Statement of Norman Stein

Before the ERISA Advisory Council

Working Group on

"Private Sector Pension Derisking And Participant Protections"

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Good morning. I am Norman Stein. I am a professor at the Earle Mack School of Law at Drexel University, where I teach and write principally in the areas of employee benefits and tax law. I also am a policy consultant for the Pension Rights Center in Washington, which is the country's only consumer organization dedicated solely to protecting and promoting the retirement security of American workers, retirees, and their families. My comments today, however, are my own and do not necessarily reflect views of either Drexel University or the Pension Rights Center.

I appreciate the opportunity to testify before you today on the topic that this work group is studying: so-called pension de-risking, the recent phenomena in which some of the largest companies in the United States seek to transfer—really unload—their risks onto the participants in the pension plans they sponsor.

I want to begin by noting four reasons why this is such an important and appropriate topic for this advisory council.

First, the first movers in this new trend—General Motors, Ford and Verizon—have done so during an era in which governmental fiscal policy has resulted in historically low interest rates. If interest rates increase, as some financial analysts predict, the cost of de-risking will drop, making the practice cheaper, more appealing, and more widespread. De-risking may seem just a brushfire now, but if fueled by rising interest rates, it will spread like wildfire. It is an urgent topic.

Second, the prospects for timely legislative solutions are slight—it took Congress more than a decade to fashion legislation curbing the worst abuses in cash balance conversions. This means it will fall to the federal regulatory agencies—the Department of Labor, the Department of Treasury, and possibly the Pension Benefit Guaranty Corporation—to address de-risking concerns in a meaningful way. If we wait for Congress, the proverbial barn gate will have been slammed shut too late.

Third, and related to the second reason, the Department of Labor has considerable regulatory power to mitigate some of the most harmful aspects of de-risking transactions. This council can thus make recommendations to the Secretary about a regulatory response to de-risking transactions.

And fourth, and probably most important, de-risking transactions that offer retirees—already in pay status—the opportunity to commute the remainder of their annuity payments into a lump sum, are among the most cynical and worst of all pension abuses that have emerged post-ERISA. Unlike terminations for reversions—where participants at least received the nominal value of what they were promised; and cash balance plans—where the most troubling problems were lack of disclosure and subjecting older employees to periods of no new pension accruals—the problem of lumping out retirees is akin to theft—a transfer, albeit in the guise of retiree choice, of assets from elderly Americans to the corporations that once employed them.

I have divided my statement into three sections. The first section briefly describes de-risking transactions, although the Council is certainly familiar with the mechanics, and explores some of the policy and legal concerns that have been raised by them. Much of this you have already heard, but I do want to draw your attention to some of the financial aspects of lumping out retirees, which saves the plan sponsor less than it will typically cost the retirees and thus, as economists would say, is Pareto inefficient. The second section concerns the settlor/fiduciary doctrine and its relationship to de-risking transactions, a topic covered in a paper that I am currently writing with Professor Dana Muir at the University of Michigan.[1] In my view, the settlor/fiduciary doctrine is central to the Department of Labor's authority to regulate de-risking transactions. The third section outlines some of the regulatory actions that the Department of Labor might take to address de-risking transactions. (I do not suggest that it is a complete list.) This section also touches upon areas in which the Department of Labor might work with its sister agencies in addressing legal concerns with de-risking.

I. *De-Risking Transactions: Mechanics, Policies Concerns and Legal Issues*

De-risking Mechanics: The term de-risking is not a statutory or technical term; rather, it is a generic term that refers to a variety of approaches that employers use to control the risks inherent in the promise to pay employees a set monthly payment for life after they retire. Some de-risking strategies are unobjectionable from any perspective, indeed laudable: for example, a plan's purchase of investment-grade fixed income securities whose maturities match predicted future benefit liabilities. But two approaches to de-risking—which can be done singly or in tandem—raise troubling legal, economic, and policy issues. The first such approach is the purchase of irrevocable commitments from insurers to pay promised benefits and the distribution of those commitments to plan participants. The second approach is to offer to retirees (and in some situations former employees with deferred vested benefits) an option, which must be

[1] Professor Muir has not reviewed my testimony and the opinions and suggestions expressed in this testimony are mine alone.

elected during a relatively brief window, to commute their remaining annuity benefits into a lump sum option. So far as I have been able to ascertain, the second approach is a new development, which plans have not previously attempted, except perhaps in a few plan terminations.

Policy Concerns with Distribution of Irrevocable Insurance Contracts:

A plan obligation to pay a defined benefit is guaranteed by the Pension Guaranty Corporation; the PBGC takes the position that its guarantees do not apply once a plan distributes an annuity contract to a participant. If an insurer becomes insolvent, the former plan participant is reliant on state insurance guaranty associations, whose guarantee vary considerably in their economic value. The determination of whether a participant is better off with his benefits in the plan or his benefits transferred to an insurance company depends on a comparison of risks: on the one hand, the risks that the plan sponsor will fail to fund the plan adequately and that PBGC guarantees will not cover a participant's entire benefit, versus, on the other hand, the risk that the insurer will fail and that the state guaranty funds will fully cover lost benefits. It is difficult to evaluate the two sets of risks, although several people who testified earlier this morning—people not tied to an industry with a predisposition toward preferring the former risk, prefer the latter. And change itself is an enemy to security: retirees, on the whole, are made anxious by changes in risk, particularly those that are difficult even for even experts to evaluate.

