ERISA Fiduciaries Under Attack: Key Litigation and Regulatory Developments
Mitigating Risks of Breach of Fiduciary Duty Claims

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Today’s faculty features:

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ERISA’s Fiduciary Rules –  
A General Overview 

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I. Overview.  

A. In general, the fiduciary provisions of the Employee Retirement Income Security Act of 1974 (“ERISA”) may be viewed as setting standards of reasonableness, fair dealing and procedural protection that are intended to protect plan participants and beneficiaries from the unnecessary loss of plan assets. In a number of cases, in order to address potential abuses, ERISA restricts transactions by reference to the parties involved, regardless of the fairness or appropriateness of the transactions.  

B. ERISA was enacted to protect participants in pension and other employee benefit plans. It generally covers private U.S. pension and welfare plans.  

1. Governmental and non-U.S. plans, and certain church plans, are among those not subject to ERISA, although they may be subject to other laws.  

2. Individual retirement accounts are not subject to ERISA’s fiduciary rules, but may be subject to comparable prohibited-transaction rules under the tax code.  

II. General Fiduciary Standards  

A. General standards include prudence and diversification, as applicable, an obligation to comport with plan documents to the extent consistent with ERISA, and a duty to act in the interest of plan participants and beneficiaries.  

1. Fiduciaries will have special responsibilities to the plan, including the responsibilities to discharge fiduciary duties solely in the interest of plan participants and beneficiaries and in accordance with the governing plan documents, and to act prudently in doing so. The prudence requirement is that a fiduciary must discharge the fiduciary’s duties “with the care, skill, prudence, and diligence, under the circumstances then prevailing, that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an exercise of a like character and with like aims.” It
has been said that a fiduciary must act with an “eye single” to the interests of participants and beneficiaries.

2. The use of modern portfolio theory (essentially allowing consideration of the portfolio as a whole in determining prudence), and deference to the decisions of non-conflicted responsible fiduciaries, are hallmarks of ERISA’s general fiduciary rules.

3. ERISA fiduciaries need to educate themselves as to the subject matter for which they are responsible and take into account appropriate considerations, thus causing some to refer to ERISA’s prudence rule as a “prudent expert” rule and to describe the prudence requirement as being one of “procedural prudence.”

B. ERISA’s fiduciary provisions were generally enacted to protect participants. Fiduciaries with respect to ERISA plans have the responsibility to act prudently, and must otherwise act in accordance with Section 404 and the other provisions of ERISA.

1. Generally, plan fiduciaries must, among other things, discharge their duties with respect to the plan in a prudent manner, solely in the interests of participants and beneficiaries, and in accordance with the documents and instruments governing the plan insofar as they are consistent with ERISA.

2. The prudence requirement with respect to investment decisions is generally satisfied if the fiduciary gives appropriate consideration to the pertinent facts and circumstances, including the composition of the plan’s portfolio with regard to diversification (unless, as noted below, otherwise provided with respect to eligible individual account plans), the liquidity and current return of the portfolio relative to the anticipated cash flow requirement of the plan and the projected return of the portfolio relative to the funding objectives of the plan.

C. One of ERISA’s explicit requirements is that a plan’s investments generally be diversified so as to minimize the risk of large losses. (In the case of an eligible individual account plan, the diversification rules are not violated by the acquisition or holding of qualifying employer securities (e.g., employer stock) or qualifying employer real property.) ERISA’s prudence and other fiduciary considerations could be applied differently in practice to plans with different designs and goals, different liability profiles, etc.

D. Liability; exculpation and indemnification; insurance.

1. In the event that a fiduciary breaches its duties, the fiduciary may be personally liable to the plan for losses, to restore profits and for other penalties. Losses to the plan are normally measured as the difference
between the most positive return of any investment offered by the plan versus the actual investment return.

2. Generally, as between the plan (and its participants and beneficiaries), a fiduciary can not be absolved from liability for fiduciary breaches. Thus, for example, a hold-harmless from a plan for breaches unless there is gross negligence may be unenforceable to the extent there is negligence.

3. Insurance is permitted, and indemnification by third parties (e.g., the plan sponsor) is viewed as comparable to insurance for these purposes (except that the insurance cannot be paid for by the plan to the extent the insurance covers breaches).

III. Allocation of Responsibility; Delegation

A. At the base of ERISA’s fiduciary structure are the trustee and named fiduciaries, and ERISA may be viewed in some respects as seeking fundamentally to identify responsible fiduciaries for the various aspects of plan-related investment and administration.

B. Plan trustees generally have exclusive authority and discretion to manage and control plan assets, except to the extent the trustees are subject to the proper directions of a “named fiduciary” or one or more qualified investment managers (i.e., banks, insurance companies or other investment advisers meeting certain specified requirements) that have been properly appointed.

C. A “named fiduciary” is a fiduciary who is named in the plan instrument or who, pursuant to a procedure specified in the plan, is identified as a fiduciary (generally by the employer).

D. If the committee is a named fiduciary and properly delegates responsibility to a qualified investment manager, it appears that the committee will generally be relieved of direct responsibility for the acts and omissions of the investment manager, but will have the responsibility to make and continue (e.g., monitor) the delegation prudently and otherwise in accordance with ERISA.

1. Another fiduciary may also appoint the qualified investment manager so long as the other fiduciary is (i) a named fiduciary, and (ii) (A) identified in the plan as a fiduciary with ability to make the appointment, or (B) selected to have such authority pursuant to express plan procedures.

2. In the case of a delegation to other than to an investment manager or any other delegation not in accordance with ERISA’s procedures, the delegating fiduciary would generally be expected to have liability for the acts and omissions of the delegee as though taken or omitted directly by such fiduciary.
3. Notwithstanding the foregoing, a fiduciary may have co-fiduciary liability for the breach of a second fiduciary where the first fiduciary (i) knowingly participates in or conceals a breach, (ii) improperly enables the second fiduciary to commit a breach, or (iii) has knowledge of a breach and does not make reasonable efforts to remedy it. Where a qualified investment manager is properly used, a trustee will not have such co-fiduciary liability under the foregoing clauses (ii) or (iii).

IV. Prohibited Transactions – In General.

A. ERISA generally prohibits transactions (e.g., sales and exchanges, and extensions of credit) between an employee benefit plan subject to ERISA and certain parties related to the plan. These so-called “parties in interest” under ERISA include, among others, an employer of plan participants, fiduciaries (for example, trustees, investment managers or investment advisers of the plan), other service providers to the plan and certain affiliates of parties in interest. Examples of service providers include brokers, custodians and other non-fiduciary plan advisers.

B. Section 4975 of the Internal Revenue Code of 1986 (the “Code”) contains corresponding prohibited transaction excise tax provisions applicable with respect to certain transactions between plans (and certain other arrangements, such as individual retirement accounts) and “disqualified persons” (which are similar to parties in interest). The taxes would be imposed upon the disqualified person involved in the transaction. (“Welfare” plans would generally be subject to ERISA penalties on parties in interest rather than taxes under the Code on disqualified persons.) The consequences (under ERISA and the Code, as applicable) can include rescission, excise taxes ranging from 15% to 100% of the amount involved and other adverse results.

C. In the financial service industry, which has become increasingly consolidated, services relationships can be extensive. Many large, diversified financial institutions assume for these purposes that they are parties in interest with respect to every plan, rather than attempting, on a case-by-case basis, to determine whether they (or any of their affiliates) have any relationship to a plan that might cause them to be a party in interest.

D. ERISA provides for various exemptions (which generally also apply for purposes of the Code) from the application of the prohibited transaction rules. Further, the U.S. Department of Labor (the “DOL”), which generally administers ERISA, has issued numerous additional exemptions.

E. Special rules may apply in the case of blind purchases and sales of certain publicly traded securities.

F. ERISA also contains provisions prohibiting fiduciary self-dealing - a fiduciary’s dealing with plan assets for the fiduciary’s own account, acting on both sides of a transaction, accepting kickbacks. A number of exemptions from rules for party-
in-interest prohibited transactions would not apply to exempt fiduciary self-dealing. While the self-dealing rules can be more intuitive than the party-in-interest prohibitions, the effect on fee structures is an example of a potentially difficult analysis under these rules.

V. “Party in Interest” vs. “Fiduciary.”

A. The concept of “party in interest” under ERISA (or “disqualified person” under the tax rules) includes, among others, an employer of plan participants, fiduciaries (for example, trustees, investment managers or investment advisers of the plan), other service providers to the plan and certain affiliates of parties in interest. Examples of service providers include brokers-dealers, banks, custodians and other non-fiduciary plan advisers. The definition is important under the “prohibited transaction” rules, which bar certain transactions between a plan and a party in interest as a per se matter.

B. By contrast, the concept of “fiduciary” includes a person (i) with discretionary authority or control respecting the management of a plan or the management or disposition of plan assets, or respecting the administration of the plan, or (ii) who provides “investment advice” for direct or indirect compensation (or who has the authority or responsibility to do so).

1. The regulations state that a person is deemed to provide “investment advice” only if (i) the person renders advice “as to the value of securities or other property, or makes recommendations as to the advisability of investing in, purchasing, or selling securities or other property,” and (ii) the person (A) directly or indirectly “has discretionary authority or control” with respect to purchases and sales or (B) renders the advice “on a regular basis . . . pursuant to a mutual agreement, arrangement or understanding . . . that such services will serve as a primary basis for investment decisions . . . , and that such person will render individualized investment advice . . . based on the particular needs of the plan regarding such matters as, among other things, investment policies or strategy, overall portfolio composition, or diversification of plan investments.”

2. Generally, a registered broker-dealer, a reporting dealer or a U.S. bank will not become a plan fiduciary solely because such person executes securities transactions on behalf of the plan in the ordinary course of its business, based on the instructions of a fiduciary of the plan if such instructions specify: (i) the securities to be purchased or sold, (ii) a price range for the purchase, (iii) a time span for the purchase, and (iv) a minimum or maximum quantity of the securities.

3. Other non-discretionary services (including settlement and financing) similarly might not cause a service provider to be deemed to be a fiduciary. The DOL has issued guidance as to when educational and consulting services might not rise to the level of being fiduciary services.
4. Proposed regulations would dramatically change the rules governing when a party may be a fiduciary.

5. The DOL has asserted, and courts have held, that the question of whether a person is a fiduciary depends on the actual facts in question, and in certain cases can be resolved by looking to the actual conduct of the parties.

6. Under the regulations, a person can be a fiduciary as to certain plan assets, without being deemed to be a fiduciary as to the entire plan (although party-in-interest status may nevertheless extend to the plan as a whole).

7. Dodd-Frank could affect this analysis for a number of financial institutions.

VI. Marketing vs. Advice.

A. A slightly different question arises when an existing fiduciary or other provider of investments or investment services seeks to cause a plan to make an investment or retain the provider for services.

B. Issues may arise as to whether information being provided is in the nature of, in effect, making a sale, or, conversely, is in the nature of fiduciary advice.

C. If the information has fiduciary attributes, a number of prohibited transactions and other concerns might arise.

D. Efforts may be made to document the relationship as being non-fiduciary in nature. However, there may nevertheless be an issue as to whether the provider is a de facto fiduciary.

E. The proposed fiduciary regulations referred to above would affect this analysis as well.

VII. Prohibited Transactions - Certain Exemptions.

A. Prohibited Transaction Class Exemptions 84-14 and 96-23 – exemptions for “qualified professional asset managers” (“QPAMs”) and “in-house asset managers” (“INHAMs”).

1. The QPAM exemption provides relief from certain prohibited transaction restrictions for specific transactions involving plan assets managed by a QPAM that has investment discretion.

2. The QPAM exemption does not provide relief for fiduciary self-dealing transactions.
3. In general, banks with equity capital or net worth in excess of $1,000,000, insurance companies with net worth in excess of $1,000,000 and advisers registered under the Investment Advisers Act of 1940 with $85,000,000 in assets under management and $1,000,000 in shareholders’ or partners’ equity may act as QPAMs, if they have acknowledged in writing that they are plan fiduciaries. Transition rules may apply with respect to the $85,000,000 and $1,000,000 tests. Additional issues in meeting the assets-under-management/equity tests may arise for newly formed advisers.

4. The QPAM exemption will not be available with respect to a transaction if either the QPAM or various affiliates of the QPAM, or an owner, direct or indirect, of 5% or more of the QPAM were convicted of certain crimes or released from prison within the 10 years immediately preceding the transaction.

