A New Wave of ERISA Litigation

• 2006, Excessive investment management and plan administration fees from § 401(k) plan’s investment options class actions
• 2018, § 403(b) class actions for failure to prudently select and continue to monitor the investment options of plans.
• Is this the next wave of litigation?
Class Actions Filed (Same 3 Law Firms)

- Masten et al. v. Metropolitan Life Insurance Co.
  - Southern District of NY—12/18
- Torres et al. v. American Airlines, Inc.
  - Northern District of TX—12/18
- DuBuske et al. v. PepsiCo, Inc.
  - Southern District of NY—12/18
- Smith et al. v. US Bancorp
  - District of Minnesota—12/18
- Smith et al. v. Rockwell Automation
  - Eastern District of Wisconsin—4/19
- Duffy et al. v. Anheuser-Busch
  - Eastern District of Missouri—5/19
- Herndon et al. v. Huntington Ingalls Industries
  - Eastern District of Virginia—5/19
- Cruz et al. v. Raytheon Company
  - District of Massachusetts—6/19
  - District of Massachusetts—6/19
What is Challenged: Pension Plan Actuarial Assumptions

- PepsiCo, American Airlines, Metlife, US Bancorp Anheuser-Busch, Rockwell and Huntington Ingalls have all been sued under a novel ERISA theory.
  - “Unreasonable” defined plan “conversion factors”
    - All involve optional forms of annuity payments and/or early retirement benefits.
    - Use of outdated mortality tables coupled with interest rates that do not reflect prevailing rates.

- **Relief sought:**
  - Retroactive increases in benefits and allow Participants to recover “actuarially equivalent” amounts
  - Reformation of the plan
  - Hold fiduciaries liable
<table>
<thead>
<tr>
<th>Plan Sponsor</th>
<th>Challenged Conversion Factor</th>
<th>Factor Type</th>
<th>Mortality Table(s) and/or Interest Rates Used</th>
</tr>
</thead>
<tbody>
<tr>
<td>PepsiCo</td>
<td>Optional Annuity</td>
<td>Fixed by payment form (i.e., 0.90 for 50% J&amp;S, 0.85 for 75% J&amp;S)</td>
<td>Not Specified</td>
</tr>
<tr>
<td>American Airlines</td>
<td>Optional Annuity</td>
<td>Mortality Table &amp; Interest Rate</td>
<td>UP 1984 and 5%</td>
</tr>
<tr>
<td>MetLife</td>
<td>Optional Annuity</td>
<td>Mortality Table &amp; Interest Rate</td>
<td>1971 GAM &amp; 6%</td>
</tr>
<tr>
<td>U.S. Bancorp</td>
<td>Early Retirement</td>
<td>Fixed by age (i.e., 0.90 for 64, 0.81 for 63, 0.73 for 61, 0.66 for 61)</td>
<td>Not Specified</td>
</tr>
<tr>
<td>Rockwell Automation</td>
<td>Optional Annuity</td>
<td>Mortality Table &amp; Interest Rate</td>
<td>1971 GAM &amp; 7% or UP 1984 &amp; 6% (depending on option)</td>
</tr>
<tr>
<td>Anheuser-Busch</td>
<td>Optional Annuity</td>
<td>Mortality Table &amp; Interest Rate</td>
<td>UP 1984 and 6.5% or UP 1984 &amp; 7% (depending on sub-plan)</td>
</tr>
<tr>
<td>Huntington Ingalls</td>
<td>Optional Annuity</td>
<td>Mortality Table &amp; Interest Rate</td>
<td>1971 GAM &amp; 6%</td>
</tr>
<tr>
<td>Raytheon</td>
<td>Optional Annuity</td>
<td>Fixed by payment form (i.e., 0.90 for 50% J&amp;S, 0.85 for 75% J&amp;S, 0.80 for 100% J&amp;S)</td>
<td>1971 GAM, UP 1984, &amp; 1971 TDF&amp;C &amp; the interest rate used by PBGC for valuing immediate annuities.</td>
</tr>
<tr>
<td>Partners Healthcare</td>
<td>Optional Annuity</td>
<td>Mortality Table &amp; Interest Rate</td>
<td>Adjusted 1951 GAM &amp; 7.5%</td>
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</tbody>
</table>
Cases are Complex

- Claims have negative optics
  - Using 1970s mortality table “looks bad”
    - Several newer tables have been issued since
- AE assumptions rarely changed in practice
  - Extremely complicated area and must grandfather prior assumptions into future
- Case is complex and theories are difficult to grasp
  - Combination of unreasonable mortality tables and unreasonable interest rates could end up being reasonable.
Substantive Allegations

The cases generally argue:

- The Plan’s optional form of benefits are not “actuarially equivalent” to a single life annuity (SLA).
  - To convert an SLA into a QJS, QOSA, or QPSA the present value of the aggregate future benefits the participant is expected to receive under either form must be determined.
    - To calculate present value an interest rate and a mortality table is used.
  - The “conversion factor” applied to the SLA to determine the amount of an alternative form of benefits uses unreasonable market interest and mortality rates.
  - **Resulting in:** Violation of § 1054(c)(3), improper forfeiture of accrued benefits, and breach of fiduciary duty for “failure to monitor”
Example: Rockwell Automation

- Allegation: Defendants misrepresented to participants that 50% JSA (using 1971 GAM table) and 10YCLA (using UP 1984 table) were actuarially equivalent to SLAs.