Moreover, there are concerns about the standards for selecting annuities. In 1995, the Department of Labor issued an interpretative bulletin with guidance for fiduciaries charged with selecting an insurer to which benefit liabilities will be transferred on plan termination. The bulletin takes the position that the responsible fiduciaries must select the safest available annuity. The bulletin, however, does not address selecting an annuity as part of a de-risking transaction, where the statutory context and policy considerations are not identical to plan terminations. Thus, the meaning of safest possible annuity in de-risking transactions may not be identical to plan terminations. For example, one option a fiduciary has in a de-risking transaction but not in a plan termination is to purchase the annuity but not distribute it to participants unless the fiduciary concludes that distribution of the annuity contract will not subject the participant to additional risk. Moreover, standards for evaluating annuity safety have evolved since 1995, when the Department issued the bulletin.

The 1995 memo also does not address other issues about the annuity contract, such as whether the fiduciary has an obligation to replicate ERISA protections—for example, protecting the annuity contract against claims in bankruptcy or garnishment. If no provisions are made in the contract, participants will be subject to the default debtor protections under state law, which vary. Moreover, without contractual restraints in the annuity agreement, there may be no meaningful limits on the insurer's ability to offer to commute the annuity contract into a lump sum payment or riskier insurance product at some point in the future. The insurer's offer might not be subject to ERISA standards, including the consent of a spouse. And on marital separation, the division of an annuity contract is more complex than dividing a pension.[2]

There are also concerns about who has responsibility if the participant in the future has questions about whether benefits have been correctly calculated, or if recoupment for overpayments is being correctly administered. The plan's fiduciary had a fiduciary responsibility to consider such claims before the de-risking; the insurer may not after the de-risking. Moreover, I once saw a plan termination case in which the insurer itself determined that

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[2] See *Breaking Up is Hard to Do, Especially with Annuities*, Investment News, March 18, 2012, http://www.investmentnews.com/article/20120318/REG/303189983#.

the plan had miscalculated benefits and unilaterally reduced future benefits, apparently pocketing the difference. The prospect that this could happen in a de-risking case is troubling.

Still another set of concerns revolve around the reality that a de-risking transaction can impair the funding levels of the remaining plan. Can a fiduciary implement a de-risking transaction if the effect is to reduce the funding ratio of the plan?

There is currently a civil action against Verizon that raises a plausible claim, to wit, that a traditional defined benefit plan cannot satisfy its benefit obligations by distributing annuity contracts to participants without the participant's (and spouse's) consent. Arguably, a distribution of an annuity contract is not the required normal form of benefit under ERISA and the Internal Revenue Code and thus requires participant consent.

A further concern is with the statute of limitations for fiduciary violations. Assume, for example, that a fiduciary purchases an annuity from an insurance company willing to write the annuity. If problems emerge in the future—problems that the fiduciaries should have been able to detect—it may well be too late to sue the fiduciary under the applicable ERISA statute of limitations.

Others have also questioned the broader economic impacts of de-risking transactions. Among the concerns here are whether the insurance industry has the capacity to absorb the massive liabilities that are being transferred to it in de-risking transactions and what effects de-risking transactions might have on the market for long-term, investment grade bonds.

Policy Concerns with Lump Sum Options:

In two of the large de-risking transactions that have already taken place, already retired plan participants were offered the option of taking a lump sum in lieu of receiving the remainder of their annuity. This is a bonanza for those who know they have a terminal illness, which permits them to engage in adverse selection by choosing the lump sum option, which is certainy more valuable than a life annuity that will be cut short by the certainty of an early death. This is the primary group—some people, such as the pension economist Alicia Munnell, believe the only group—that will be financially better off swapping their annuity for a lump sum. Everyone else, or almost everyone else, who selects a lump sum will be forfeiting a substantial portion of their retirement savings.

It is reasonable to assume that the plan sponsor that permits retirees an election to convert their remaining annuity into a single-sum payment is not doing it because it wants to provide a large financial windfall for former employees with terminal illnesses. And since rational insurance companies will charge higher premiums for a group annuity contract that permits the terminally ill to opt out of the insurance pool, we can assume that the employer expects to cover the higher premium costs and then some because it predicts that other participants will choose the substantially less costly, and substantially less valuable, lump sum option.

Why is this? There are a number of reasons. First, the interest rates used to value the lump sum under the Internal Revenue Code and ERISA are substantially higher than the interest rate that insurance companies use in setting premiums. Moreover, the average longevity of many work forces is greater than reflected in the mortality tables that are used to value lump sums and the insurance company will thus assume longer life expectancy in setting premiums. Finally, the employer is paying the insurance company a charge to cover future administrative costs and insurance company profit that it will not need to pay to a participant who receives a lump sum. At the last meeting of this working group, there was testimony that indicated that offering lump sum options can save the employer up to 30% in some circumstances over purchasing an annuity contract.