5. Transaction-specific requirements.

   a. The QPAM exemption will not be available with respect to a transaction with plan assets if, at the time of the transaction, a party in interest involved in the transaction, or its affiliate, has the authority to (i) appoint or terminate the QPAM as manager of the plan’s assets involved in the transaction, or (ii) negotiate the terms of the applicable management agreement with the QPAM on behalf of the plan. This requirement is one with respect to which a manager may be particularly reluctant to provide any assurances. The DOL’s view is that, if a plan’s investment in a commingled fund in which two or more unrelated plans invest is less than 10% of the total investment in the commingled fund, the foregoing requirement is inapplicable to that plan, and, therefore, satisfaction of the appointment/termination condition is not required with respect to such a plan in order for the QPAM exemption to apply.

   b. The party in interest involved in the transaction cannot be the QPAM or a person related to the QPAM.

   c. The QPAM exemption will not be available as to any plan maintained by an entity if the total assets of plans maintained by that entity (and its affiliates) constitute more than 20% of total client assets under the management of the QPAM at the time of the transaction.

   d. The continuing-transaction doctrine can apply as to various QPAM requirements.

6. Special rules apply where a QPAM affiliated with an employer seeks to act with respect to its own plans.
7. The INHAM exemption is similar to the QPAM exemption, except that it applies with respect to captive managers (and has fewer independence requirements).

B. Statutory “service provider” exemption.

1. Under the statutory service-provider exemption (as distinguished from the statutory exemption for compensation for services), many transactions between a plan and a party in interest that is a mere service provider, and which is not a fiduciary (or an affiliate thereof) who has or exercises any discretionary authority with respect to the assets involved in the transaction, will not be prohibited if the transaction is for “adequate consideration.” “Adequate consideration” for securities with a market is generally the prevailing price on an exchange or the offering price on a market that is not an exchange, taking into account factors including transaction size and market liquidity account, and in other circumstances is fair market value as determined in good faith by a plan fiduciary in accordance with regulations. Depending on the way in which the new rules are interpreted, many transactions for adequate consideration with mere service providers may in a number of cases now be exempt from the prohibited transaction rules, without reference to conditions and other requirements that may have been present under other available exemptions.

   a. Issues may be particularly likely to arise in certain circumstances under the “adequate consideration” rules.

   b. The definition of “affiliate” is unclear.

   c. Special issues may arise in the case of investment by a “plan assets” fund.

2. The exemption does not apply to self-dealing transactions, and such rules are not affected. Thus, for example, asset managers will continue to be subject to rules prohibiting fiduciaries from dealing with plan assets for their own account, acting on both sides of a transaction involving plan assets or receiving kickbacks in connection with plan assets.

3. The exemption also does not apply to employer securities or compensation for services, and existing exemptions therefor are unaffected.

C. Prohibited Transaction Class Exemption 75-1, Part II – exemption for certain principal transactions involving securities.

1. Provides relief for purchases and sales of securities between a plan and (i) a registered broker-dealer, if the broker-dealer customarily purchases and sells securities for its own account in the ordinary course of its business, or (ii) a reporting dealer who makes primary markets in U.S.
government securities (and who reports its positions on a daily basis), or a U.S. bank, if the reporting dealer or bank, as applicable, customarily purchases and sells U.S. government securities for its own account in the ordinary course of its business. In the case of transactions with reporting dealers and U.S. banks, such transactions must involve U.S. government securities.

2. The broker-dealer, reporting dealer or U.S. bank, as applicable, must be a party in interest solely by reason of its (or an affiliate's) being a non-fiduciary service provider to the plan.

3. No relief is provided for fiduciary self-dealing transactions (except that, in certain circumstances, the purchase or sale by a plan of securities issued by an open-end investment company registered under the Investment Company Act of 1940 is exempt, even if the broker-dealer, reporting dealer or the U.S. bank is a fiduciary).

4. Because the exemption only applies with respect to securities, it might not be applicable to, for example, swap transactions and various other derivatives.

D. Prohibited Transaction Class Exemption 2006-16 – securities lending. The exemption for securities lending allows for the lending of securities by a plan to certain parties in interest and for the compensation of fiduciaries for the provision of securities lending services if specified conditions are met.

E. Prohibited Transaction Class Exemption 95-60 – exemption for transactions with insurance company general accounts that are deemed to consist of plan assets by virtue of the purchase by plans of certain types of insurance contracts.

F. Statutory exemption permitting certain corrections. There is a statutory 14-day correction period for certain transactions relating to the holding, acquisition or sale of a security or commodity where it is later discovered that such transaction was prohibited. The reach of this provision to a number of transactions that might not generally be considered “security” transactions will need to be reviewed, in light of the particular definition of “security” used for this purpose. The 14-day correction period will begin upon the discovery (or at the time at which discovery could have reasonably been made) that the transaction would be prohibited. The relief will not generally be available (i) in the case of transactions for employer securities or employer real property or (ii) in the event that a fiduciary or the party in interest knew (or reasonably should have known) at the time of the transaction that such transaction would be prohibited.

G. Selected examples of other exemptions.

1. Prohibited Transaction Class Exemption 86-128 – exemption for provision of certain brokerage services. Provides relief for certain fiduciaries who
wish to act (or use certain affiliates to act) as brokers for a plan if specified conditions are met.

2. Statutory exemption for foreign exchange transactions (see also Prohibited Transaction Class Exemptions 94-20 and 98-54). Permits a plan to enter (and a fiduciary to cause a plan to enter) into certain foreign currency transactions.

3. Prohibited Transaction Class Exemption 75-1, Part V – exemption for extensions of credit to a plan, in connection with the purchase or sale of securities, by a registered broker-dealer that is a party in interest.

4. Prohibited Transaction Class Exemption 75-1, Part III – exemption for certain purchases of securities during the existence of an underwriting or selling syndicate. Provides relief for certain acquisitions by a plan of registered securities during the existence of an underwriting or selling syndicate, when a fiduciary (or an affiliate of such fiduciary) of the plan is a member of such underwriting group or selling syndicate, provided that the transaction is not with such fiduciary and other specified conditions are met.

5. The “underwriter exemptions” – a relatively large set of individual exemptions permitting plans to purchase debt and equity interests in certain asset (generally, investment-grade senior or (in certain cases) subordinated asset-backed and mortgage-backed securities), depending upon the institution sponsoring the vehicle, the types of assets and the types of swaps (if any), and numerous other factors.

6. Prohibited Transaction Class Exemption 75-1, Part IV – exemption for certain transactions with market makers. Provides relief for certain transactions by a plan with a market maker, even though such market maker is a fiduciary (or an affiliate of such fiduciary) of the plan, if specified conditions are met.

7. Prohibited Transaction Class Exemption 84-24 – exemption for certain transactions involving insurance agents and brokers, pension consultants, insurance and investment companies and investment company principal underwriters. Provides relief for a number of transactions, including certain transactions between plans and investment companies (and principal underwriters), where the investment company, the principal underwriter or the investment company’s advisor is a party in interest solely by virtue of sponsoring a master or prototype plan or providing nondiscretionary trust services, if specified conditions are met.

8. Prohibited Transaction Class Exemption 81-8 – short-term investments. Permits plans to engage in transactions involving certain short-term investments (e.g., commercial paper and repurchase agreements).
9. Prohibited Transaction Class Exemption 77-4 – acquisition of affiliated mutual fund shares. Permits a plan to purchase and sell shares of a registered, open-end investment company, where the applicable plan fiduciary is an investment adviser to the investment company and the conditions of the exemption are satisfied.

10. Prohibited Transaction Class Exemption 77-3 – various exemptions for in-house plans. Permits a mutual fund’s investment adviser or principal underwriter (or an affiliate thereof) to acquire securities of such mutual fund from and sell such securities to a plan which covers employees of the mutual fund, where the conditions of the exemption are satisfied.

11. Individual exemptions, generally.

   a. The DOL also has the authority to grant additional prohibited transaction exemptions on a case-by-case basis.

   b. In some cases in which an exemption is sought that is similar to other existing exemptions, expedited procedures may be available.

VIII. Certain Other Recent Statutory Exemptions

   A. Cross-trades – Cross-trades will be statutorily exempt from certain prohibited transaction rules if (i) the transaction is a purchase or sale for no consideration other than a cash payment against prompt delivery of a security for which market quotations are readily available, (ii) the transaction is at the independent current market price of the security, (iii) no brokerage commission, fee (except for disclosed customary transfer fees) or other remuneration is paid in connection with the transaction, (iv) the cross-trading program is pre-approved by another plan fiduciary after disclosure, (v) each plan (or, as applicable, master trust of a single employer or controlled group) involved has assets of at least $100 million, (vi) quarterly reports with required information are provided, (vii) the manager’s fees are not based on consent to cross-trading, and, generally, no other service is conditioned on such consent, (viii) the manager’s policies and procedures regarding cross-trading meet certain requirements, and (ix) the manager has designated an individual responsible for reviewing and annually reporting (under penalty of perjury) on certain matters relating to cross-trading.

   B. Electronic communication networks – In 2004, the DOL issued Advisory Opinion 2004-05A regarding electronic communication networks (“ECNs”). There is now statutory relief for ECNs. Transactions involving the purchase or sale of securities or certain other property between a plan and a fiduciary or other party in interest will broadly be exempt from the prohibited transaction rules if (i) the transaction is executed through an ECN, alternative trading system, or similar execution system or trading venue subject to regulation and oversight by the applicable federal regulating agency or other applicable foreign regulating entity, (ii) (A) the transaction is effected pursuant to rules designed to match purchases
and sales at the best price available through the execution system or (B) neither the execution system nor the parties to the transaction take into account the identity of the parties in the execution of trades, (iii) the price and compensation associated with the purchase and sale are not greater than those associated with an arm’s-length transaction with an unrelated party, (iv) if the party in interest has an ownership interest in the trading system or venue, the trading system or venue has been authorized by the plan sponsor or other independent fiduciary for such transactions, and (v) the plan fiduciary is provided with 30 days’ advance written notice of the execution of the initial transaction.

C. Block trading - There is a statutory exemption for block trading that applies to any transaction involving the purchase or sale of securities between a plan and a party in interest (other than a fiduciary (although there is some question about whether the non-fiduciary requirement will be retained in the statute)) if (i) the transaction involves a block trade (i.e., a trade allocated across two or more unrelated client accounts of a fiduciary) of at least 10,000 shares or $200,000; (ii) at the time of the transaction, the interest of the plan (together with the interests of any other plans maintained by the same plan sponsor) does not exceed 10% of the aggregate size of the block trade, (iii) the terms of the transaction, including the price, are at least as favorable to the plan as an arm’s-length transaction, and (iv) the compensation earned with respect to the trade is not greater than the compensation that would be earned in an arm’s-length transaction with an unrelated party. (Until matters relating to the non-fiduciary requirement noted above are resolved, it may be premature to consider this exemption for application in practice.)

IX. Trust Requirement, Custody and Bonding

A. Generally, all assets of a plan must be held in trust.

1. In the case of look-through vehicles, this requirement can generally be satisfied if the interest in the look-through vehicle is held in trust.

2. Note that a number of issues under this and other rules may arise in the case of assets posted as collateral.

B. Custody

1. The indicia of ownership of plan assets must be maintained within the jurisdiction of the U.S. district courts, unless an exception applies.

2. The DOL has provided an exception for non-U.S. securities, and non-U.S. currencies held in connection with the purchase or sale of such securities, provided that such assets are under the control of, among other qualifying entities, a U.S.-registered investment adviser that is organized under U.S. law, has its principal place of business in the United States and has total client assets under its management and control in excess of $50 million.
and capitalization in excess of $750,000. If the manager does not meet this exception, there is also an exception that permits a qualifying U.S.-registered broker-dealer to hold such assets under its exclusive control or in a “good control location” as in Rule 15c3-3 under the Securities Exchange Act of 1934; provided that the broker-dealer is liable to the plan to the same extent as if it had retained physical possession of the assets and provided certain other requirements are met. (For this purpose, non-U.S. securities includes securities issued by non-U.S. issuers and non-U.S. governments and securities issued by U.S. issuers for which the principal trading market is outside the United States.)

C. Bonding.

1. ERISA generally requires so-called “plan officials” to be bonded, generally in an amount not exceeding $500,000 per plan, as set forth in the statute and regulations. See also DOL Field Assistance Bulletin 2008-4. The precise manner in which the bonding rules apply to certain “plan assets” investment vehicles may not be entirely clear.

