Pressures rising for fiduciaries on company stock in 401(k) plans

DOL, SEC legal filings in closely watched case seen adding to burden

BY **ROBERT STEYER** | MARCH 21, 2016

Pressure on defined contribution plan fiduciaries is expected to rise as recent legal filings by the Department of Labor and Securities and Exchange Commission appear to expand their responsibilities when it comes to managing company stock funds, several ERISA attorneys say.

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Nancy Ross doesn't think DC plan fiduciaries should be 'watchdogs for the entire company.'

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Some of these comments "will turn fiduciaries, in effect, into in-house securities regulators," said Stephen Rosenberg, a partner in The Wagner Law Group, Boston.

"Fiduciaries have obligations to participants and beneficiaries," added Nancy Ross, a partner at Mayer Brown, Chicago. "They are not to be the watchdog for the entire company. It's a quagmire."

The attorneys were referring to amicus briefs filed March 11 by the SEC and the DOL in the case of Whitley et al. vs. BP PLC et al., now before the 5th U.S. Circuit Court of Appeals, New Orleans. Participants of a BP 401(k) plan accused the company and its plan of breaching fiduciary duties in managing a BP stock fund in the plan. Their briefs supported the BP participants.

The participants alleged company executives failed to provide important information about safety procedures before the April 2010 explosion on the Deepwater Horizon oil rig in the Gulf of Mexico that killed 11 workers.

They claimed company executives provided inaccurate information about oil leakage after the explosion. As a result, they said, participants who held BP American depository shares in the BP stock fund suffered when the stock plunged. And they argued BP fiduciaries could have acted to protect participants by halting further purchases of company stock and/or publicly disclosing information about BP safety practices.

The defendants have maintained, among other things, that they were hamstrung by contradictions between federal securities laws and ERISA.

The DOL said BP plan executives could have taken several actions regarding material non-public information to meet their ERISA obligations without violating securities laws. "In the circumstances here, putting an immediate end to the fraud advances the objectives of both ERISA and securities laws," said the DOL amicus brief.

Fiduciary responsibilities

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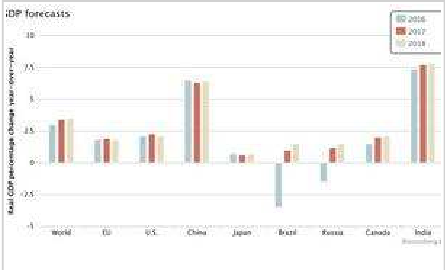

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Both the SEC and DOL outlined the responsibilities of plan fiduciaries who become aware that an employer's publicly traded stock is "materially overvalued due to an undisclosed fraud," as the SEC's filing stated.

They said plan executives could publicly disclose fraud, halt purchases and sales of company stock when fraud was identified, ask persons responsible for the alleged fraud to make public disclosures or file a "whistleblower" complaint to the DOL and/or SEC.

Some of these recommendations will "raise the role of fiduciaries to a level that Congress never intended" when it passed the Employee Retirement Income Security Act, Ms. Ross said.

"Fiduciaries could be second-guessing their (corporate) executives," said Jan Jacobson, senior counsel for retirement policy at the American Benefits Council, Washington, a trade group representing large corporations. ABC supports BP in this case and has supported DC plans in other stock-drop cases.

In their filings, the SEC and the DOL said they were seeking to clarify the responsibilities of plan fiduciaries and reconcile apparent differences between ERISA and federal securities laws. Although they filed separate legal briefs, they collaborated on their analysis of permissible plan fiduciary behavior.

Amicus briefs lack the force of law or regulation, but "they have some persuasive value" for plan fiduciaries, said Mr. Rosenberg of The Wagner Law Group. "They want to make it clear you can comply with securities law and take action. But this is not a get-out-of-jail-free card."

The SEC's comments are noteworthy because they were, in effect, requested by the U.S. Supreme Court, in a June 2014 decision that now governs Whitley vs. BP and all other stock-drop cases. In Fifth Third Bancorp et al. vs. Dudenhoeffer et al., the Supreme Court struck down the presumption-of-prudence principle, which the justices criticized as "defense friendly."

In its 9-0 decision, the Supreme Court offered several suggestions to courts on evaluating how fiduciaries managed company stock funds. It instructed lower courts to weigh how fiduciaries' responsibilities under ERISA might conflict with the "complex insider-trading and corporate disclosure requirements" of federal securities laws. The Supreme Court said fiduciaries' actions shouldn't do "more harm than good."

Writing for the court, Justice Steven Breyer noted the SEC "has not advised us on its views on these matters, and we believe those views may well be relevant."