The costs to a retiree who elects a lump sum (other than the retiree who is aware that he will have a shorter than average life expectancy) will generally exceed the savings to the employer. And why is this? In part it is because the retiree will have to invest the lump sum assets and pay retail-level fees that will reduce her return on investment. The retiree may also lack the competence and experience to allocate her lump sum to appropriate asset classes. It will be difficult for even investment-savvy retirees to come close to realizing a rate of return that matches the discount rate used to convert their benefits into a lump sum, especially since orthodox asset allocation for a retiree properly leans toward a conservative portfolio. High returns and the high risk they impose are for the young in age, not the young at heart.

Moreover, an 80-year old retiree with several hundred thousand dollars will be seen by some unscrupulous financial advisers and out-and-out scam artists as bearing an irresistible gift. And that retiree, especially if burdened by diminished mental capacity, may begin to consume beyond sustainable levels. And in some cases, let us be frank, financially stressed relatives will borrow (or worse) from the retiree. And much of the ultimate harm may be visited upon the spouse in traditional households, since she is likely to be the one who outlives the couple's assets. And retirees and their spouses will both lose important protections against creditors.

And finally, if the retiree the day after he or she receives a lump sum decides it was an error and decides to enter the private annuity market, she is likely to find that the annuity that she can purchase is only 50% to 70% percent of the benefit she earned under the plan.

So why do employers expect so many retirees to make decisions against the retiree's economic interest and in favor of the employer's economic interest? Here again the answer is multi-factorial. Behavioral economists have shown that individuals have difficulty accurately discounting future payments and thus will overvalue lump sums. Financial advisers who work on commission have a financial interest in recommending that a participant forego the annuity in favor of a lump sum. Children may pressure their retired parents to take a lump sum. And as I've previously alluded to, some retirees will be experiencing diminished mental capacity and simply not be able to make good decisions. It is no wonder so many retirees make bad choices and no wonder that cynical employers anticipate that they will make bad choices. Offering a lump sum option to retirees is, in short, a form of corporate elder abuse.

There are of course issues concerning the legality of offering a lump sum option. In my judgment, there is ample legal authority to have justified the IRS to prohibit offering a lump sum to someone in pay status. And there are unresolved issues concerning the type and quality of disclosure that a fiduciary should have to make in implementing a de-risking transaction that includes a lump sum option.

II. De-risking Transactions and the Settlor/Fiduciary Doctrine

Someone who takes a quick look at ERISA's fiduciaries provisions may be surprised to learn that de-risking transactions, particularly those that include lump sum options, are permissible. Section 404(a) of ERISA provides that fiduciaries of ERISA plans must act for the sole benefit of participants and their beneficiaries and de-risking transactions are deliberately designed to impair the welfare of participants and beneficiaries. Why then are they permitted?

The answer can be found in the judge-made settlor-fiduciary doctrine, which holds that amending a plan—and a de-risking transaction is done pursuant to plan amendment—is not a fiduciary decision at all, regardless of its impact on participants. Rather, it is a settlor action, made by the plan sponsor in its business capacity as the designer of an employee benefits plan. The decision to de-risk is thus a settlor function and does not need to be made for the best interests of the plan participants. Indeed, in one view of the doctrine, it can be made to harm their interests rather than advance them.

But the actions of plan officials to implement a plan amendment are fiduciary acts and are subject to all ERISA standards of fiduciary conduct. Thus, the key questions in de-risking transactions are these: what decisions and actions are implementation decisions rather than settlor decisions, and what does implementation require in a de-risking transaction? It is in the answers to these questions that the Department of Labor can find much of its authority to regulate de-risking transactions.

(I have included as an appendix to this paper an excerpt from the paper I am writing with Professor Muir; the excerpt traces the origins of the settlor/fiduciary doctrine.)

As I earlier indicated, the choice of an annuity provider is not a settlor function, but rather is an implementation decision. Similarly, the fiduciary's negotiation with the insurer over the annuity's features and contractual provisions are implementation decisions. It is within the Department of Labor's authority to issue guidance both on how to select an insurer and on the contractual provisions that a fiduciary must ensure are included in the annuity contracts that the fiduciary negotiates on behalf of the plan.

It is also within the Department's authority to issue guidance that provides that a fiduciary implementing a decision to offer retirees a lump sum has a fiduciary responsibility to minimize the possibility that the retiree will make an imprudent decision. To do this requires a robust level of disclosure and might also in some circumstances require that the plan provide retirees with independent fiduciaries to give them advice on whether to take a lump sum or continue receiving their monthly benefits. A fiduciary may also have a duty not to implement a compressed window period for choosing a lump sum if the fiduciary determines that the compressed window period will result in participants being pressured into making poor choices.

In an ideal regulatory environment, the disclosures and other protections required of the fiduciary would be sufficiently effective to substantially reduce the number of people who imprudently choose a lump sum option. In such a world, the plan sponsor's cost-benefit analysis of whether to offer the lump sum option would likely result in no such option being offered.