2. Although the DOL had at one time proposed an exemption from the bonding requirements for certain broker/dealers, the exemption was never adopted. Now, under the statute, the bonding requirements will not apply to an entity that is registered as a broker or dealer under Section 15(b) of the Securities Exchange Act of 1934, if the broker or dealer is subject to the fidelity bond requirements imposed by a so-called self-regulatory organization.

3. The statute, in the case of plans that hold employer securities, increases the maximum amount of the required bond from $500,000 to $1,000,000. See also DOL Field Assistance Bulletin 2008-4. The scope of the new requirement is arguably unclear. See generally Letter from the American Bar Association to the DOL, Comments Concerning ERISA Bonding Rules (Jan. 23, 2008).

X. “Plan Assets” Issues.

A. In many cases, if an employee benefit plan acquires an equity interest in another entity, the entity’s assets may be deemed to constitute “plan assets” (unless an applicable exception or exemption applies). In that event, the entity and its assets may be subject to the provisions of ERISA and the Code governing plans. The desired structure of many investment vehicles would not be feasible if its assets were deemed to be plan assets subject to full ERISA regulation, and thus it is often essential that a vehicle qualify for an applicable exemption or exception.

B. Questions may arise regarding the identification of those assets which are subject to ERISA regulation as assets of an employee benefit plan. The issues may not seem apparent, as it might be thought that the assets of a plan are generally those
assets that are held in the plan’s tax-exempt trust. However, the DOL is concerned that, if a plan makes an equity investment in an entity, the entity may serve as a mechanism by which ERISA regulation can be avoided.

1. As a clear example, a plan may set up a subsidiary through which to invest its assets. It would not generally be expected that such subsidiary should be free of ERISA regulation merely because it is separately organized from the plan’s trust. Rather, it would be expected that such an entity should be looked through, back to the plan, for purposes of applying ERISA.

2. As a converse example, it would appear equally likely that the mere purchase of stock by a plan in a large, publicly traded operating company should not cause the assets of the company to be deemed to be plan assets subject to ERISA.

3. The DOL Regulations attempt to provide rules for analyzing the vast number of entities that are not described by the foregoing two extremes.

C. The DOL Regulations establish the general rule that, when a plan invests in the equity of an entity, the assets of the entity are deemed to be plan assets subject to ERISA, unless an exception applies.

1. The question of whether an instrument is debt or equity for these purposes can be a difficult one.

2. Debt with substantial equity features is effectively considered equity. In certain cases, the analysis may be undertaken in light of the manner in which the tax attorneys are analyzing the instruments in question.

D. There are several basic exceptions to this rule under the Regulations (and under ERISA itself, as applicable). Thus, equity investment in the following does not cause a look-through problem under the Regulations.

1. Regulated investment companies – Investments in mutual funds and other registered investment companies do not cause a look-through problem.

2. Publicly traded, widely held securities – These are securities considered sufficiently subject to other regulatory constraints. The exception applies only to U.S. registration, and is subject to various specific requirements.

3. Operating companies (in general) – These are entities that are engaged, directly or through majority-owned subsidiaries, in the production or sale of a product or service other than the investment of capital. There are two hybrid vehicles, known as “venture capital operating companies” (“VCOCs”) and “real estate operating companies” (“REOCs”).

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a. In general, a VCOC is an entity which satisfies the following two requirements: (i) on its initial valuation date (which is the date on which the VCOC makes an investment other than a short-term investment pending long-term commitment) and on at least one day in every subsequent pre-established annual 90-day valuation period (which must begin no later than the anniversary of the initial valuation date), at least 50% of the VCOC’s assets (other than short-term investments pending long-term commitment or distribution to investors), valued at cost, must be invested in qualifying venture capital investments, and (ii) the VCOC must actually exercise “management rights” with respect to one or more of the qualifying investments. For purposes of the Regulations, qualifying venture capital investments are investments in operating companies (which are not VCOCs) pursuant to which the VCOC has or obtains management rights, and management rights are contractual rights directly between the investor and the operating company authorizing the investor to participate substantially in, or substantially influence the conduct of, the management of the operating company.

b. The DOL takes the position that an entity cannot be a VCOC until its initial valuation date (that is, the first day on which the VCOC makes an investment other than a short-term investment pending long-term commitment). Thus, some funds will not accept any plan investment until the time of the fund’s first long-term investment.

c. In addition, the DOL appears to take the position that an entity which is not a VCOC on its initial valuation date can never be a VCOC. Thus, in many cases, a fund will attempt to ensure that it qualifies as a VCOC on the date on which it makes, for the first time, any investment which is not a short-term investment pending long-term commitment (whether or not the fund has plan investors on that date).

4. The 25% test – The rule that a plan’s investment in an equity interest of an entity will cause the entity’s assets to be plan assets will not apply where “[e]quity participation in the entity by benefit plan investors is not significant.”

a. For these purposes, equity participation by “benefit plan investors” is “significant” on any date if, immediately after the most recent acquisition of any equity interest in the entity, 25% or more of the value of any class of equity interests in the entity is held by benefit plan investors. Under the 25% test, the value of any equity interests held by an entity or other person (other than a benefit plan investor) who has discretionary authority or control with respect to
the assets of the entity or any person who provides investment advice for a fee with respect to such assets, or any affiliate of such an entity or other person, is disregarded.

b. Because the regulatory approach previously focused on the general type of investor in the entity, the concept of benefit plan investors for purposes of making the 25% calculation covered a wide range of employee benefit plans and other arrangements, including, among others, employee benefit plans that are not themselves subject to ERISA or the Plan Asset Regulation. For example, governmental plans and foreign plans were generally considered benefit plan investors for these purposes.

c. Generally, non-ERISA plans are no longer considered benefit plan investors, and the 25% test will now operate as a true de minimis rule, more simply testing whether ERISA plans, rather than all plans in the aggregate, exceed the 25% limitation. Thus, non-ERISA plans are now grouped with other non-plan investors in the calculation under the 25% test, and investment by governmental, non-U.S. and other non-ERISA plans may (with respect to ERISA concerns) be accepted without limitation. (Indeed, whereas before the acceptance of investment by non-ERISA plans served to constrain the ability of an entity to accept investment by plans, now investment by non-ERISA plans will serve to make more room for investment by ERISA plans (i.e., by increasing the denominator under the 25% test, without increasing the numerator).)

d. An entity will be deemed to hold plan assets only to the extent of the percentage of the equity interests in the entity held by benefit plan investors. Subject to the manner in which the new rules may be interpreted, this change may make it easier for structured vehicles using the 25% test to accept investments from a fund-of-funds which is only partially, but not entirely, comprised of ERISA assets.

e. Among the areas in which difficult interpretive issues can arise are (i) when an interest would be considered an “equity interest” or one with substantial equity features, (ii) when a subset of equity will be viewed as a separate “class” for purpose of testing and (iii) when certain investments are considered inside investments that would have to be disregarded for purpose of the 25% test.

E. Under a certain U.S. Supreme Court decision, the assets in an insurance company’s own general account could be considered subject to ERISA, depending upon the type of insurance contracts that the company has sold to ERISA plans.
ACKNOWLEDGMENT AND DISCLAIMER:
I appreciate this opportunity to give comments about what I believe to be a hugely important topic, namely the valuation of “hard-to-value” assets. I am presenting today as a risk management and valuation professional. My industry experience includes work on several trading desks, forensic financial analysis, model verification, hedge effectiveness testing and rendering opinions of value. I am the author of Risk Management for Pensions, Endowments and Foundations (John Wiley & Sons, 2005). I have written and spoken extensively about valuation and risk management from an investment fiduciary perspective. I am the creator of a syndicated pension blog, www.pensionriskmatters.com, and an investment compliance and best practices blog, www.goodriskgovernancepays.com.

Fiduciary Leadership, LLC is an independent analysis, research, litigation support and training company. Clients include service providers as well as pension fiduciaries, in the United States and abroad, and their attorneys. The company’s primary goal is to assist decision-makers by providing tools, process checks and educational information about retirement plan risk management, financial and otherwise. We believe that every strategy and product should be reviewed on its own merits and is neither “good” nor “bad.” We believe that anticipated performance should be considered on the basis of both return and risk.

The remarks provided herein reflect my own opinions and not those of the company. I am neither an attorney nor a CPA nor an actuary. This statement is not intended to offer legal, financial or accounting advice, but rather, to provide general information only.

INTRODUCTORY COMMENTS:
My comments today are in response to your fact-finding hearings, after which the ERISA Advisory Council will make a recommendation to the U.S. Department of Labor about what, if anything, regulation-wise, should be done regarding investments in “hard to value assets.”

I concur with others who assert that additional regulation would be redundant and arguably counterproductive. For one thing, empirical evidence suggests that a “one size fits all” mandate could induce perverse outcomes. Plan sponsors may get overly scared about investing in “hard to value assets” and ignore them altogether rather than conducting a thorough analysis as to their suitability. I don’t believe it is the current intent of any regulator to have plan fiduciaries automatically shrink the universe of possible product and/or strategies. Second, a more flexible environment that
encourages industry participants to “do the right thing” makes for a better reward system, thereby (hopefully) motivating plan sponsors to improve on existing policies and procedures, if not already in place.

In a recent *Financial Times* editorial, it was somewhat cynically inferred that attempts to create alternative fund valuation policies and practices are more show than anything else, a way to allay concerns on the part of institutional investors.1 Whether this is true or not is unknown. However, the notion of perception versus reality can likewise be applied to retirement plans. Given current disclosure rules, it is often difficult to distinguish pro-active plan sponsors from those who ignore or do little to implement effective risk management (and, by extension, valuation) initiatives. It would be far superior if market dynamics could correctly match demand for “good” plan sponsors with those that embrace (“supply”) an enterprise risk mentality.

Alas, a pure free market environment is more of a theoretical construct than reality. ERISA and the Pension Protection Act of 2006 are here to stay. This means that regulators are confronted with whether to add more rules or work with existing mandates. I vote for the latter and believe that real reform is nevertheless possible as long as regulators acknowledge certain exigencies and structural complications. Think about the following three hypothetical situations. (This is not an exhaustive list nor are these examples meant to single out a particular type of fund or strategy.)

- **Hypothetical Situation One**: A retirement plan fiduciary is too far removed from the valuation information hub to properly assess whether sufficient safeguards are in place. Consider a defined benefit plan that employs a consultant to select and monitor a particular hedge fund manager. That particular hedge fund manager employs a prime broker. It could be difficult (perhaps impossible) for the consultant to directly verify how the prime broker values “hard to value” assets on behalf of the hedge fund unless the pension consultant has ample access to the prime broker (which may not be possible for confidentiality reasons). This in turn is problematic for the consultant who is expected to report back to the plan sponsor. It is likewise an issue for the plan sponsor. Could plan fiduciaries possibly be subject to breach allegations under this scenario because their access to necessary and sufficient information is limited?

- **Hypothetical Situation Two**: Relevant parties, expected to formally vet valuation numbers, do not possess the requisite specialized training and experience to render an opinion of value. Consider the appraisal industry. Business valuation professionals cannot be accredited unless and until they have successfully completed numerous specialized courses and met stringent experiential requirements. Their reaccreditation requires a similar adherence to pre-specified standards. Not all individuals who offer pricing services can meet these standards.

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1 "Funds of hedge funds," *Financial Times*, July 17, 2008
services are accredited and/or possess a specialized knowledge of valuation. Could plan sponsors possibly be subject to breach allegations if they fail to sufficiently monitor the capabilities of individuals who render mark-to-model or mark-to-market numbers that are used to make retirement plan financial management decisions?

- **Hypothetical Situation Three**: SOME FUND MANAGERS, ACROSS STRATEGIES AND ASSET CLASSES, ARE GRANTED TREMENDOUS LATITUDE TO SELF-REPORT MARK-TO-MODEL OR MARK-TO-MARKET NUMBERS. A cursory review of a sufficient number of Private Placement Memorandums and other relevant documents suggests that asset managers frequently enjoy such freedoms. Common sense suggests that traders who are compensated on the basis of self-reported performance numbers are conflicted, however well intentioned they may be. “Follow the money” is apt advice. Could plan sponsors possibly be subject to breach allegations if they ask too few questions about key person risks, including the basis on which traders are compensated?

The topic of “hard to value” asset assessment is broad. It is impossible to offer a comprehensive analysis in a few pages. With that caveat, the remainder of my report attempts to provide meaningful answers to questions put forth to testifying experts, in preparation for today’s hearings. I am happy to field inquiries for those who seek further commentary.