<table>
<thead>
<tr>
<th></th>
<th>2018 Treasury Assumptions</th>
<th>1971 GAM/7%</th>
<th>UP-84/6%</th>
</tr>
</thead>
<tbody>
<tr>
<td>SLA</td>
<td>$1000</td>
<td>$1000</td>
<td>$1000</td>
</tr>
<tr>
<td>10 YCLA</td>
<td>$972.62</td>
<td>$911.13</td>
<td>$911.58</td>
</tr>
<tr>
<td>50% JSA</td>
<td>$926.67</td>
<td>$875.14</td>
<td>$900.07</td>
</tr>
</tbody>
</table>

- Here, plaintiff retired at age 60 and 1 month and accrued an SLA of $1,616.25/month. He is receiving a 10YCLA paying $1,534.32/month.
  - If the Treasury assumptions were applied he would be paid $54.42 more per month.
Are These Cases Going Away?

• U.S. Bancorp’s Motion to Dismiss was denied
  – Question of ERISA violation, not the tax code
  – Case is going to proceed
    • What does this mean for the other cases? Unclear

• Plaintiff’s lawyers will continue bring actuarial equivalence lawsuits
ERISA Requirements

- Two primary laws regulate most of employee benefits:
  - Internal Revenue Code
    - Code rules DO require actuarial equivalence between a single life annuity and joint survivor annuity.
    - Code rules do NOT mandate specific mortality tables or interest
  - Employee Retirement Income Security Act of 1974
    - Strict requirements for plans, plan sponsors, and plan fiduciaries
    - Who is responsible—settlor, fiduciary?
Potential Liability?

• Limited legal and professional guidance
  – ERISA/Code provisions not definitive
  – IRS/Treasury guidance also not definitive
  – No actuarial standards that directly apply

• Seems like burden of proof is on the plaintiffs
  – Range of reasonableness

• Negative publicity/loss of reputation in community
Fiduciary Liability

• **Is this a fiduciary function or a settlor function?**

• Increased fiduciary liability insurance premiums or denied coverage.
  – Removal and disbarment from acting as a future fiduciary
    • Disclosure of fiduciary breach on personal filings, such as loan applications, securities licenses, and any job or charitable board application.

• **Compensatory Damages**
  – Fiduciary could be held *personally liable* to restore plan losses and any profits made through use of plan assets.
What Comes Next?

- Review your AE assumptions
- Ensure conversion methodology is consistent and reasonably justified under the circumstances
- Consider whether a plan amendment is required to change assumptions
  - Identify and deal with any potential cutback issues
- Consider outside, privileged legal review
  - Independent actuary?
Managing Potential Liability

• Assume that fiduciary, not actuary, responsible for decision-making and monitoring benefit conversions
  – Fiduciary must:
    • Investigate actuarial methods and qualifications
    • Ensure actuary has complete information about population.

• Investigate and documents:
  – How many defined plans do you offer? How do conversion factors compare across your defined benefit plan payment forms? Are changes warranted?
Managing Potential Liability

- Investigate and document:
  - How many defined benefit plans (including “component plans”) do you offer?
  - For each defined benefit plan, do any participants accrue benefits under multiple formulas?
  - How do conversion factors compare across your defined benefit plan payment forms?
  - Are conversion factors specified in your plan document in a manner that precludes employer discretion?
  - Does each defined benefit plan specify how annuity conversion factors are calculated for each payment form?
  - Does each defined benefit plan specify how early commencement factors are calculated for each payment form?
  - Does each defined benefit plan require, for any purpose, the use of a specific mortality table and/or a specific interest rate?
  - For each defined benefit plan, are there any discrepancies between how the plan is being operated and how it was set up?
  - Are conversion factor changes warranted?
  - Could some plan participants receive less if the conversion factors are “modernized”?
Key Takeaways

• More actuarial equivalence litigation is coming
• Review plans and their conversion factors
  – Ensure the methodology used is consistent, reasonable, and justified.
• Prepare fiduciaries to be responsible decision-makers
• Consult an independent actuary