III. Possible Regulatory Approaches

Transfers of Benefit Obligations to Insurance Companies:

A. *Issue guidance that indicates that fiduciaries have a responsibility to negotiate annuity contract provisions that replicate ERISA protections.*

B. *Issue guidance that indicates that fiduciaries have a responsibility to negotiate annuity contract provisions that prevent an insurer from offering lump sum commutations of annuity contracts or offering to exchange the annuity for a different insurance contract.*

C. *Ensure participant protections in cases of benefit miscalculations and recoupment of benefit overpayments.* .

The Problem: If a plan miscalculates a benefit (or improperly reduces a benefit through recoupment) and the liability for the benefit is transferred to an insurer, from whom does the participant seek redress? And redress here can mean at least two things: first, correction of the erroneous benefit calculation; and second, in the case of recoupment, fiduciary consideration of whether the benefit reduction should be modified because of hardship. Under current law, there might not be recourse against the plan because the retiree may no longer be a plan participant.

A solution: Issue guidance that interprets the DOL regulatory position on the definition of participant so that a person continues to be a participant if they have a colorable claim that their entire benefit has not been transferred to the insurer or if they have a colorable claim that recoupment should be waived or mitigated because of hardship to the participant.

D. *Clarify fiduciary standards for annuity selection in de-risking transactions.*

The problem: Even though the decision to amend a plan to provide for de-risking may be a settlor function, the selection of an annuity contract is a fiduciary activity. The Department published an interpretive bulletin on the selection of an annuity contract by a defined benefit plan for benefit distribution. The bulletin provides generally that a fiduciary in a defined benefit plan must select the safest available annuity. The bulletin then describes the factors that the fiduciary must consider in a thorough, objective and analytic search to identify the safest available annuity. The bulletin also notes that a fiduciary may not purchase an inferior, i.e., annuity that is less safe than the safest annuity available, simply because there are not available funds to purchase the safest annuity. In that case, the fiduciary may act only if the plan sponsor provides the additional funds necessary to purchase the annuity. On the other hand, the bulletin also indicates that the fiduciary might in some circumstances choose a less safe annuity if the fiduciary determines that is in the best interests of the plan participants—for example, because it increases plan surplus, which will be used to benefit the participants.

The interpretative bulletin was issued in 1995, before the wave of current de-risking transactions. There are a number of issues concerning annuity purchases in de-risking transactions that cannot be fully or satisfactorily answered from the 1995 interpretive bulletin, and which the Department of Labor could clarify, including:

(1) Whether in a de-risking transaction, the fiduciary must ensure that the annuity is at least as safe as a PBGC-guaranteed annuity, which might in certain circumstances mean not purchasing an annuity for some or all participants, or purchasing reinsurance from a second insurer, or retaining the annuity contract in the plan?

(2) Whether the fiduciary must insure that the transfer of benefit liabilities to an insurer does not impair the funded status of the plan after the de-risking transaction?

(3) Whether any independent fiduciaries who are engaged to identify an acceptable annuity provider should be asked to waive the statute of limitations so that participants can consider bringing actions against them if the insurer fails?

E. *Study whether participant and spousal consent is required for the distribution of an annuity contract.*

In coordination with the Department of Treasury, study the issue of whether participant consent is required prior to an ongoing plan's distribution of an annuity contract in satisfaction of plan benefits.[3] The Department of Treasury could indicate that no rulings or determination letters on distribution of annuity contracts from certain ongoing plans will be issued during the study period unless the participant's (and spouse's) consent is first obtained.

II. Lump Sum Options for Retirees

A. *Provide guidance indicating that fiduciaries in de-risking transactions have a responsibility to provide adequate disclosures to ensure that retirees understand the adverse financial consequences of a lump sum option.*

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[3] The study would not extend to plans that are funded by insurance contracts where it is the practice to distribute the contract to the participant.

In addition, the Department should coordinate with the Department of Treasury to create explicit disclosure requirements for lump sum options offered to people already in pay status.

B. *Provide guidance indicating that in certain circumstances fiduciaries in de-risking transactions have a responsibility to provide participants with an independent fiduciary to advise them on whether to elect a lump sum.*

C. *Study whether a plan may give a lump sum election to individuals already in pay-status.*

In connection with the Department of Treasury, study whether current law permits a plan to give a lump sum option to a person to the extent his benefit is already in pay status. The Department of Treasury could indicate that no rulings or determination letters on de-risking transactions involving lump sums will be issued until the study is complete.