**ROLE OF VALUATION:**

SHOULD VALUATION ISSUES PLAY A ROLE IN THE SELECTION OF PLAN INVESTMENTS, AND IN ACHIEVING PROPER ASSET ALLOCATION AND DIVERSIFICATION? Famed American author Mark Twain once said “There are two times in a man’s life when he should not speculate: when he can’t afford it and when he can.” Applied to retirement schemes (whether defined benefit or defined contribution in nature), failure to recognize valuation analysis as an integral part of risk management is arguably a form of speculation. It is impossible to effect proper risk mitigation (not necessarily the same thing as risk minimization) without understanding what drives performance. To believe otherwise is folly. The creation of an effective hedge, determination of optimal asset allocation and/or the assessment of a strategy such as Liability-Driven Investing with a portable alpha kicker are just a few of the countless activities that, properly carried out, depend on good risk management steps (and, by extension, a thorough understanding as to how and why prices vary across asset classes and over time).²

² For purposes of this testimonial statement, market prices (to the extent they exist) are assumed to equal value. A discourse as to when this is unlikely to occur is outside the scope of this brief discussion.
It is unclear as to whether the notion of stringent pension risk management ("pension" being used herein as a generic term that encompasses all retirement benefit programs) is fully embraced by plan sponsors. Publicly available information is sketchy. More vocal pension plan leaders deserve praise for their comprehensive and sophisticated (holistic) approach to risk management. Others arguably need to improve their current practices. A soon-to-be released study of pension risk management policies and practices of 162 U.S. and Canadian plan sponsors, conducted by Pension Governance, LLC, with funding and research support from the Society of Actuaries, suggests a mixed bag with respect to the pervasiveness of financial and fiduciary risk awareness. While the survey centers on the use of financial derivatives by plan sponsors, some of the key findings more broadly inform and disturb.

For said survey, the term "USER" defines a plan that trades derivatives in its own name. A NON-USER does not trade derivatives in its own name. By definition, both USERS and NON-USERS may nevertheless be exposed to the use of derivatives if any or all of their external money managers employ futures, options, swaps and hybrid instruments. Aware that response rates fall with every additional question asked, an already long survey was truncated. Some of the questions we wanted to ask but did not ask include the following. When a plan sponsor affirms that they interview external money managers about their valuation policies and procedures, what kinds of exact inquiries are made and of whom? How much time is spent in discussing risk management policies and procedures? How much rigor is applied by plan sponsors so they feel comfortable with the models employed by fund managers, whether the managers self-report or use a third party pricing service? In the absence of a Chief Risk Officer function, how do plan sponsors assess their organization’s internal risk management activities as well as those of third party service providers?

An excerpt of the survey follows:

- Plan size seems to be one factor that distinguishes USERS and NON-USERS, with 39% of USERS managing plans in excess of $5 billion versus 14 percent of NON-USERS for plans larger than $5 billion.
- Pension decision-making appears to vary considerably by job function, with 48% (37%) of USERS (NON-USERS) choosing "Other" rather than selecting from eleven titles such as Actuary, Benefits Committee Member, CFO or Human Resources.
- Time allocation varies considerably with 64% (40%) of USERS (NON-USERS) saying they spend 75 to 100 percent of their work week to pension issues
- A majority of USERS acknowledge their fiduciary duties to hedge with 64% answering affirmatively than NON-USERS with 64% (55%) answering “Yes” when asked whether they discuss asset (liability) hedging. In contrast, 48% (39%) NON-USERS answer “Yes” about asset (liability) hedging conversations.
Few plans currently embrace an enterprise risk management approach with 59% (57%) of USERS (NON-USERS) responding that their organization does not use a risk budget. When asked if their organization has or is planning to hire a Chief Risk Officer, 57% (64%) of USERS (NON-USERS) answered “No.” For those organizations with a Chief Risk Officer, 62% (43%) of USERS (NON-USERS) state that defined benefit plan duties are handled by someone else.

Defined benefit plan redesign does not appear to be an imminent priority with 68% (58%) of USERS (NON-USERS) answering “No” when asked if changes are imminent.

NON-USERS cite numerous reasons for not using derivatives directly, including, but not limited to, “lack of fiduciary understanding” (25%), “perception of excess risk” (31%), “considered too complex” (23%), “prohibition against possible leverage” (19%) and “defined benefit plan risk not considered significant” (28%).

A query about the review of external money managers’ risk management policies results in 70% (58%) of USERS (NON-USERS) responding “Yes.” Fifty-two percent (57%) of USERS (NON-USERS) say they review external money managers’ valuation policies.

Sixty-eight percent (61%) of USERS (NON-USERS) include questions about the use of derivatives and risk management as part of the Request for Proposal (“RFP”) process.

Survey respondents seem to rely mainly on basic tools to measure risk. Eighty-three percent (64%) of USERS (NON-USERS) rank standard deviation first. Seventy-nine percent (63%) of USERS (NON-USERS) rank correlation second.

Survey respondents worry about the future with 58% (60%) of USERS (NON-USERS) ranking “accounting impact” as a concern. Other pain points include, but are not limited to, “actuarial analysis,” “fiduciary pressure,” “longevity of plan participants,” and “regulation.”

INVESTMENT POLICIES:
WHAT, IF ANY, MODIFICATIONS TO PLAN INVESTMENT POLICIES AND GUIDELINES SHOULD PLANS CONSIDER WHEN UTILIZING “HARD TO VALUE ASSETS”? At a minimum, and certainly not a maximum, an Investment Policy Statement should address whether, and to what extent: (a) a plan is permitted to expose itself to “Hard to Value Assets” (b) how financial and operational leverage is to be defined, measured and managed (c) which parties will take responsibility for identifying “red flags” and act to limit or exit exposure to a particular type of “Hard to Value” Asset (d) how risk factors associated with “Hard to Value Assets” will be identified, measured and managed, ideally by segmenting HTV assets into appropriate sub-sectors (e) how fee economics are to be analyzed by type of HTV asset sub-sectors and whether risk-adjusted return expectations are adequate in a risk budget context (f) the role of external third parties as either
functional or contractual fiduciaries with respect to “HTV” asset manager selection, monitoring and firing (g) frequency
of review of HTV asset performance, taking into account liquidity and trading limit factors and strategic asset allocation
objectives (h) how limits will be established, monitored and revised, as necessary. Ideally, a plan sponsor creates a
separate Risk Management Policy for itself and external asset managers, respectively. The Risk Management Policy
should serve as a detailed guide for all things risk management, including the identification and ranking of various
risks, including but not limited to, liquidity, price, operational, settlement, legal, fiduciary and model risk.

In 1996, then Assistant Secretary of Labor, Olena Berg, urged plan sponsors to focus on risk analysis when
considering the use of derivative instruments. A portion of that letter is excerpted below. This official guidance, while
written more than 10 years ago, applies to “Hard to Value Asset” investing as well.3 Note the text that relates to
valuation of derivative instruments.

“Plan fiduciaries have a duty to determine the appropriate methodology used to evaluate market risk and the
information which must be collected to do so. Among other things, this would include, where appropriate, stress
simulation models showing the projected performance of the derivatives and of the plan’s portfolio under various
market conditions. Stress simulations are particularly important because assumptions which may be valid for normal
markets may not be valid in abnormal markets, resulting in significant losses. To the extent that there may be little
pricing information available with respect to some derivatives, reliable price comparisons may be necessary. After
entering into an investment, a plan fiduciary should be able to obtain timely information from the derivatives dealer
regarding the plan’s credit exposure and the current market value of its derivatives positions, and, where appropriate,
should obtain such information from third parties to determine the current market value of the plan’s derivatives
positions, with a frequency that is appropriate to the nature and extent of these positions.”

DEFINITION:

AS FIDUCIARIES, WHAT DO YOU DEEM TO BE OR WHAT DO YOU EXPECT TO BE “HARD TO VALUE ASSETS?” It depends in part on
how the term “Hard to Value Assets” is being defined. For example, some hedge funds may regularly buy and sell
actively traded stocks and bonds for which market prices are readily available. It would therefore be inaccurate to
characterize that hedge fund as a “Hard to Value Asset.” In contrast, some traditional assets might be classified as

3 http://www.dol.gov/ebsa/regs/ILs/il032196.html
“Hard to Value.” A money market mutual fund (perhaps a 401(k) plan choice) that invests in securities with embedded derivatives might be properly classified as a “hard to value asset.”

There is disagreement as to whether any or all of “hard to value” money pools constitute a separate asset class. Additionally, there is significant risk diversity across types of funds, managers and strategies. Making sweeping performance statements is ill-advised. With these qualifiers in mind, a sampling of “Hard to Value Assets” is shown below:

- Hedge funds
- Funds of funds
- Private equity funds
- Complex derivatives
- Venture capital funds
- Infrastructure
- Commodity pools
- Real estate funds
- Compound or contingent securities or instruments.

Diversification is a frequently proffered justification for the allocation of monies to “Hard to Value Assets.” A discussion of empirical evidence that either confirms or refutes diversification potential is outside the scope of this statement but is nevertheless critical for any plan sponsor to consider. Cash flow transformation, transference of risk, synthesizing an exposure to a particular sector and/or return enhancement are some of the many reasons one might consider “HTV” instruments and/or funds. Achieving an absolute return target was likewise cited in “Defined Benefit Plans: Guidance Needed to Better Inform Plans of the Challenges and Risks of Investing in Hedge Funds and Private Equity, (U.S. Government Accountability Office, August 2008).

While there has been focus to date on pension plans that allocate monies to “Hard to Value Assets,” it is unclear whether those who abstain have conducted a thorough review of probable risks and returns before making a final decision. Is an arbitrary rejection of “Hard to Value Assets” a possible breach of fiduciary duty? This puzzle is left to

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legal experts but prudent process might be interpreted as mandating a discussion of the appropriateness of “Hard to Value Assets” before deciding whether to add them to a portfolio or reject their use.\(^5\)

Notwithstanding the legal issues regarding process, doing one’s homework as a precursor to exclusion or acceptance of “Hard to Value Assets” should reflect care in avoiding pitfalls such as: (a) over-reliance on a simple measure like the Sharpe Ratio (b) limiting return analysis to a “too long” period of time (c) recognizing that price behavior and correlations are time-variant (d) assuming that statistical measures tell most of the story (e) ignoring impact of fees (f) incorporating deal structure terms (such as transferability restrictions or valuation carve-outs in the form of lock-ups, side pockets, most favored nation clauses, side letters, etc) (g) not asking questions about market or industry fundamentals (For example, for a venture capital or private equity holding that dominates a particular portfolio, asking questions about a likely exit strategy and timing of such makes sense.) and/or (h) forgetting to use common sense and “conducting sanity checks.” The list is long. A good starting point is to ask an “HTV” asset manager what keeps him or her up at night and what is being done to mitigate the stated risks.

ROLE OF THIRD PARTIES:
WHO CAN THE FIDUCIARY RELY UPON WHEN ASCERTAINING THE VALUE OF “HARD TO VALUE ASSETS” WHEN THE FIDUCIARY IS INCAPABLE OF VALUING, IN ORDER TO FULFILL THEIR FIDUCIARY RESPONSIBILITY TO PLAN PARTICIPANTS? This question is disturbing. If a fiduciary is (a) truly incapable of understanding valuation risks of “Hard to Value Assets” and (b) does not feel comfortable delegating duties and then overseeing third parties, does a foray into “Hard to Value Assets” make sense? Assuming that a plan sponsor feels comfortable identifying and assessing a third party’s abilities, and at the risk of oversimplification, I think a reasonable solution is to search for those independent individuals (organizations) who (that) can adequately value various holdings, by type of product, sector and/or complexity. For example, a plan sponsor with an investment in fallen angel fixed income securities may feel more comfortable with a bankruptcy expert than a derivatives pricing specialist.

While specific questions will vary, depending on the type of service provider, an RFP (Request for Proposal) might include, but is not limited to, questions such as those listed below:

- How many valuation specialists does the service provider have on staff?
- Describe each person’s specialized valuation-centric training and experience by sectors of the “HTV” market.

\(^5\) While most of the discussions about “Hard to Value Assets” center on interest by defined benefit plans, defined contribution plan fiduciaries should query their external money managers to identify any “hidden” exposure.
• Are there any compensation arrangements in place that could render the valuation numbers as subjective and therefore of little use to a plan sponsor?

• Does the third party service provider have adequate technology systems in place that capture data and allow for back-testing and stress-testing a particular model?

• Is there a chain of command as to which persons have the authority to pull the plug on trading in complex instruments (if an external money manager is providing marks)?

