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# **A Challenge to Actuarial Assumptions in Defined Benefit Plans: Latest Developments in the Legal Landscape**

Recent Case Law, Claims and Defenses, Fiduciary Obligations, Avoiding Administrative Pitfalls, Plan Modifications

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WEDNESDAY, SEPTEMBER 23, 2020

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

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Today's faculty features:

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# A Challenge to Actuarial Assumptions in Defined Benefit Plans: Latest Developments in the Legal Landscape

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Katherine Kohn, Esq.

Brian Lamb, Esq.

Josh Shapiro

GROOM LAW GROUP

# Agenda

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- I. Overview of Actuarial Assumptions
- II. Overview of Claims
- III. Developments on Motions to Dismiss
- IV. Class Certification
- V. Expert Testimony
- VI. Motions for Summary Judgment
- VII. Practical Considerations

# Overview of Actuarial Assumptions

# Overview of actuarial assumptions

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- Case study: joint and survivor annuity
  - Plan benefit expressed as a single life annuity
  - Participant may elect a J&S annuity
  - Portion of benefit will continue to surviving spouse
- Joint and survivor benefit
  - On the average, benefit is paid for a longer period of time
  - Lower payment amount needed for equivalence
  - Reduction expressed as a J&S factor (e.g. 95%)



# Overview of actuarial assumptions

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- J&S factor may vary based on:
  - Age of participant at retirement
  - Age of spouse at retirement
  - Percentage of benefit payable to surviving spouse
- Other considerations
  - Gender of participant and spouse
  - Health status
- Simplified factors

# Overview of actuarial assumptions

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- Plan administration
  - Maintain actuarial equivalence of benefits
  - Assumptions specified in plan document
  - Prescribed by IRS for lump sums
- Actuarial valuations
  - Funding and accounting requirements
  - Funding discount rate and mortality prescribed by IRS
  - Other assumptions generally selected by actuary

# Overview of actuarial assumptions

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- Mortality assumptions
  - Typically based on published mortality tables
- Key considerations
  - Historical trends
  - Experience of individual plans
  - Anti-selection
  - Benefit-weighted versus participant-weighted
  - Future expectations and uncertainties
  - Impact on factors

# Overview of actuarial assumptions

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- Impact of updated assumptions
  - May increase some benefits and decrease others
  - Mortality assumption
  - Discount rate
- Concept of reasonableness
  - Clear that two different results can both be reasonable
  - Not clear how far apart they can be

# Overview of Claims

# Overview of Plaintiffs' Claims

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- 11 cases filed against both plan sponsors and plan fiduciaries
- Plaintiffs receive optional forms of benefits or early retirement
  - QJSA, QOSA, QPSA, certain-and-life
- Plaintiffs challenge mortality assumptions used to calculate benefits
  - 1951, 1971, 1983, 1984 tables (in some instances, adjusted)
    - Interest rates range from 5%-7.5%
  - If mortality table is unknown, challenge conversion factor

# Overview of Plaintiffs' Claims

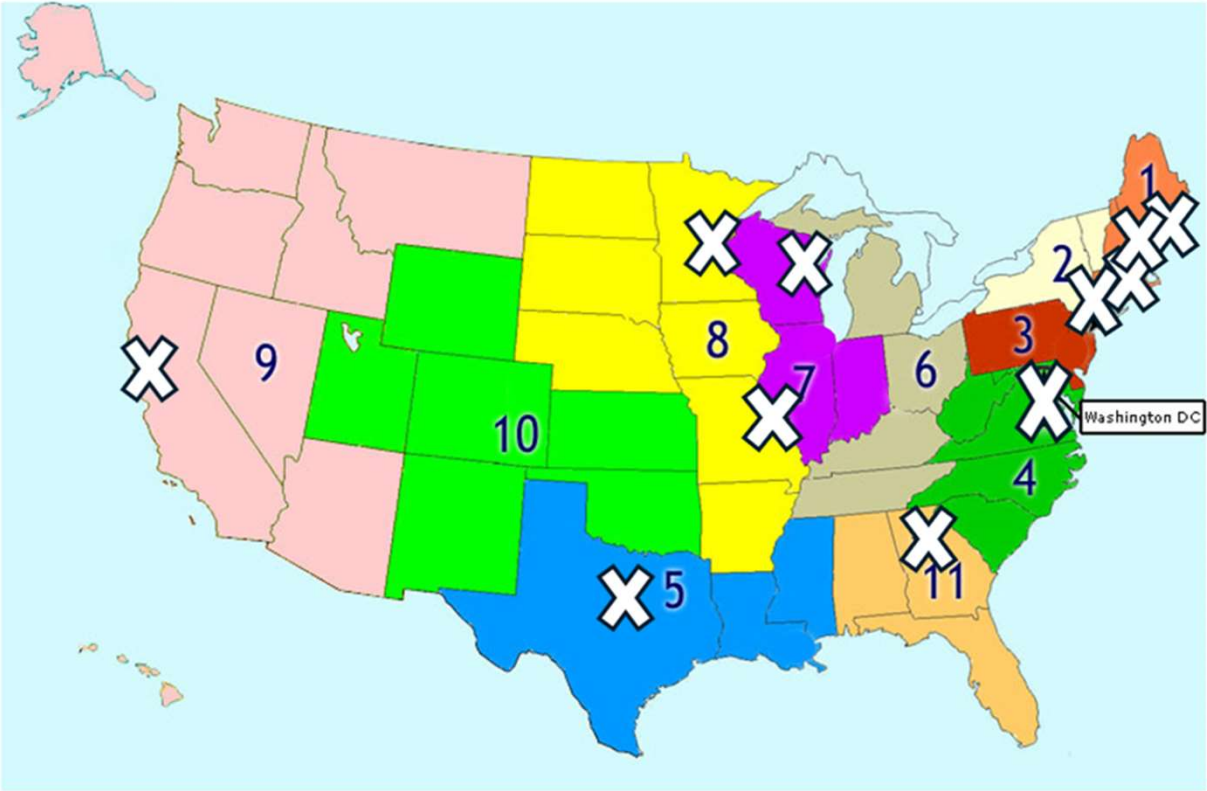
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- Allegations:
  - Assumptions do not produce actuarially equivalent benefits
  - Violate ERISA's non-forfeiture requirement
  - Current IRS assumptions should be used
- Claims:
  - Declaratory and equitable relief (ERISA 502(a)(3))
  - Reformation of plan (ERISA 502(a)(1) and/or (a)(3))
  - Breach of fiduciary duty (ERISA 502(a)(3))