APPENDIX

Excerpt from Draft Paper on Settlor/Fiduciary Doctrine

Dana Muir and Norman Stein, Two Hats, One Head, No Heart: The Anatomy of the ERISA Settlor Doctrine

The settlor/fiduciary doctrine is an accretion of guidance from the Department of Labor (DOL) and decisions by the courts. The first explicit iteration of the settlor/fiduciary distinction came in the form of a 1986 DOL information letter in response to "questions regarding the extent to which ERISA's fiduciary duty rules would apply to the decision to terminate a pension plan."[4] The DOL letter indicated "that in light of the voluntary nature of the private pension system governed by ERISA, the Department has concluded that there is a class of discretionary activities which relate to the formation, rather than the management, of plans. These so-called "settlor" functions include decisions relating to the establishment, termination and design of plans and are not fiduciary activities subject to Title I of ERISA."[5] The letter went on, however, to express the view that "[a]lthough the decision to terminate is generally not subject to the fiduciary

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[4] John N. Erlenborn, Department of Labor Information Letter 1 (Mar. 13, 1986), *available at* http://www.dol.gov/ebsa/regs/ils/il031386.html. John Erlenborn was a ten10-term Congressman from Illinois who helped create a house pension task
force and was a key participant in the legislative process that produced ERISA.
See, e.g., Nicholas Braude, "John Ernlenborn, Patriarch of Pension Legislation, dead at 78, Pension & Investments (November 14, 2005), http://www.pionline.com/article/20051114/PRINTSUB/511140711.

[5] *Id.*

responsibility provisions of ERISA, the Department has emphasized that activities undertaken to implement the termination decision are generally fiduciary in nature."[6]

In an important sense, though, the letter was disingenuous in the way it set up the issue, for there was no genuine disagreement that an employer enjoyed virtually unfettered control over the decision to establish, terminate, or design (subject to ERISA's substantive requirements) an employee benefit plan, for these were not controversial issues, although perhaps they should have been in certain contexts. Rather, the letter was effectively focused on a narrower issue, which was controversial: did an employer's decision to terminate an overfunded pension plan for the purpose of capturing its surplus assets implicate fiduciary duties, particularly when the employer had to amend the plan to create an employer right to the surplus assets? Given that the ERISA definition of fiduciary includes a person "to the extent . . . he exercises . . . any authority or control respecting management or disposition of [a plan's] assets,"[7] it was certainly within the parameters of plausible argument that the decision to amend a plan to create an employer right to capture a defined benefit plan's surplus assets was a fiduciary decision and perhaps even that the mere decision to terminate an overfunded plan for the purpose of recovering plan assets was a fiduciary decision. After all both the decision to terminate the plan and the recapture of the assets involve the exercise of authority or control of the disposition of a plan's assets.[8] But the Federal courts ultimately confirmed, elaborated the DOL's settlor/fiduciary distinction, with the

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[6] *Id.*
[7] ERISA § 3(21)(A), 29 U.S.C. § 1002(21)(A) (2006).
[8] *See* Amato v. Western Union Intl., Inc., 773 F.2d 1402, 1417 (2d Cir. 1985) (holding, at least arguably, that an employer's decision to capture plan assets could be a fiduciary decision). For a discussion of *Amato* and cases from the period addressing plan terminations that affect early retirement benefits, see Dana M. Muir, *Changing the Rules of the Game: Pension Plan Terminations and Early Retirement Benefits*, 87 MICH. L. REV. 1034, 1051-52 (1989).

Supreme Court endorsing and demarcating the distinction between settlor and fiduciary functions in a trilogy of cases, with the last of the cases giving the doctrine particularly broad scope.[9]

The Court decided the three trilogy cases in the relatively short period between 1995 and 1999. The first case, *Curtiss-Wright Corp. v. Schoonejongen,* involved a health care plan that did not include a detailed amendment procedure.[10] For the first time, the Supreme Court decided that employers had a fundamental right to amend or terminate their employee benefit plans even if the plan itself did not provide for amendments or termination at the discretion of the employer. The Court did so with little analysis other than a citation to a Sixth Circuit decision.[11]

The Sixth Circuit case involved an amendment to an unwritten severance benefit plan, which it amended by adopting a written severance plan that denied benefits to employees who remained employed after a sale of the business in which they were employed. The plaintiffs argued that this amendment of the plan constituted a fiduciary breach.[12] In determining that no breach occurred, the Sixth Circuit drew a line between decisions relating to plan assets or plan administration (fiduciary actions) and decisions such as plan adoptions, terminations and amendments, which firms undertake as business decisions (not fiduciary actions).[13]

The very next year the Supreme Court again took up the question of an employer's right to amend its plan in *Lockheed Corp. v. Spink,* a case involving a defined benefit pension plan.[14] The facts of the case were simple: the employer added an early-retirement provision to its plan, a provision that required an electing a participant release all employment claims against the employer.

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[9] *See* Hughes Aircraft Co. v. Jacobson, 525 U.S. 432 (1999).
[10] 514 U.S. 73, 81-83 (1995).
[11] *Id.* at 78 (citing Adams v. Avondale Indus. 905 F.2d 943, 947 (6th Cir. 1999)).
[12] 905 F.2d at 947.
[13] *Id.*
[14] 517 U.S. 882 (1996).