• What is the oversight process that determines when positions in “Hard to Value Assets” should be reduced, if possible (if an external money manager is providing marks)?

• What percentage of the overall market for a particular “HTV” sector does the external money manager control?

Interestingly, and somewhat anecdotally, hedge funds (an increasing favorite of defined benefit plans) have yet to look to the business valuation industry for much assistance. A recent survey of 39 appraisers, jointly conducted by Business Valuation Resources, LLC and Pension Governance, LLC, suggests a gap between the need for and the use of professional valuation experts. Some highlights are summarized below:

• Of the few survey respondents who currently provide services to hedge funds, appraisers say that 55% of their clients have a formal valuation process in place.

• Appraisers who took the survey say that almost half of their hedge fund clients generate valuation numbers internally. A quarter of their clients rely on third party administrators. Relatively few used certified business appraisers.

• Many reasons were given by appraisers as to why hedge funds procure a valuation. These include, but are not limited to: auditing (33% of respondents), asset allocation (27%) and performance reporting (24%), redemption (18%) and risk management (18%).

• Eight out of 10 appraisers with hedge fund clients say they’ve never been called in to assist their hedge fund clients with the development of a valuation policy.

• When asked about standards (guidelines), 48% of respondents claim their clients cite fair value accounting rules, 23% of respondents say their hedge fund clients use no standards and 23% of survey-takers cite the Private Equity Industry Group Guidelines (PEIGG) as a guide for their hedge fund clients.

• For those survey respondents who choose not to pursue hedge fund valuation work, appraiser liability is cited as the primary deterrent (77% of respondents), followed by 54% of survey-takers who say they are unfamiliar with the hedge fund industry.
POLICIES AND PROCEDURES
WHAT VALUATION POLICIES AND PROCEDURES SHOULD A FIDUCIARY ADOPT WHEN HOLDING “HARD TO VALUE ASSETS?”

Suggestions are provided in the foregoing section about Investment Policy Statements. Industry valuation guidelines (and there are many) offer further insight. Critical questions abound as to how a fiduciary can establish effective valuation policies and procedures. A number of the many “must do” elements are listed below:

- Determine what valuation standards apply. While there is some overlap, voluntary and mandatory valuation standards may conflict with each other.
- Clarify definitions. “Fair value” for purposes of dissenting shareholder actions does not necessarily mean the same thing as “fair value” for financial accounting purposes.
- Aside from mandatory reasons, identify when valuations should be done at other times (i.e. to cash out of a position, adjust a hedge or exit a relationship with a particular money manager).
- Identify whether it makes sense to value individual holdings versus a portfolio, with the latter taking into account correlation offsets (to the extent that correlation is a viable metric of association).
- Document how competing valuation numbers will be reconciled for different purposes (i.e. financial reporting versus economic risk management)
- Identify how competing models will be vetted and either accepted or rejected.
- Identify how model risk will be managed and who has the responsibility for kicking the tires on complex algorithms.
- Identify how and how often model error will be measured.
- Identify which individuals and/or organizations will render prices, by category of “Hard to Value Assets.”
- Identify requisite frequency of valuation reports.
- Query external fund managers as to whether a function risk officer is in place and ensure that this person does not report to the trading desk.
- Agree that a formulaic approach to valuation will be avoided (i.e. discounting a holding by the same percentage each year for an identified expected holding period).
- Examine market microstructure characteristics such as trading volume and bid-ask differentials (when possible).
- Identify data sources and possible discrepancies across data vendors.

EDUCATION AND DISCLOSURES:
WHAT DISCLOSURES AND EDUCATION MEASURES ARE REQUIRED OR SUGGESTED FOR PARTICIPANTS AND FIDUCIARIES WITH RESPECT TO PLANS WHICH INVEST IN “HARD TO VALUE ASSETS?” Our firm offers a wide array of training deliverables in the investment risk and valuation areas. We’ve found that it is best to modify the training and case studies to accommodate the educational and experiential background of a particular audience. Providing technical education to persons unfamiliar with investment principles is a challenge. Acknowledging that even persons with advanced degrees in fields such as math and finance do not always agree on certain valuation models or theories, it may not be straightforward to convey model basics, let alone nuances, to persons unaccustomed to doing a deep dive into risk and valuation data.

Nevertheless, the need for valuation education is paramount in my view and deserves considerable attention. Asking investment fiduciaries to construct a valuation risk driver matrix is a good starting point. The resulting visual is a great reminder that risk can initially be evaluated on a qualitative basis. For example, suppose an investment fiduciary knows that both an increase in interest rates and a depreciation of the Euro vis-à-vis the U.S. dollar is likely to erode the value of the plan’s global bond exposure. That decision-maker puts a minus sign in the relevant table cell. When eventually asked to review valuation numbers for that part of the portfolio, he or she possesses a sensibility about the directional impact of at least two risk drivers.

Regarding disclosure, a broad topic indeed, I think it is critically important to have numbers that do more than hint at economic reality. Disclosure-related compliance is a time-consuming and expensive process. The final numbers should give shareholders, plan participants and other interested parties timely insight as to whether their money is at risk. The current state of public financial disclosure bodes poorly for anyone seeking quality information about how retirement plans govern themselves, how they implement risk management (including valuation) policies and procedures and how they oversee the use of outside parties.

A few months ago, the Financial Accounting Standards Board (“FASB”) requested comments from interested parties about a possible revision to FAS 132 (as a way to enhance pension disclosures). I am taking the liberty of excerpting text from my May 2, 2008 letter. A review of all of the comment letters is worthwhile. I believe they are posted to the FASB website.
An assessment of fair value should, at a minimum, reflect transferability restrictions. A plan may report stellar returns and yet be unable to liquidate a position. Plan sponsors require cash to write monthly retirement checks. It is unclear as to whether the categories you propose will fully inform about the ability to exit a position and raise cash.

Consider derivative instruments. Even if they are segregated by type of contract, it is important to know much more than notional principal amounts and other numerical metrics. Other items of interest include (but are not limited to): (a) type and quality of posted collateral, frequency of monitoring and identification of monitoring parties (b) whether the derivative instrument is being used to hedge (c) efficacy of hedge (d) concentration of counterparties by type of instrument on a net and gross basis (e) which, if any, independent parties value the various derivative instruments and (f) what risk metrics are used to determine likely economic impact of derivatives.

A category such as “equity securities” is overly broad. A pension fund may invest in both blue chip stocks and “wallflowers” that are followed by few, if any, securities analysts and tend to trade in thin markets. They are dissimilar in many ways, not the least of which is the ability to unwind a position with ease.

In a similar fashion, outright ownership of land or buildings would be categorized as “real estate” as would an investment in a real estate investment trust or, as you indicate, a hedge fund that owns real estate or invests in infrastructure. The risk-return tradeoff, fees and legal protections vary considerably. These differences would be camouflaged if different types of holdings are lumped together.

Some hybrid instruments could be categorized in one of several ways. Convertible bonds may, given prevailing market conditions, trade more like equity than debt. A balanced mutual fund invests in both debt and equity. Complex securities embed derivatives. International stock and/or bond pools may be partially or fully hedged with foreign exchange contracts. Could disparate treatment of hybrid instruments give rise to difficulties in financial statement interpretation across plan sponsors and pension plans?

Lumping concentration numbers together with the use of a filter such as country may be helpful but insufficient. It would be nice to know how a plan sponsor decides on a particular concentration, what person(s) monitors the concentrations, what triggers a “fire alarm” breach and what should happen when a concentration is exceeded. Perhaps FASB assumes that this kind of information will be included in a narrative description of the pension plan’s investment policies and procedures.

FASB is proposing that valuation information be provided on an annual basis. This renders much of the reported data worthless for anyone seeking to assess whether a plan sponsor is likely to encounter liquidity problems in meeting its obligations to existing retirees. While frequent valuations may be overly expensive (and possibly misleading), a financial statement user needs to understand what keeps pension plan managers
up at night. The creation and disclosure of a risk factor matrix is one approach. Disclosing periodic stress test results is another approach. In any event, one hopes that the pension plan is already conducting risk analyses at regular intervals. If true, disclosing information about test results should not cause an undue burden on plan sponsors.

- FASB proposes the disclosure of “information about valuation techniques and inputs.” Does FASB want information about the use of an outside vendor to be disclosed? Does FASB expect disclosure text to include a discussion about (a) how often models are tested and by whom (b) when models are revised and for what reasons and (c) whether model errors are consistent or vary?

- In the event that an external money manager refuses to disclose information about his or her model, does that put a pension plan at risk for disclosure non-compliance?

- For hedge funds, will a pension plan be in disclosure non-compliance if a side pocket arrangement is in use? It would be extremely helpful to know how hedge fund managers determine what goes inside a side pocket. If the side pocket is “large,” disclosures about the contents and a qualitative assessment of risk factors is recommended.

- Financial statement users stand to benefit from disclosure of multiple metrics. However, not all metrics are created equal. Reliance on a single measure such as the Sharpe Ratio is misleading at best. It is a snapshot assessment based on standard deviation of returns. It says little about a pension fund’s risk control processes, including the selection and vetting of external money managers. Additionally, some prices (returns) are not normally distributed. While there is merit in allowing pension plans latitude, hopefully there will be some uniformity of appropriate metrics across plan sponsors. Otherwise, a financial statement user may end up comparing apples and oranges.

- Regarding valuation adjustments such as discounts for lack of marketability, it is imperative to understand whether a formulaic approach is being employed and why. Many valuation standards forbid the use of an arbitrary approach.

- When a pension plan invests in private equity for strategic long-term reasons, the position is often held at cost unless a write-down is deemed inevitable. Will FASB require annual valuations (even if the pension plan deems the resulting numbers “illusory”) or allow for an exemption of assets held specifically for long-term reasons? Will the length of the expected holding period be a consideration?

- Has FASB given any consideration to the existence of competing valuation standards (binding or voluntary) and possible reconciliations thereof? They include, but are not limited to, USPAP, PEIGG and IOSCO/MFA.

- Will revisions to FASB Statement No. 132 comport with relatively recent changes in Form 5500 reporting rules?”
CONCLUDING REMARKS:

In summary, risk in and of itself is not a bad thing to be avoided at all costs. However, being forced to accept uncompensated risk is economically imprudent and should not stand as acceptable. Investment fiduciaries must embrace the notion that (a) valuation analysis is an integral part of pension risk management and (b) effective pension risk management is an ongoing process. When scant attention is paid to pension risk identification, measurement and management, a nasty domino effect is likely to ensue. Realized losses, sub-par performance, cash flow pressures, rating downgrades, higher cost of capital, damage to corporate reputation and possible litigation or regulatory enforcement challenges are just a few of the many possible adverse consequences. While any or all of these outcomes are undesirable, probably the most acute fallout is an increased probability of being unable to keep promises to plan participants.

Again, many thanks for inviting me to participate today. I am happy to assist with any educational or information analysis initiatives that help to advance pension best practices in the area of investment fiduciary risk management (and, by extension, valuation). Before I close, I would like to publicly acknowledge the great work being done by countless plan fiduciaries and their service providers who recognize and embrace the importance of effective pension risk management. They often toil behind the scenes and get little incremental compensation, if any at all. They deserve acclaim.

Very Sincerely,

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Financial Model Mistakes Can Cost Millions of Dollars

By Susan Mangiero – May 31, 2011

Aristotle wrote, “Quality is not an act; it is a habit.” Applied to investment matters, the message is paramount. Ongoing vigilance regarding financial models is critical to gauging whether the models are working as they should. The failure to catch a financial model’s mistakes can cost millions of dollars and create a litany of problems. Some financial services organizations and their investors have learned the hard way that computer-driven models are only as good as the people in charge of creating, reviewing, and modifying them as needed. Given the fact that the proper management of more than $30 trillion in global assets significantly depends on having good financial models in place, it is important to understand what can go awry and how to avoid material losses.

A recent example of losses resulting from a financial model error should serve as a wakeup call. Three AXA Rosenberg entities settled a $242 million enforcement action by the U.S. Securities and Exchange Commission (SEC) related to a computer programming error. According to SEC Director Carlo di Florio, the firm swept the error “under the rug” as opposed to dealing with it immediately by communicating with clients. Doing so cost the firm $217 million to be paid as recompense to investors who were harmed, $25 million in penalties, and the costs of “hiring an independent consultant with expertise in quantitative investment techniques who will review disclosures and enhance the role of compliance personnel.” Carlo di Florio, Speech by SEC Staff, Remarks at the IA Watch Annual IA Compliance Best Practices Seminar, Office of Compliance Inspections and Examinations, SEC, March 21, 2011. Bruce Karpati, co-chief of the Asset Management Unit in the SEC’s Division of Enforcement, cautioned “quant” managers to be “fully forthcoming about the risks of their model-driven strategies, especially when errors occur and the models don’t work as predicted.” SEC, Press Release No. 2011-37, “SEC Charges AXA Rosenberg Entities for Concealing Error in Quantitative Investment Model: Firms Agree to Pay More Than $240 Million to Settle SEC Charges.”

