduciary** to oversee.

# DEFINED CONTRIBUTION PLAN ISSUES—PLAN ELECTRONIC SYSTEM FAILURES

- This past month has seen unusually volatile markets.
  - Large volumes.
  - Large market swings.
- Robinhood, a broker dealer that uses an app to conduct transactions, actually failed to execute trades for over a day.
- Unprecedented call volume could overload systems, call center, trading apps, or possibly a brokerage window.
- The plan committee considerations
  - **Revise and test systems**,
  - **Review plan disclosures** to **add language** that systems may be temporarily unavailable due to unprecedented calls for service.



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# DEFINED CONTRIBUTION PLAN ISSUES—TARGET DATE FUNDS

- Target date funds, now ubiquitous in plans.
  - Likely to underperform other assets as markets decline.
  - Participants often have an expectation that such funds are more conservative, or “safer,” than other investments.
  - Some target date funds that are based upon a basket of government and municipal securities may perform demonstrably worse than other funds.

- Disclosures on target date funds can be problematic.
  - Plaintiffs’ bar was increasingly targeting before the current economic downturn.

- Fiduciary committees should:
  - Examine carefully their target fund investments
  - Understand the mix of investments making up the fund
  - Be especially wary of securities largely predicated on government and municipal bond securities

# DEFINED CONTRIBUTION PLAN ISSUES—STABLE VALUE FUNDS

- Stable value funds may experience negative returns in this interest rate environment.
  - Participants regard as conservative investments that preserve capital.
  - SVFs are often offered because they generally have a superior return over money market funds.
  - These negative returns occurred in the 2008 recession.

- In 2009, a Chrysler SVF in a deferred compensation plan paid $.89 on the dollar when it was liquidated prior to the company's bankruptcy proceedings.

- In 2008, State Street-managed SVFs had losses requiring State Street Fund to contribute over $610 million to the funds.

- Possible claims can also arise over the SVF's fees, which of course will drag on the return, and the wrap contracts, which rely in the financial integrity of the issuer.

# DEFINED CONTRIBUTION PLAN ISSUES—STABLE VALUE FUNDS (CONT'D)

- A fiduciary committee has to examine the following issues with SVFs:
  - Fees
  - Investment mix
  - Wrap contracts and the integrity of the issuer
  - Performance
  - Plan disclosures to participants

# DEFINED CONTRIBUTION PLAN ISSUES—MONEY MARKET FUNDS

- Like SVFs, money market funds can experience negative returns.

- On March 20, the Federal Reserve instituted a new lending facility to support money market mutual funds.
  - Mirrored the Fed's actions in 2008.

- These fund disclosures can be problematic because they often advertise a stable $1 share price.

- Fiduciary committees should examine:
  - Fees
  - Disclosures
  - Performance

# DEFINED CONTRIBUTION PLAN ISSUES—BOND FUNDS

- Bond funds will underperform in a sustained economic decline accompanied by a low interest rate environment.
  - Participants regard as safer,
  - First Pennsylvania case

- Fiduciary committees should examine:
  - Fees
  - Disclosures
  - Performance

# DEFINED CONTRIBUTION PLAN ISSUES—ADMINISTRATIVE FEES

- Fees have been decreasing,
  - May tick up because of overall asset attrition,
  - due to reduced investment performance.
- Critical that Committees examine fees.

# DEFINED CONTRIBUTION PLAN ISSUES—PARTIAL TERMINATIONS

- Many plan terms require 100% vesting if a high percentage of employees are terminated or laid off.

- Obvious impact of furloughs and RIF
  - Timing and execution must be carefully planned and executed
  - Make sure all actors (e.g., HR, benefits, etc.) are coordinated.

# DEFINED CONTRIBUTION PLAN ISSUES

- **Administrative Fees**
  - Fees, which have been decreasing, may tick up because of overall asset attrition due to reduced investment performance.
  - Committees have to examine fees critically.

- **Partial Terminations**
  - Many plan terms require 100% vesting if a high percentage of employees are terminated or laid off.

# WELFARE PLAN ISSUES—PARTIAL TERMINATIONS

- With many employers reducing their workforce, plan eligibility issues will arise.

# WELFARE PLAN ISSUES—
# EXTENDED HOSPITAL STAYS

- For coronavirus patients, plans will experience higher expenses for extended hospital stays.