In *Spink* the Court went beyond its cursory determination in *Curtiss-Wright* and addressed the question of what employer actions vis-à-vis a plan constitute fiduciary actions.[15] In contrast to the policy-based approach the DOL took in its 1986 letter, the Supreme Court based its decision on ERISA's definition of fiduciary.[16] According to the Court, the statute's activity-based fiduciary definition means that some employer actions are fiduciary actions and others are not.[17] Since ERISA's language does not specifically include plan design among the discretionary actions that give rise to fiduciary status, as compared to its inclusion of plan administration and management and control of plan assets, the Court determined that the act of amending a plan is not a fiduciary act. Its discussion of the distinction between discretionary acts of plan design (not fiduciary acts) and discretionary acts of plan administration and management (fiduciary acts) is where we find the Court's first and only explicit reference in an ERISA case to "the settlor-fiduciary distinction."[18]

By the third case the Court became impatient with the limitations being imposed by the lower courts on employer actions and wrote in broad terms. The *Hughes Aircraft Co. v. Jacobson* case involved a plan sponsor's amendment of a defined benefit plan, in which employees who elected to participate in the plan had been required to make annual contributions.[19] It was this facet of requiring employee contributions that distinguished the *Hughes* plan from the plan that had been at issue in *Spink.* Over time the *Hughes* plan had become overfunded, which permitted Hughes to cease making any contributions to the plan for a period of eight years, even though employees continued to contribute

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[15] *Id.* at 890-91.
[16] 517 U.S. at 89-0-91.
[17] *Id.*
[18] *Id.* at 891. Prior and subsequent Supreme Court decisions have discussed settlor principles in ERISA cases. *See, e.g.,* CIGNA v. Amara, 131 S. Ct. 1866, 1868 (2011); Firestone Tire & Rubber Co. v. Bruch, 489 U.S. 101, 112 (1989).
[19] 525 U.S. 432, 435 (1999).

during this period.[20] Hughes then amended the plan on two occasions, first to use some of the surplus assets to provide enhanced early retirement benefits for selected employees, and second, to eliminate the contribution requirement for newly hired employees.[21]

A group of plan participants alleged that Hughes had breached its ERISA fiduciary duties when it amended the plan to use the surplus assets to benefit some contributing employees disproportionately (the first amendment) and when it amended the plan to use the surplus assets to provide benefits for employees who had not contributed to the plan at all (the second amendment).[22] The Ninth Circuit ruled that, to the extent that the surplus assets were attributable to the employee contributions, the participants had stated a cause of action for an ERISA fiduciary breach.[23] One way of understanding the distinction drawn by the court is that the employees' contributions made them co-settlors[24] of the plan. Thus, Hughes would not have the power to unilaterally amend the terms of the plan.

In a unanimous decision the Supreme Court reversed the Ninth Circuit,[25] using expansive and unambiguous language to make clear that decisions to amend or terminate a plan are not fiduciary decisions under any circumstances. In *Hughes*, the Court's language left little room for the lower courts to continue to draw distinctions between various types of benefit plans.

> We made clear in *Spink* that our reasoning applied both to "pension benefit plans" and "welfare benefit plans," since "the definition of fiduciary makes no distinction between persons exercising authority over these different types of plans. Our conclusion applies with equal force to persons exercising authority over a contributory plan, a noncontributory plan, or any other type of plan. Our holding did not turn, as the Court of Appeals below thought, on the type of plan being amended for the simple reason that the plain language of the statute

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[20] *Id.* at 436.
[21] *Id.*
[22] *Id.* at 436-37.
[23] *See* Jacobson v. Hughes Aircraft Co., 105 F.3d 1288, 1297 (1997), *amended by,* 128 F.33d 1305 , *reversed by,* 525 U.S. 432 (1999)
[24] *See* 105 F.3d at 1311 (dissenting judge writing: "The majority seems to be saying that employees are co-settlors of contributory plans.").
[25] *Id.* at 435.

> defining fiduciary makes no distinction. Rather, it turned on whether the employer's act of amending its plan constituted an exercise of fiduciary duty. In *Spink*, we concluded it did not.[26]

The *Hughes* Court's approach clearly links back to its reliance in *Spink* on ERISA's definition of fiduciary. Again, the Court focused on the difference between design decisions and discretionary plan administration. Even in the context of a plan where employees made contributions, the decision treats only Hughes as the plan settlor. And, as the settlor, Hughes was free even to determine who would receive plan benefits. In the words of the Court:

> The same act of amending here also does not constitute the action of a fiduciary, although Hughes' Plan happens to be one to which employees contribute. In general, an employer's decision to amend a pension plan concerns the composition or design of the plan itself and does not implicate the employer's fiduciary duties which consist of such actions as the administration of the plan's assets. ERISA's fiduciary duty requirement simply is not implicated where Hughes, acting as the Plan's settlor, makes a decision regarding the form or structure of the Plan *such as who is entitled to receive Plan benefits* and in what amounts, or how such benefits are calculated. A settlor's powers include the ability to add a new benefit structure to an existing plan. Respondents' three fiduciary duty claims are directly foreclosed by *Spink*'s holding that, without exception, "plan sponsors who alter the terms of a plan do not fall into the category of fiduciaries.[27]

The *Hughes* decision also quoted language from *Spink*, which listed specific actions that are settlor actions and not subject to ERISA's fiduciary obligations.