The Importance of Financial Models

Nearly every financial transaction that takes place between capital market participants involves a model of some type. Examples include a private equity fund manager who forecasts projected cash flows of a portfolio company or an endowment seeking to optimize its mix of stocks, bonds, and alternatives such as hedge funds or real estate. Valuation models are a mainstay in determining the right price for a stock, bond, or derivative instrument like an executive stock option. Countless asset managers rely on computer algorithms to determine how much to hedge particular holdings. “Quants” deploy various formulas to guide how they trade. Main Street investors are undeniably impacted by the pervasiveness of computational finance in Wall Street dealings. A failure to build correct models and review them over time for continued
appropriateness can, and has, resulted in large economic losses for numerous individual and institutional investors.

Models are a means to an end. Wall Street does not hire programmers simply to create elegant mathematical code. The transfer of securities (whether via an exchange or through a private negotiation) with a tally of more than $30 trillion and the associated bottom line of brokerage dealers, advisers, portfolio managers, and investment banks are tied to algorithms that dictate, predict, and allocate. Millions of individuals move money every day as a result.

Conceptually, a model is meant to be a numerical reflection of financial conditions in a perfect world that is characterized by rational buyers and sellers, no unprecedented directional jumps in price, zero transaction costs, and a free exchange of information. As the last few years have revealed, however, markets can get messy, and people do not always behave in a disciplined fashion.

Care must be taken to construct a model and to test it. Underlying assumptions must be revisited on an ongoing basis, preferably by an independent expert who will not receive a raise or bonus tied to flawed results from a bad model. Someone has to kick the proverbial tires to make sure that answers make sense and to minimize the adverse consequences associated with mistakes in a formula, bad assumptions, incorrect use, wild results that bear no resemblance to expected outcomes, difficulty in predicting outputs, and/or undue complexity that makes it hard for others to understand and replicate outputs. Absent fraud or sloppiness, precise model results may be expensive to produce and therefore unrealistic in practice. As a consequence, a “court or other user may find a model acceptable if relaxing some of the assumptions does not dramatically affect the outcome.” Susan Mangiero, “The Risks of Ignoring Model Risk” in Litigation Services Handbook: The Role of the Financial Expert (Roman L. Weil et al, eds., John Wiley & Sons, 3d ed. 2005).

Given the importance of models, regulators are watching. During the previously mentioned March 21, 2011, presentation, di Florio listed valuation, asset verification, and portfolio management as exam focus areas, all of which are impacted by the viability of financial models.

**Potential Damages Resulting from Financial Model Errors**

When things go wrong in an asset manager’s financial model, investors can incur outright losses along with a foregone opportunity to have allocated their money elsewhere had they known about model problems in a timely fashion. Economic losses likewise occur for an asset manager when current clients pull millions of dollars or prospective investors go away, limiting future fees that can be earned as a percentage of assets under management.

Damages also occur when assets or liabilities are incorrectly priced because inputs to a valuation model are erroneously calculated. Garbage In, Garbage Out (GIGO) spells trouble. For example, what an investor ought to pay for a complex instrument such as a mortgage-backed security
relies on inputs such as projected interest rates and the extent to which homeowners will repay their debt and at what level. If interest rates have just fallen considerably and a large number of borrowers refinance as a result, another plunge in interest rates is unlikely to encourage yet another large spate of prepayments. With respect to projecting interest-rate paths that will be used to discount security cash flows, the shape of the yield curve, macroeconomic considerations, and volatility are just a few of the factors that comprise the “nested” model. Said another way, if interest rate projections and/or prepayment assumptions are not effectively modeled first, the results from applying the mortgage backed security valuation model will be influenced accordingly.

Using unsuitable models also causes damages. For example, the use of a simple Black-Scholes option pricing model is often criticized as a less than perfect choice for valuing executive stock options because few stock options trade in an open market, their exercise is restricted, and issuance by closely held companies complicates stock price determination. Susan Mangiero, “Model Risk and Valuation,” _Valuation Strategies_ (March/April 2003).

When a model is used for risk-management purposes such as determining the size of a hedge, mistakes may result in too much or too little protection for the investor or issuer of debt (Hedging techniques can be a useful tool for both investment and corporate-finance purposes.). Neither outcome is ideal. In addition, hedging may end up costing more than it should if a risk-averse investor buys or sells a derivative instrument that has been incorrectly valued.

For long-term investors such as defined-benefit plans or university endowments, models are frequently used to determine how to properly allocate large sums of money. Should model problems occur, institutions may find themselves unduly overexposed or underexposed to certain industries, issuers, and/or money managers. This in turn opens a veritable Pandora’s box in the form of potential fiduciary breach, imprudence, violating donors’ mandates, accelerated funding for plan sponsors, and the cost of potentially having to rebalance.

**Mitigating Model Risk**

In light of the importance of financial models and the potential damages resulting from model errors, expect more attention to be paid to the use of models and the risk that accompanies poor practices.

A prescription for model risk mitigation includes, but is certainly not limited to, the following action steps:

- Hire knowledgeable programmers with capital market experience;
- Create and follow a set of policies and procedures that govern how and who will validate financial models over time and what will trigger revisions in a model(s);
- Avoid conflicts of interest that would reward managers for ignoring problems and would potentially preclude an independent and objective assessment of problems and related corrective action(s);
Test assumptions for validity in stable markets as well as extreme circumstances;
Stress a model using a sufficient number of economic scenarios to gauge its predictive power and whether results can be relied upon in both good or bad times;
Educate personnel about how a particular model is supposed to work;
Establish a response strategy should a problem occur and investors need to be informed before things get out of hand;
Scrap models that are overly complex and expensive to replicate;
Don’t be afraid to ask questions about inputs, data quality, results, and concerns; and
 Invite informed outsiders to offer an independent and regular critique on a confidential basis.

Conclusion
In the words of famed philosopher George Santayana, “Those who do not remember the past are condemned to repeat it.” Certainly, the recent market meltdown offers valuable lessons. For example, as Elliot Noma, managing director with Garrett Asset Management, LLC, rightly points out, “Those traders who assumed adequate diversification of home loans backing mortgage securities were exposed to model risk, just as some of their peers incurred losses for underestimating counterparty default risk.” Famed writer Ray Bradbury was not far off the mark when he said, “Living at risk is jumping off the cliff and building your wings on the way down.” Executives who ignore model risk do so at the peril of their investors and may want to think about how to explain their actions in subsequent legal proceedings.

Keywords: litigation, expert witnesses, financial model, model risk, valuation

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Four misconceptions about fiduciary liability insurance

06 | 7 | 2011 Posted By Jerry Kalish

With the increasing spotlight on fiduciaries and their responsibilities for ERISA plans, many employers are asking themselves whether it’s time to buy fiduciary liability insurance.

With personal assets on the line for breach of fiduciary responsibility, there is no “one size fits all” answer. But, if you are a fiduciary considering fiduciary liability insurance, here are four misconceptions that can get in the way of proper decision making:

1. **The ERISA Fidelity bond protects my personal assets.** Not at all. Fidelity bonds which are required by ERISA provide coverage for acts of fraud or dishonesty but only for the benefit of the plan and the plan’s participants. It does not protect the fiduciaries themselves for liability claims.

2. **I’m covered under our Employee Benefit Liability (EBL) policy.** Not entirely. EBL insurance policies cover many claims arising out of errors or omissions in the administration of a benefit plan, but may not cover other aspects of fiduciary liability, e.g., investment of plan assets.

3. **I’m covered under our Directors and Officers (D&O) policy.** Usually not. These types of policies generally only cover directors and officers for their activities in that capacity and not as plan fiduciaries. They generally exclude coverage based on violations of ERISA.

4. **I would be indemnified against any personal liability.** Maybe yes, maybe no. ERISA specifically precludes a plan from indemnifying a fiduciary for breach of fiduciary responsibility. So who’s left? The employer who even if willing, may not have the financial resource to indemnify or may be restricted to do so by state law.

Fiduciary liability insurance can not, of course prevent law suits. But in conjunction with sound plan management, it can be an effective part of your risk management program. In other words, you can’t eliminate the risk, but you can maximize the protection. Consider talking to your property and casualty broker or consultant about fiduciary liability insurance.
Release Us From Confusion Over ERISA Fiduciary Claims

BY ANDREW L. ORINGER, JOSHUA A. LICHTENSTEIN, AND ADAM E. STELLA

Introduction

Class-action litigation has found its way to the Employee Retirement Income Security Act of 1974 (“ERISA”) in quite a high-profile fashion. In so-called “stock-drop” and “indirect-fee” cases, among others, plan participants acting as class representatives have asserted on behalf of a broader group of participants that plan fiduciaries have breached their duties to the detriment of the plan. But what if the putative class representatives have generally released claims against their employer, and a host of other parties connected with the employer? Would they be barred from bringing their claims? If so, and if no other putative representatives are interested in bringing the claim, an otherwise cognizable class action may find itself with no road down which to proceed.

A quick review of the cases might lead one to conclude that releases are not effective to forestall a participant’s effort to bring a class action. In case after case, courts have concluded that general releases do not bar the bringing of ERISA fiduciary claims, and in a number of cases plaintiffs have been permitted to continue with claims notwithstanding their having given general releases. A natural conclusion is that the courts are hostile to the notion that ERISA fiduciary claims are not susceptible to being released.

Well, not so fast – maybe the courts are saying something a bit different. Maybe the courts have been saying that there is something about the particular releases on which they are ruling that renders them ineffective to forestall the fiduciary claims at issue. This article will explore the possibility that a particular release or covenant not to sue may, depending on how it is drafted, indeed be sufficient to act as a defense to a class representative’s purported claim.

A number of cases, while ultimately stopping short of holding that a release bars a claim sought to be brought, provide clues as to how a release or covenant not to sue may indeed bar the bringing of a claim. The recent case of In re Schering-Plough ERISA Litigation is both illustrative of this line of cases, in that it declines to hold squarely that a release bars the bringing of the claims being asserted in a class action, and especially instruc-

1 Unless otherwise indicated, all section references herein are to sections of ERISA.

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2 A somewhat different question is whether the putative representative may be disqualified to serve as such, notwithstanding the potential viability of the representative’s own claim. This result, which is also considered below, could ultimately be equally satisfying to the defendant, if it results in the dismissal of the class action, even if the result is less satisfying as a theoretical matter, in that, by hypothesis, the release is being held to be inapplicable to the asserted claim.

3 589 F.3d 585, 48 EBC 1385 (3d Cir. 2009).
tive, as it contains a fairly comprehensive analysis that may show what a release or covenant not to sue might need to provide in order to bar an ERISA fiduciary claim.

Before turning to the jurisprudence addressing the release question in the context of ERISA fiduciary claims, this article will explore the nature of the claims being considered here, and why those claims may be fundamentally different in nature than other claims that may be more obvious subjects for a traditional release. Critical to the question of whether a contractual release provision reaches any given claim may be an analysis of just what the nature of the claim is. Ultimately, the question will be: must a release necessarily fall short of being an effective defense to the bringing of an ERISA fiduciary claim?

Whose Claim Is It Anyway?

When a participant alleges that a fiduciary has breached a fiduciary duty, and that relief is available in respect of such breach, the claim is brought under Section 502(a)(2). Section 502(a)(2) provides that a civil action may be brought by (among others) a participant or beneficiary (for convenience, participants and beneficiaries are referred to below collectively as “participants”) for appropriate relief under Section 409. Under Section 409, a plan fiduciary who breaches fiduciary duties under ERISA “shall be personally liable to make good to such plan any losses to the plan resulting from each such breach, and to restore to such plan any profits of such fiduciary which have been made through use of assets of the plan by the fiduciary, and shall be subject to such other equitable or remedial relief as the court may deem appropriate . . .”