# Developments on Motions to Dismiss



# Actuarial Assumptions – Cases Filed



# MTDs– Procedural Arguments

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- Failure to exhaust administrative remedies
- Failure to meet pleading standards
- No private right of action under Code and Regs
- Lack Article III standing - no injury
- Improper to bypass terms negotiated by union
- Breach of fiduciary duty claim is duplicative

# MTDs – Substantive Arguments

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- Selecting assumptions is a plan sponsor function, not a fiduciary function
- ERISA grants sponsors wide latitude in selecting the actuarial assumptions; great differences of opinion
- ERISA does not require each component of an actuarial calculation to be determined in isolation

# MTDs – Substantive Arguments

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- High interest rates offset outdated mortality tables
- Life expectancy has been falling for years
- Determination of reasonableness should be made at time assumptions are put into the plan document
- When Congress intends mortality tables to be updated, it specifies that timing expressly

# MTDs – Substantive Arguments

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- Treasury regulations continue to approve UP 1984 for other purposes
- No basis in ERISA for requiring that actuarial factors calculating J&S benefits be “reasonable”
- Plaintiffs’ attack reasonableness but don’t say what would be reasonable
- Difference of 5% or less is deemed “approximately equal in value” as a matter of law

# Motion to Dismiss Scorecard

Case	Defendants' Motion to Dismiss
MetLife	No ruling yet
American Airlines	Denied
Pepsi	Granted
U.S. Bank	Denied
Rockwell Automation	Denied
Anheuser-Busch	Denied
Huntington Ingalls	Denied
Raytheon	Denied
Partners Healthcare	Denied
AT&T	No ruling yet
UPS	Granted

# MTD Rulings – Meaningful Guidance?

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- The rulings fall into two categories
  - Those focused on procedural issues
    - Pleading standards
    - Limitations on what can be considered when deciding a Rule 12(b)(6) motion to dismiss
    - Exhaustion of remedies
  - Those focused on substantive issues
    - What the law requires or means
    - Differences between groups of participants/plaintiffs

# Motion to Dismiss - Granted

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- PepsiCo
- UPS



## *DuBuske v. PepsiCo* (S.D.N.Y.)

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- Order granting Motion to Dismiss – August 5, 2020
- Ruling focuses on the nature of the plaintiffs
  - Plaintiffs fail to plausibly allege a violation of ERISA’s anti-forfeiture provision, ERISA Section 203(a), because the provision applies only to normal retirement benefits upon the attainment of normal retirement age – whereas here, all the plaintiffs took early retirement; they never attained retirement age, so the anti-forfeiture provision never attached.
  - The Court distinguished *Smith v. U.S. Bancorp* as a case applying to normal retirement age.
  - The Court subsequently granted, in part, plaintiffs’ motion for reconsideration and instructed plaintiffs to file an amended complaint.
  - Instead, the case settled within two weeks.

