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.
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.
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.

• 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 copay 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.

  – 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 not claims for monetary relief.
DEFINED BENEFIT PLANS—PLAN LIABILITY LITIGATION (CONT’D)

  – 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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