In a number of contexts, a fiduciary may wish to be protected from potential claims under these rules. Further, parties who have agreed to indemnify the fiduciary, or who otherwise may be responsible for the fiduciary’s breaches, may wish to dispose of the possibility of such liability. In a typical case, a departing employee may be offered severance payments in exchange for a general release of all claims, including ERISA claims. However, as shall be seen, below, a release of claims, even if it expressly includes ERISA claims, may fail to protect ERISA fiduciaries from future ERISA claims if the release does not account for the analytical difference between individual claims and plan claims. This distinction is both particularly fine and particularly significant in the context of a participant-directed defined contribution plan. Because participants may experience differing losses depending on how they elected to direct plan investments, their losses may appear to be individual rather than plan losses. As an example, one participant in a defined contribution plan may direct his entire account to be invested in employer stock, while another participant may direct his entire account to be invested in a mutual fund that does not invest in employer stock. If the price of the employer’s stock sharply declines following these investment decisions, the first participant may sue the ERISA fiduciaries of the plan

alleging that employer stock should not have been a plan investment option.

The Supreme Court determined some time ago that Section 502(a)(2) claims, whether or not brought by participants, are claims brought on behalf of the plan, and not claims held personally by the participants. In Massachusetts Life Insurance Co. v. Russell, the Court considered whether a plan fiduciary could be held liable for extracontractual compensatory or punitive damages to a participant caused by improper or untimely processing of benefits claims. The Court held that, because Section 502(a)(2) authorized an action by a participant on behalf of a plan, an individual participant as such could not recover such damages pursuant to 502(a)(2).6

The question of whether the reasoning in Russell and its progeny applies in the case of a defined contribution plan arose in the case of LaRue v. DeWolff, Boberg & Associates. The plaintiff in LaRue claimed that ERISA fiduciaries of the plan in which he was a participant failed to follow his investment directions, causing him to suffer certain losses. The Supreme Court held that losses to individual accounts in participant-directed defined contribution plans are plan losses rather than individual losses, and that, therefore, participants could sue on behalf of the plan under Section 502(a)(2) for damages arising from such losses.

In LaRue, the issue effectively came to involve the question of whether a participant could bring a claim for what amounted to individualized – if not literally individual – relief, in light of the Russell reasoning that the claim had to be brought on behalf of the plan. While the result that a claim for a loss to an individual account under a defined contribution plan had to be somehow cognizable under ERISA may have seemed obvious to some, the rationale used in LaRue to reach that result has potential significance to the release-related questions being examined herein.

LaRue ultimately holds that, while the damages and potential remedies are individualized in nature, the claim asserted in LaRue was indeed a claim brought on behalf of the plan.Essentially, the Court held that a claim can be a claim on behalf of the plan, even if the particulars of the claim are not generic to the plan and even if the remedies might flow back to a single particular account. As the Court said, “although § 502(a)(2) does not provide a remedy for individual injuries distinct from plan injuries, that provision does authorize recovery for fiduciary breaches that impair the value of plan assets in a participant’s individual account.”

Such a Section 502(a)(2) claim seems distinguishable from claims held by the participant in the participant’s personal capacity, such as a claim for benefits under the plan. In the case of a claim for benefits, the benefits are straightforwardly and directly the participant’s own,

4 A plan fiduciary or the Secretary of Labor may also bring a claim under Section 502(a)(2). As discussed below, the possibility of other plaintiffs under Section 502(a)(2) aside from participants will have some relevance to the consideration of whether a release should be considered potentially applicable regarding ERISA fiduciary claims.

6 473 U.S. at 142.
8 The question was not entirely obvious to all, however, as illustrated by a degree of uncertainty in the lower courts (including, indeed, the circuit court in LaRue). Compare, e.g., LaRue v. DeWolff, Boberg & Assoc., 450 F.3d 570 (4th Cir. 2006), rev’d, 552 U.S. 248 (2008), with, e.g., In re Schering-Plough Corp. ERISA Litig., 420 F.3d 231 (3d Cir. 2005), later decision, 589 F.3d 585, 48 EBC 1385 (3d Cir. 2009).
9 See also Graden v. Conexant Sys., Inc., 496 F.3d 291, 295 (3d Cir. 2007).
10 552 U.S. at 256.
and the claim therefor is likewise straightforwardly and directly the participant’s. Thus, losses that may appear to be individual rather than plan-wide losses may indeed be plan and not individual losses. This distinction, however fine, is critical to the ERISA civil enforcement scheme under Section 502(a)(2), which is the provision under which participants may bring actions against plan fiduciaries for monetary damages. That is, participants may only bring actions against fiduciaries, rather than the plan itself, in their capacity as representatives of the plan seeking recovery of monetary damages on a plan-wide basis for plan-based losses rather than for the participant's individual losses.

### Speeding the Plough to a Quicker Dismissal?

#### Can ERISA Fiduciary Claims Be Contractually Barred?

Over time, a body of cases has developed in which releases have been held not to extend to claims against ERISA fiduciaries for fiduciary breaches. The prevalence of cases in which courts have declined to dismiss ERISA fiduciary claims on the basis of a general release could understandably lead one to wonder whether a release as applied to an ERISA fiduciary claim is somehow void as against public policy or otherwise invalid. However, a close examination of the case law reveals that there may not be per se a legal impediment to the application of a release, or at least of a covenant not to sue, to an ERISA fiduciary claim.

For example, in *George v. Kraft Foods Global, Inc.*, the plaintiffs sought to recover alleged losses suffered by a plan on a plan-wide basis as a result of alleged fiduciary breaches, including losses relating to fees and expenses paid by the plan that were allegedly unreasonable and excessive, not incurred solely for the benefit of the plan and its participants and undisclosed to participants. The defendants argued that a number of participants had executed releases and that those participants should not be included in the class definition.

The court rejected the defendants’ argument. However, the court’s reasoning may be telling regarding the underlying question of whether a release can bar the bringing of an ERISA fiduciary claim. In deciding the release point, the *Kraft* court stated:

We are not prepared to say that a release signed upon an employee’s termination can never waive claims brought by a class of plaintiffs on behalf of a plan. It strikes us that this is a matter by the language of the release at issue. . . . In this case, the release language cited by defendants does not purport to limit any plaintiff, including the named plaintiffs acting as class representatives, from joining a class seeking relief on behalf of the Plan. The releases address individual, not Plan, claims, and there is no evidence that the releases reflected an intent of the plaintiffs to release their right to seek Plan relief – even if that later might rebound to their benefit. General releases do not waive claims not known or contemplated by the signatory party at the time of the release . . . . Thus, we reject the attempt to include in the class definition a limitation based on the signing of releases.

As the foregoing carefully crafted language shows, the court arguably did not decide that the release in *Kraft* could not have reached the ERISA fiduciary claims at issue. Rather, the court seems to have decided that the release simply did not reach the claims that the plaintiffs were attempting to bring.

The more recent *Schering-Plough* case explores similar issues in more detail and gives further insight regarding the nuances of the applicable analysis. *Schering-Plough* is a stock-drop case in which, after a loss in value of the employer stock in the plan, participants who directed that their accounts invest in the stock sued the plan’s fiduciaries for having included employer stock as an investment option under the plan.

Following her termination of employment, and before the action was commenced, the putative lead plaintiff had signed a broad release of claims and covenant not to sue in exchange for an enhanced severance package. The separation agreement stated:

In exchange for the “enhanced” severance payment, I release the Company (which includes Schering-Plough, and all of its subsidiaries, affiliates, officers, directors, and employees) from all claims and liabilities which I have or may have against it as of the date on which I sign this Agreement . . . . Furthermore, I promise that I will not file a lawsuit against the Company in connection with any aspect of my employment or termination. I also waive the right to all remedies in any such action that may be brought on my behalf.

The court proceeded to dissect this language in the context of the ERISA fiduciary claims at issue in *Schering-Plough*. The court’s preliminary steps – steps which are critical to the questions being examined in

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11 Note that Chief Justice Roberts’ concurrence in *LaRue* specifically questions whether the claim there could not have been brought under Section 502(a)(1)(B), which relates to claims for benefits. *LaRue*, 552 U.S. at 257 (Roberts, C. J., concurring).

12 In contrast, Section 502(a)(3), which relates to claims for violations of plan terms and of Title I of ERISA, is a provision that authorizes claims by participants as such, although Section 502(a)(3) does not allow monetary damages. See, e.g., *Great-West Life & Annuity Ins. Co. v. Knudson*, 534 U.S. 204, 27 EBC 1065 (2002); see also § 502(a)(1). The question of the scope of available relief under ERISA is an extensive topic, see, e.g., Oringer, “A Regulatory Vacuum Leaves Gaping Wounds – Can Common Sense Offer a Better Way to Address the Pain of ERISA Preemption?” 26 Hofstra Labor & Empl. Law J. 409 (Spring 2009), and is beyond the scope of this article.

13 251 F.R.D. at 346-47 (citations omitted).

14 251 F.R.D. at 375-76, 589 F.3d at 591.

15 251 F.R.D. at 346-47 (citations omitted).

16 *Bowles v. Reade*, 198 F.3d 752, 23 EBC 2337 (9th Cir. 1999), and *In re Polaroid ERISA Litigation*, 240 F.R.D. 65, 34 EBC 2322 (S.D.N.Y. 2006), both pre-*LaRue* cases, hold that releases do not bar the claims there at issue. (*Bowles* in particular is often cited in support of the notion that an individual participant does not have authority to waive claims brought on behalf of an ERISA plan. See generally Thorne and Abel, “Two Years Earlier: The Legacy of *LaRue*” (45 PBD, 3/10/10; 37 BPR No. 11, 3/16/10). However, neither case expressly considers the distinction between an individual participant’s ability to release a plan’s claims, and the ability of that particular individual to agree not to bring a claim on behalf of the plan. See also *Johnson v. Couturier*, No. 2:05-CV-02046-RRB-KJM (E.D. Cal. Oct. 13, 2006), later decision, 45 EBC 2562 (E.D.Cal. 2008), mot. for stay pend’g app. denied, No. 2:05-CV-02046-RRB-KJM (E.D. Cal. Dec. 18, 2008), aff’d in part, rev’d in part, 572 F.3d 1086 (9th Cir. 2009), consent judgment, No. 2:05-CV-02732-RRB-GGH (E.D. Cal. Mar. 11, 2010).

17 See *Schering-Plough*, 589 F.3d at 591.

18 589 F.3d at 592 n.4.
this article – involved exploring (i) whether “the release and the covenant not to sue [were] void against public policy, and thus of no force,” and (ii) if not, whether the particular release and covenant not to sue in Schering-Plough would “bar [the plaintiff] from being able to maintain an action under ERISA § 502(a)(2).”

The court’s exploration of the first of these two questions, whether the release and covenant not to sue were void as against public policy and thus of no force, focused on Section 410(a). Section 410(a) states that “any provision in an agreement or instrument which purports to relieve a fiduciary from responsibility or liability for any responsibility, obligation, or duty under this part shall be void as against public policy.”

The court squarely rejected the contention that Section 410(a) renders a release and covenant not to sue of no force or effect as to ERISA fiduciary claims. The court stated that Section 410 “applies only to instruments that purport to alter a fiduciary’s statutory duties and responsibilities, whereas an individual release or covenant not to sue merely settles an individual dispute without altering a fiduciary’s statutory duties and responsibilities.” The court agreed with the notion that “a release does not relieve a fiduciary of any responsibility, obligation, or duty imposed by ERISA; instead, it merely settles an individual dispute that the fiduciary did not fulfill its responsibility or duty on a given occasion.”

The court went on to explain that Section 410 extends “only to contractual or other devices that purport to alter the statutory obligations of a fiduciary under ERISA, and [does not . . . reach] a release of claims signed by an individual claiming the breach of a fiduciary duty.” The court in effect drew a distinction between the proscribed exculpation of a fiduciary for breaches, on the one hand, and an individual participant’s contractual choice to waive (or not to pursue) a claim, on the other.

Stated another way, the party with the Section 502(a)(2) claim is the plan, and the Schering-Plough release in no way purported to exculpate the plan’s fiduciaries on behalf of the plan. Indeed, it is arguably the case, and arguably should be the case, that individuals cannot cause the plan as a whole to waive its fiduciary claims, with effect for all plan participants.

The question being considered here, though, is not whether an individual can waive a plan’s claims, but, rather, whether one or more individual participants may simply agree by contract not to cause the plan to bring those claims. And, as Schering-Plough indicates, why shouldn’t particular participants be free to enter into such a contractual agreement? Allowing an individual participant to waive his or her right to bring an action on behalf of the plan respects the individual’s right to contract, while also serving an important function that could redound to the participant’s own benefit. As stated by the court in Schering-Plough, “Otherwise, individuals could never amicably resolve litigation over these issues.”