## *Brown v. United Parcel Service* (N.D. Ga.)

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- Order granting Motion to Dismiss – August 27, 2020
- The court applied the 11<sup>th</sup> Circuit’s particularly rigid requirement that ERISA claimants exhaust their administrative remedies before filing a complaint in federal court
  - Some circuits do not require administrative exhaustion when the claims are statutory (such as claims for breach of fiduciary duty), as opposed to claims for benefits under the terms of the plan
- The ruling highlights a procedural hurdle for plaintiffs in some jurisdictions but does not provide plan sponsors with any substantive guidance on the merits of the disputes over the meaning of actuarial equivalence

# Motion to Dismiss - Denied

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- American Airlines
- US Bank
- Rockwell Automation
- Anheuser-Busch
- Huntington Ingalls
- Raytheon
- Partners Healthcare

# Motions to Dismiss – Still Pending

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- MetLife
- AT&T

## *Masten v. Metropolitan Life Ins.* (S.D.N.Y.)

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- First case filed (12/3/18); motion to dismiss pending since 4/18/19
- Main arguments:
  - A matter of plan design
  - ERISA does not require use of any particular assumptions
- More than 30 notices, letters and orders addressing supplemental authority have been filed

## *Eliason v. AT&T, (N.D. Cal.)*

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- Main arguments
  - Plaintiffs lack Article III standing because they have not suffered any injury
  - Plaintiffs fail to allege facts warranting reformation
  - Plaintiffs failed to exhaust their administrative remedies
  - Plaintiffs fail to state claims against AT&T, the plan sponsor, and AT&T Services
  - The case should be transferred to the N.D. Texas, where the plan is administered

# Strategic Takeaways from MTD Phase

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- Heavy focus on procedural issues
- Light on substantive guidance
- Plaintiffs quickly settle cases that hit turbulence
- No global strategic knockout blows for participants or plan sponsors in this phase

# Class Certification



# Class Certification

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## *Torres v. American Airlines*-Class Cert denied

- Putative class members receive JSA, QPSA, and CLA benefits.
- Plaintiffs' argument for class cert:
  - Same actuarial assumptions applied
  - All class members received fewer benefits than they would have received using current assumptions
- American Airlines argument against class cert:
  - Conflict of interest - some class members' benefits would be reduced using current assumptions
  - Named plaintiffs could not advocate for a single interest rate assumption
- Court denied the motion
  - Plaintiffs not adequate representatives
  - Relief not appropriate for the class as a whole
- Parties settled

# Class Certification

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## *Herndon v. Huntington Ingalls Industries* Class certification stipulation

- Putative class members receive JSAs-50%, 75%, and 100%, with or without pop up options.
  - Does not include CLA benefits, which are also available under the plan.
- Same assumptions (1971 GAM and 6%) are used to calculate all JSAs.
- Defendants did not oppose class certification and the parties enter into a stipulation.

# Expert Testimony

# Expert Testimony

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## *Herdon v. Huntington Ingalls*

- Plan mortality experience
  - Mortality table in plan is 1971 GAM
  - Plan primarily covers male blue-collar employees
  - Defense expert claims experience supports current factors
  - Plaintiff expert disagrees
  - Appropriateness of reflecting anti-selection
  - Development of mortality experience analysis

# Expert Testimony

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## *Herdon v. Huntington Ingalls (cont.)*

- Applicability of actuarial standards of practice
- Range of reasonableness
  - Defense expert claims range of +/- 5%
  - Plaintiff expert argues this range is too wide
  - Relative values guidance from IRS
  - Actuarial standard of practice are silent
  - Difficult to identify range of practice

# Expert Testimony

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## *Cruz v. Raytheon Company*

- Flat J&S factor for all participants
- Pooling
  - Reasonable for an average participant vs. all participants
- Impact of early retirement subsidies
- Anti-selection
  - Gender mix of participants who elect J&S benefits
- Range of reasonableness

# Motions for Summary Judgment

# Motions for Summary Judgment

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## *Herdon v. Huntington Ingalls Industries*

- Huntington Ingalls Industries (“HII”) moved for summary judgment.
  - Use of plan-specific mortality tables and an adjusted market discount rate and results in benefits that are less than what plaintiff and class members receive under the Plan.
  - Equivalence based on conversion factor, not underlying assumptions.
  - Can unilaterally renegotiate bargained terms.
- Magistrate recommended that summary judgment be denied.
  - A reasonable factfinder could conclude that the 1971 GAM is not reasonable.
  - Cannot bargain out of ERISA’s requirements.
- Both parties also moved to exclude expert testimony.
  - Magistrate recommended denying both motions, finding the opinions to be relevant.



# Motions for Summary Judgment

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## *Cruz v. Raytheon*

- Plaintiff's arguments for summary judgment
  - Plaintiff also moved to exclude Raytheon's expert's testimony.
- Raytheon's arguments for summary judgment
  - Plan's conversion factor falls within the range of reasonable conversion factors identified by Raytheon's expert.
    - This is true even using plaintiff's expert's assumptions.
    - Focus on result of factors, not underlying assumptions.
  - Plaintiff is receiving a subsidized benefit- more than benefit at normal retirement age
  - ERISA does not require constant updating of conversion factors.

# Practical Considerations

# Practical Considerations

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- Review of plan documents through counsel
- Careful tracking of and response to participant inquiries
- Look out for plaintiffs' firms' solicitation
- Control messaging
- Wait and see-could have decision on the merits soon

# Thank You

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