Among the key points in its amicus brief, the SEC:

nagreed with the DOL that a DC plan executive who is aware of an employer's undisclosed fraud "can satisfy ERISA obligations by disclosing the fraud." Securities laws require a plan executive "who made or was responsible for misstatements or omissions constituting fraud" to make a public disclosure "that renders the prior statements not misleading." Any disclosure must be public; a plan executive cannot disclose the fraud only to the participants in the company stock fund.

nemphasized that a fiduciary must suspend purchasing and selling company stock on behalf of participants. ERISA might require fiduciaries to "refrain from purchasing additional shares of overvalued employer stock," but they "must concurrently refrain from effecting sales" to avoid violating securities laws and "from trading on the basis of inside information about the employer's fraud." Suspending trading must be reported "promptly" in an 8-K form.

nnoted that the standard for defining "material" information in ERISA "is essentially identical" to the standard governing securities laws.

nsaid several other DOL recommendations for fiduciaries "would not be inconsistent with the securities laws." Noting that the DOL said a fiduciary "could urge persons responsible for the fraud to disclose it," the SEC said such a request "does not conflict with securities laws." Also, the DOL's suggestion that a fiduciary could report fraud directly to the DOL or SEC "would not conflict with securities laws," the SEC said.

More litigation ahead?

This latter group of recommendations is what most troubles ERISA attorneys. "There can be all kinds of disagreements over what is misleading and fraudulent," said Ms. Jacobson of the American Benefits Council. Her organization has filed an amicus brief in the Whitley case, saying that a pro-participant ruling could accelerate sponsors' moves to eliminate their company stock funds because of expanded litigation risk.

If courts follow the DOL's suggestions, “it would vastly increase the number” of stock-drop cases filed against DC plans, Ms. Jacobson said.

Some wording in the DOL amicus brief is so broad that “all a plaintiff would have to do is allege fraud or misrepresentation” after a stock declines for a court to agree to hear — rather than dismiss — a fiduciary breach complaint, she said.

Mr. Rosenberg of The Wagner Law Group said he expected the SEC and DOL comments would encourage participants' lawyers to file more stock-drop lawsuits, but he doubted these amicus briefs would provoke DC plans to get rid of company stock funds.

Although the DOL and SEC have told sponsors what they can do, they also “definitely lay out the steps and gives a road map” to plaintiffs' attorneys, Mr. Rosenberg said.

He is telling clients that their fiduciaries have a dilemma, especially when faced with the prospect of asking an executive responsible for alleged fraud to make a public disclosure. If the plan selects in-house fiduciaries, “you have to consider who to put in that position,” he said. “How much (inside corporate) information is he exposed to?”

After having read the SEC and DOL comments, “I would say you really should hire an independent fiduciary” to manage a company stock investment option, he said.

Some DC plans have hired independent fiduciaries. Although their hiring doesn't absolve a company of all responsibilities, third-party managers aren't exposed to inside information that might be the source of potential fraud.

If a plan's fiduciaries are company employees, “you need a securities lawyer on speed dial,” Mr. Rosenberg added. “You almost need an independent securities lawyer” to provide advice to the in-house fiduciaries.

"Chilling effect'

Ms. Ross of Mayer Brown said the amicus briefs, especially that of the DOL, “will have a chilling effect” on the willingness of company officials to serve as fiduciaries for the DC plan. “This increases pressure on fiduciaries. When they learn of unsavory behavior, they will have to debate: "What should I do about the plan? What should I do about the shareholders?'”

The DOL and SEC comments “will have a small likelihood of incentivizing the plaintiffs' bar” to file more stock-drop lawsuits, said Ms. Ross, adding that these lawyers already have been using the 2014 Supreme Court ruling as a basis for litigation.

ERISA attorney Jeremy Blumenfeld said he doubted the SEC and DOL amicus briefs would lead to more stock-drop suits or lead to DC plans terminating company stock funds.

“I don't think what the DOL said was new,” said Mr. Blumenfeld, a Philadelphia-based partner at Morgan Lewis & Bockius LLP, who represents DC plans in fiduciary-breach cases. “I don't think they are adding any more ammunition to the plaintiffs' bar.”

Mr. Blumenfeld said the SEC comments about fiduciaries needing to halt purchases and sales of company stock when they become aware of an employer's undisclosed fraud should help sponsors. Taking action won't prevent the stock from going down, he said, but it will show that fiduciaries responded promptly and properly to the SEC guidelines.

As for the role that the SEC's comments could play in future stock-drop cases, Mr. Blumenfeld noted that the Supreme Court wanted the agency's views. “It would not surprise me” if the SEC's brief might be given more weight by lower courts than amicus briefs traditionally filed by government agencies, he said. n

This article originally appeared in the March 21, 2016 print issue as, "Pressures rising for fiduciaries on company stock".

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