> "Plan sponsors who alter the terms of a plan do not fall into the category of fiduciaries. As we said with respect to the amendment of welfare benefit plans, 'employers or other plan sponsors are *generally* free under ERISA, for any reason at any time, to adopt, modify, or terminate welfare plans.' When employers undertake those actions, they do not act as fiduciaries, but are analogous to the settlors of a trust."[28]

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[26] *Id.* at 443-44.
[27] *Id.* at 444-45 (emphasis added).
[28] *Id.* at 443 (quoting Lockheed Corp. v. Spink, 517 U.S. 882, 890 (1996) (other citations omitted)) (emphasis added).

This language, with its inclusion of the modifier "generally" arguably left some room for lower courts to maneuver. As a general matter, however, that has not happened.

In *Hughes Aircraft*, the Court ignored rather than engaged the interests of employees. This was not a necessary outcome. The Court could have recognized that, at least because of the direct contributions they made to the pension plan, the employees also held interests in the plan and acted as plan settlors. In our judgment, the broad sweep of the Court's language in *Hughes Aircraft* regarding the settlor/fiduciary doctrine sometimes (but not always) yields questionable policy outcomes.

II. Doctrinal Boundaries and Application

One of us observed shortly after the Supreme Court's *Hughes Aircraft* decision that the parameters of the settlor/fiduciary doctrine were not clearly defined.[29] More than thirteen years later, some lack of clarity remains but overall the trend has been against findings of fiduciary status. Courts continue to address questions that turn on the distinction between plan design and termination, which are not fiduciary acts, and implementation of those decisions, which are fiduciary acts. The first subsection below analyzes the doctrine in that area, beginning with one of the Supreme Court decisions that directly addressed the settlor/fiduciary distinction since the trilogy.

A. Implementing the Definition of Implementation

In 1999 Professor Muir wrote about the settlor/fiduciary doctrine that the "dichotomy between actions taken to amend plans, and actions taken to implement amendments and, by implication, terminations, is likely to continue to create problems."[30] That has proven to be true.

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[29] Muir, *supra* note, at 220.
[30] Muir, *supra* note [lab law], at 220.

On the one hand, we can say that the lack of doctrinal clarity surrounding these questions is problematic for all the usual reasons that uncertainty in law is sometimes considered problematic. But we also see the lack of clarity as offering judges an opportunity to tame some of the more problematic aspects of the settlor/fiduciary doctrine, an issue to which we will return in the last section of this Article.

In its 2007 decision in *Beck v. PACE International Union,* the Supreme Court took up the line drawing challenge in a case involving a plan termination.[31] Crown Paper and its parent (Crown) sponsored multiple DB plans at the time Crown declared bankruptcy.[32] Some of the plans, which covered unionized employees, had enjoyed more financial success than Crown had and in total they were overfunded by approximately $5 million. Crown decided to terminate the plans by purchasing annuities, which was the typical way of terminating a fully or overfunded funded plan. Through the annuities, the employees and retirees would receive all of their promised pension benefits assuming the continued claims-paying ability of the insurance company. The $5 million of overfunding, which would then remain, would go into the bankruptcy estate to be allocated to Crown's creditors.[33]

The union, PACE International Union (PACE), had other ideas. PACE proposed that Crown transfer all of the liabilities and assets in the relevant plans to a multiemployer pension plan that covered PACE union members. That would have enabled the multiemployer plan to capture the $5 million in excess funding. Crown proceeded with its purchase of annuities without seriously considering PACE's proposition. PACE then alleged that Crown had violated its fiduciary obligation to act for the exclusive purpose of providing plan benefits when it

[31] 551 U.S. 96 (2007).
[32] *Id.* at 99.
[33] *Id.*

decided to implement the plan terminations through annuity purchases in order to recapture assets for Crown's creditors.[34]

The first issue, and the relevant one for this Article, on which the Supreme Court granted certiorari, was whether the decision to purchase annuities was part of the decision to terminate the plan, and thus was not a fiduciary decision, or whether it constituted implementation of the termination decision, and thus was a fiduciary decision.[35] The bankruptcy court, district court, and Ninth Circuit Court of Appeals all found in PACE's favor; Crown's decisions not to consider PACE's plan merger proposal and to purchase the annuities were acts undertaken in the implementation of the termination.[36]

The Supreme Court, in a unanimous decision, disagreed. The Court relied on ERISA's language governing plan terminations and guidance by the applicable regulatory agencies to decide that a plan merger is not a permissible process for plan termination.[37] PACE had argued that the statutory language clearly permitted merger as an allowable way to implement a plan termination.[38] The Supreme Court, however, agreed with the Pension Benefit Guaranty Corporation's (PBGC) interpretation of the statute to mean that "merger is an *alternative* to (rather than an example of) plan termination."[39] Applying this view of the statute, once Crown decided to terminate the pension plans, which it was entitled to do without fiduciary ramifications under the settlor/fiduciary doctrine, the decision to purchase annuities was subsumed in that termination decision.[40]

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[34] *See id.* at 100.
[35] *Id.* at 101.
[36] *Id.* at 101.
[37] *Id.* at 102-10.
[38] *Id.* at 105.
[39] *Id.* at 104 (emphasis in original).
[40] *See id.* at 102.