- Several carriers are waiving copayments and providing other benefits
  - Raises an issue with self insured plans
  - One medical condition will receive preferential treatment
  - Depending upon plan terms, a self insured plan may opt out of co pay waivers
  - If it opts out, there maybe an issue under the Mental Health Parity Act if the plan treats Covid differently than other conditions

# WELFARE PLAN ISSUES—
# OUT OF NETWORK PROVIDER ISSUES

- There already is a surfeit of cases challenging plan payment reductions to out of network providers

- In the current medical crisis, it is very likely that participants will be serviced by out of network providers

# DEFINED BENEFIT PLANS

- Single Employer Plan Funding Implications Due to Market Downturn.
- Run on Retirements Due to Low Interest Rates Increasing Lump Sum Payments and Increased Employee Turnover.
- Cash Balance Plans Concerns with Low Interest Rates Causing Backloading Issues.
- Multiemployer Plans Concerns Due to Increased Underfunding.
- Plan Liability Litigation—*Thole v. U.S. Bank NA*

# DEFINED BENEFIT PLANS—SINGLE EMPLOYER PLANS FUNDING CONCERNS

- Under the PPA, single employer defined benefit plans are required to be 80% funded to avoid benefit restrictions.
  - Coronavirus Aid, Relief, and Economic Security Act (“CARES Act”) gives some funding relief for companies,
  - allowing benefit restrictions for 2020 determinations to be based on 2019 funding.
  - Lump sums typically are determined by reference to a rate in a specific month from a prior year, which may drive issues next year.
- The rapid drop in fixed and equity investment markets.
  - Undoubtedly cause funding concerns for some plans,
  - requiring increased sponsor plan contributions.
- Sponsors should budget potential additional plan contributions

# DEFINED BENEFIT PLANS—
# ASSET EROSION DUE TO INCREASED LUMP SUM PAYMENTS DUE TO LOW INTEREST RATES

- Interest rates are at historical lows with the Fed Rate falling to its **current 0.25% from 1.75%** as of February 21.

- The net effect will be to increase lump sum payouts because the rate multiplier has fallen.
  - Increases the product.

- Coupled with more participants seeking lump sum payouts.
  - Due to employment severances and early retirement options.

- Plans will face additional lump sum payout liabilities.

# DEFINED BENEFIT PLANS—CASH BALANCE PLANS—BACKLOADING AND FORFEITURES

- Low interest rates.
  - Could trigger minimum interest crediting,
  - to avoid backloading and forfeitures.

- Active interest credit rate.
  - The rate that is applied to the hypothetical account balance,
  - for purposes of satisfying the backloading rules.

# DEFINED BENEFIT PLANS—MULTIEMPLOYER PLAN ISSUES

- Underfunding rise may increase dissolution risks.
  - Mass withdrawal liability exposure.
- Complete withdrawals may increase.
- Partial plan terminations.
  - Due to employee layoffs and furloughs
  - Severance vs. furlough considerations
  - Also a concern with single employer plans.

# DEFINED BENEFIT PLANS—
# PLAN LIABILITY LITIGATION

- Participants in defined benefit plans historically lacked standing to challenge funding and investment decisions.
  - Employers, not plan participants, assume the risk for plan underperformance.

- ***Palmason v. Weyerhaeuser Co.***, No. C11-0695RSL, 2013 WL 4511361 (W.D. Wash. Aug. 23, 2013)
  - Participants had standing to pursue claims for **equitable relief** based on deprivations of specific statutory rights and protections—*e.g.*, defendants' alleged self-dealing—but **<u>not</u> claims for monetary relief**.

# DEFINED BENEFIT PLANS—
# PLAN LIABILITY LITIGATION (CONT'D)

- ***Thole v. U.S. Bank NA***, 873 F.3d 617 (Oct. 12, 2017)
  - District court eventually dismissed on standing grounds,
  - U.S. Bank made voluntary contributions to overfund the plan.
- Eighth Circuit affirmed
  - Rejected participants' argument that they had standing because plan was underfunded when they filed suit.
- Participants' cert petition
  - Can a plan participant or beneficiary can seek **(1) injunctive relief** or **(2) restoration of plan losses** without demonstrating individual financial loss.
- Oral argument was held on January 13.
  - If resolved in the participants' favor, it could open the floodgates for such claims.

# Thank You


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