It is worth focusing on precise language in the *Beck* decision and teasing out its implications. The Court set the stage for its analysis by stating that "Which hat the employer is proverbially wearing depends upon the *nature of the function performed*."[41] It also noted that this "inquiry . . . is aided by the common law of trusts."[42] This seems to mean that if the nature of the action is one that would historically have been performed by a trust settlor then the action is not subject to ERISA's fiduciary standards. The *Beck* Court quoted from the *Hughes Aircraft v. Jacobson*[43] decision a phrase that has been cited by a number of lower courts, stating: "'[D]ecision[s] regarding the form or structure' of a plan are generally settlor functions."[44] This language may imply that the settlor/fiduciary analysis takes into account the effect of a decision so that even decisions not implemented by plan amendment may be settlor decisions.

Consider the Court's approach to the settlor/fiduciary distinction in *Beck.* The Court appeared willing, if ERISA provided for multiple ways to implement a termination, to treat the selection of a particular implementation method as a fiduciary decision. The Court decided, however, that the condition precedent did not exist; a merger is not a statutorily permitted way to implement a plan termination.[45] Thus, Crown's decision to terminate was a decision on the plan's structure or form[46] making it a settlor decision and, as a result, Crown had no obligation to consider PACE's merger proposal.[47]

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[41] *Id.* at 101 (emphasis added).
[42] *Id.*
[43]525 U.S. 432, 435 (1999).
[44] 551 U.S. at 101-02 (quoting Hughes Aircraft Co., 525 U.S. at 444).
[45] 551 U.S. at 110.
[46] *Id.* at 101-02.
[47] *See id.* It is not clear, even if termination could have been accomplished by means of a merger, that Crown would have been obligated to merge the plans. The Court found it unnecessary to address the issue of whether a decision on a plan merger "could switch from a settlor to a fiduciary function depending upon the context in which the merger proposal is raised." *Id.* at 102. The Court termed that "an odd" idea. *Id.*

Varity Corp. v. Howe, is the only case in which the Supreme Court applied the settlor/fiduciary doctrine and found that employer acts were fiduciary in nature because they constituted plan administration. The employer and plan sponsor, Varity, had consolidated its financially unsuccessful divisions into a new subsidiary.[48] To encourage active employees in those divisions to transfer voluntarily to the new subsidiary, Varity engaged in an extensive communications program. Although Varity had intentionally structured the new subsidiary to be financially insolvent, the communications program omitted that information. Instead, Varity represented to the employees that they could expect benefits equivalent to those they had enjoyed while employed at Varity. The business results were predictable: the subsidiary failed. The health care plans then terminated, leaving participants without those benefits. The participants sued, alleging that Varity's communications violated ERISA's fiduciary standards. The preliminary question, though, was whether Varity acted as a fiduciary when communicating about the plan with the employees. The Supreme Court held that Varity undertook the communications program as part of its *implementation* of the new plan and, thus, Varity was a fiduciary when communicating.[49]

The Court based its fiduciary categorization of Varity's acts on the common law of trusts and the context of the representations. According to the Court: "The ordinary trust law understanding of fiduciary 'administration' of a trust is that to act as an administrator is to perform the duties imposed, or exercise the powers conferred, by the trust documents."[50] This includes powers "necessary or appropriate"[51] to carry out the purposes of the trust even when the

[48] 516 U.S. 489 (1996).
[49] *Id.* at 498-505. Varity also transferred approximately four thousand retirees to the benefit plans of the new organization without obtaining the retirees' consent.
[50] *Id.* at 502.
[51] *Id.*

trust documents do not explicitly grant specific powers. Communicating forward-looking information about the plan to employees asked to make decisions based on that information is an act in furtherance of the trust's purposes.[52] From a contextual perspective, the Court believed that reasonable employees could believe that their employer was acting at least in part as administrator of the plan when talking about the plan's future.[53] We can speculate that the Court may have come to a different conclusion if Varity's communications with its employees had not been so transparently dishonest. The lack of a definitive boundary between fiduciary and non-fiduciary acts means that courts have some discretion in characterizing particular actions. Variety was wearing at least two hats and arguably three during this time period. Decisions on terms of Varity's plans were undertaken while wearing its fiduciary hat. Arguably, the decision to create a new subsidiary and to offer employees the opportunity to transfer to that subsidiary was made while wearing its business decision-maker hat.[54] And, as the Court held, communications to employees about the plan were made while wearing its fiduciary hat.

The courts have confronted questions involving the distinction between plan adoption, amendment, and termination, which are settlor actions, and conduct that occurs while implementing those settlor actions or engaging in plan management, which is subject to fiduciary standards in a wide variety of contexts. For ease of reference, we will refer to this strand of the settlor/fiduciary doctrine as the "plan structure" strand.

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[52] *Id.*
[53] *Id.* at 503.
[54] *See infra* text accompanying notes [ ].