Were ERISA Fiduciary Claims Contractually Barred?

Having concluded that Section 410(a) did not render the plaintiff’s individual release and covenant not to sue void against public policy, the Schering-Plough court went on to consider the effect of the particular release in Schering-Plough as applied to the fiduciary claims being asserted. At this point, the inquiry essentially became an analysis of the contractual terms of the release.
to see whether or not the action being brought was contractually barred.\textsuperscript{27}

The court appropriately highlighted that the type of claims asserted in \textit{Schering-Plough} were, “by their nature, plan claims,”\textsuperscript{28} and that the complaint framed the “cause of action in terms of claims brought `on behalf of’ the Plan. Nowhere does [the plaintiff] present the claims as anything but causes of action that belong to the Plan and are based on duties owed to the Plan.”\textsuperscript{29}

Indeed, as discussed above, an individual participant’s release arguably could not have validly released the plan’s claims, regardless of how it was drafted, because a Section 502(a)(2) claim seems not to be the participant’s to release.

So, even if the participant executes a release of all of the participant’s claims, a seemingly broad release may well not result in the participant’s having given the very agreement that the employer needs regarding fiduciary claims – the agreement not to cause the plan to pursue the plan’s claims.\textsuperscript{30} Thus, in \textit{Schering-Plough}, the court held that “[the plaintiff’s] release does not bar her from bringing the § 502(a)(2) claim on behalf of the Plan.”\textsuperscript{31}

\section*{How Could ERISA Fiduciary Claims Be Contractually Barred?}

But what of the covenant not to sue? As discussed below, the court’s holding regarding the release was not the end of the inquiry. Indicating the court’s willingness to enforce the contract as written and effectuate the parties’ mutual intent, the court in \textit{Schering-Plough} conferred on the defendants a not-so-insubstantial consolation prize, querying whether the plaintiff could serve as a class representative or retain the benefits of any recovery from the lawsuit.

The court’s inquiry regarding this point focused largely on the typicality requirement applicable where an individual seeks to act as a class representative. The typicality requirement is that “the claims or defenses of the representative parties are typical of the claims or defenses of the class.”\textsuperscript{32}

Regarding typicality, the court appears to have proceeded consistently with its determination discussed above that the plaintiff’s release and covenant not to sue were not insufficient as a matter of law. The court’s discussion of the typicality requirement strongly suggests that the release and covenant not to sue could indeed have barred those claims, depending on a number of factual details. The court stated:

First, … [the plaintiff] signed a Separation Agreement that included a general release and a covenant not to sue. As a result, she may be subject to unique defenses that could become a focus of the litigation, rendering her atypical and making class certification inappropriate. For instance, even if a release does not bar an individual from bringing an ERISA § 502(a)(2) claim on behalf of a plan, it could be argued that the covenant not to sue bars [the plaintiff] from filing a lawsuit and serving as a lead plaintiff in an action against \textit{Schering-Plough}. Second, it could be argued that because of this release and covenant not to sue, [the plaintiff’s] interests and incentives may not be sufficiently aligned with those of the class. Given her release, [the plaintiff] may not have a monetary stake in the outcome.”\textsuperscript{33}

The court also addressed the final class-certification prerequisite, which is that “the representative parties will fairly and adequately protect the interests of the class.”\textsuperscript{34} It has been stated that one component of the adequacy inquiry involves “uncover[ing] conflicts of interest between named parties and the class they seek to represent.”\textsuperscript{35} The court noted that many of the same questions regarding the plaintiff’s typicality also raised issues as to her adequacy as a class representative.

27 Courts have indicated a willingness to parse contractual release language and enforce terms as written. In \textit{Loomis v. Exelon}, 41 EBC 1150 (N.D. Ill. 2007), later decision, 48 EBC 1184 (N.D. Ill. 2009) the court allowed a class to be certified where some class members signed releases because the releases did not explicitly waive claims that were unknown at the time of signing. In \textit{Howell v. Motorola, Inc.}, 35 EBC 2708 (N.D. Ill. 2005), the court upheld a release of all rights to sue for liabilities that arose or could have arisen on or prior to the date the release was signed. In \textit{Laurenzano v. Blue Cross & Blue Shield of Mass. Ret. Inc. Trust}, 191 F. Supp. 2d 223 (D. Mass. 2002), the court held that a release of claims against the employer, but not claims that arise under the plan, did not effectively release ERISA claims. In \textit{Amara v. CIGNA Corp.}, 534 F. Supp. 2d 288 (D. Conn. 2008), the court held that a defendant’s waiver, which included an exception for claims under its retirement plan, was not specific enough to limit the plaintiffs’ claims under ERISA. While recognizing that “employees can release claims of statutory ERISA violations in return for severance benefits,” 534 F. Supp. at 314, the Amara court noted that there should be closer scrutiny where the waiver involves pension benefits under ERISA, and determined that the defendant did not meet this higher standard and that the court would not rewrite the release. See also \textit{In re ADC Telecommunications ERISA Litig.}, 35 EBC 2473 (D. Minn. 2005) (raising issues as to her adequacy as a class representative). The court stated:

28 589 F.3d at 594 (citation omitted).
29 589 F.3d at 594; see also \textit{In re JDS Uniphase Corp. ERISA Litig.}, Master File No. 03-04743 WWS (N.D. Cal. Sept. 11, 2006) (stating that the release was on behalf of the participant’s claims, not the plan’s claims), sum. judg. denied, Master File No. 03-04743 WWS (N.D. Cal. Apr. 24, 2007). If one assumes that the parties’ interest is that the releasor will not proceed against the company’s interests, then, in such a case, the court’s task, it is submitted here, is to identify the scope of the claims being contractually foregone, and, in the absence of countervailing policy considerations, to proceed accordingly.
30 589 F.3d at 595 (citation omitted).
32 589 F.3d at 599-600 (footnote omitted).
Again focusing on the particulars of the release and covenant not to sue in *Schering-Plough*, the court stated:

For example, if some or most members of the class do not have releases or covenants not to sue, then [the plaintiff in *Schering-Plough*] may be subject to a unique defense. If [the plaintiff’s] release is held to bar her recovery in the form of individualized augmented benefits, she may lack the same financial stake as the other members of the class. Also, [the plaintiff] may have different incentives in terms of how much time, energy, and money she is willing to spend pursuing the claim.36

The court remanded, declining to decide the typicality issue and directing the district court to conduct a “‘more rigorous analysis’ into the effect of [the plaintiff’s] release and covenant not to sue and the extent to which other members of the class have signed similar agreements.”37 As to adequacy, the court directed the lower court to “give further consideration to the interests of the members of the class, and the impact of the release and covenant not to sue, as bearing on [the plaintiff’s] ability to be an adequate class representative.”38

In finding this middle ground, the court may well have gone down a path that could be quite acceptable to the defendant. If the putative class representative cannot proceed with the class action, then the case may be dismissed without deciding whether the putative representative could have prevailed in asserting that the release and covenant not to sue did not in fact bar the claim.39 But the relevance of the court’s reasoning to the inquiry being undertaken here is in the indication that certain drafting approaches to a covenant not to sue could more directly act as an absolute bar to having, as well as to bringing, a claim.40

36 589 F.3d at 602 (citation omitted).
37 589 F.3d at 600 (footnote omitted).
38 589 F.3d at 602.
39 See, e.g., *J.H. Cohn & Co. v. Amer. Appraisal Assoc.*, 628 F.2d 994, 999 (7th Cir. 1980) (“[T]he presence of even an arguable defense peculiar to the named plaintiff or a small subset of the plaintiff class may destroy the required typicality of the class . . . . The fear is that the named plaintiff will become distracted by the presence of a possible defense applicable only to him so that the representation of the rest of the class will suffer.” (citations omitted)); see also *In re Bell S. Corp. ERISA Litig.*, 1:02-CV-2440-JOF (N.D. Ga. Sept. 30, 2005) (holding that a class could not be certified because named plaintiffs who signed releases were inadequate representatives of the class, which included those who did not sign releases, stating that releasor lead plaintiffs “clearly cannot bring claims on behalf of the class with the same vigor and interest as someone who had not signed such releases”).
40 Focusing on typicality rather than the underlying viability of the claim in light of the contract can have interesting ramifications. For example, in *Melong v. Micronesian Claims Comm’n*, 643 F.2d 10 (D.C. Cir. 1980), the court refused to certify a class where the class representatives themselves had not signed releases, but most class members had. See also *In re Aguila ERISA Litig.*, 237 F.R.D. 202, 210-11 (W.D. Mo. 2006) (certifying a class containing a mix of releasors and nonreleasors, but stating that nonreleasors could be decertified as class members following further litigation), later decision, No. 04-00865-CV-DW (W.D. Mo. Nov. 27, 2006); *In re Williams Cos. ERISA Litig.*, 231 F.R.D. 416, 423 (N.D. Okla. 2005) (noting that a mixed releasor and nonreleasor class was “trouble-some” but not “disqualifying to class certification” and addressing the issue in part by appointing a releasor to join the nonreleasor lead plaintiffs).

In this regard, it is submitted here that, if the covenant not to sue in *Schering-Plough* had been sufficiently clear, the court’s rationale could have led it to hold not only that the putative representative may have failed to satisfy the typicality and adequacy requirements for acting as a class representative, but also that the plaintiff was entirely foreclosed by contract from proceeding with the claim.41 For example, consider if the covenant not to sue had included a provision along the following lines: “I expressly (i) agree not to be a class representative or be part of a class regarding any action under ERISA, or otherwise to bring an action under ERISA on behalf of a plan or trust for relief such plan or trust under ERISA, and (ii) to the extent permitted by law, agree not to retain the benefits of any decision, judgment or settlement in any such action.” Given the court’s reasoning that releases of Section 502(a)(2) claims are not void as against public policy, and that a covenant not to sue could serve as an impediment to retaining proceeds in a prevailing lawsuit or bringing a claim altogether, one may reasonably wonder how broadly a court would apply such a provision.42

Illustrating the potential importance of the reach of a release or covenant not to sue in the context of class actions that a terminating employee may thereafter seek to bring, the *Schering-Plough* court noted that the individual seeking to bring the class action “is now the sole representative of the class, and she signed a Separation Agreement with Schering-Plough that includes both a release and a covenant not to sue.”43 Thus, if the release and covenant not to sue would bar the plaintiff’s claim, or otherwise stop the plaintiff from acting as a class representative, the entire class action could be jeopardized. With the Holy Grail for the defendants being the early-stage dismissal of a lawsuit that could have resulted in extensive dislocation, expense, and li-

41 A litigant’s likelihood of success in defending against a class action would seem more absolute and certain where the court would respect and enforce a plaintiff’s agreement not to bring the lawsuit, rather than where there the court focuses on a more amorphous cloud over the appropriateness of the putative representative to serve as a named plaintiff. Cf. *Langbecker v. Electronic Data Systems Corp.*, 476 F.3d 299, 313, 39 EBC 2352 (5th Cir. 2007) (questioning whether a mixed class could meet class certification requirements, and arguably implying that a release could bar the bringing of Section 502(a)(2) claims).
42 At first blush, it might appear that a provision such as the one in text above could raise issues regarding the coordination of the provision with other provisions in the release that may relate, for example, to preservation of claims under an ERISA plan which are made in the ordinary course for benefits in accordance with the terms of the plan. Some coordination of the covenant not to sue with the release of the participant’s own claims may be appropriate, as the covenant not to sue will not generally be intended to foreclose the participant’s claims for ordinary-course benefits. However, this coordination may be facilitated by the fact that, as indicated above, the kinds of fiduciary claims which are the focus of this article are claims brought by the participant on behalf of the plan, while the kinds of ordinary-course claims that one might expect to be preserved are the participant’s own claims for plan benefits. This distinction may make it less difficult to distinguish in the contract between the kinds of eventful individual claims that are sometimes sought to be preserved, and extraordinary claims on behalf of a plan for breaches of fiduciary duty which might be more likely to be expected to be waived.
ability, a covenant not to sue that actually forecloses the lawsuit could loom large indeed.

**Conclusion**

LaRue-type reasoning, with its emphasis on Section 502(a)(2) fiduciary claims as being those of a plan, even if brought by a participant, appears to have led a number of courts to decline to conclude that general releases of individual claims necessarily reach such claims. However, that state of affairs may be the beginning, not the end, of the inquiry regarding whether a release and covenant not to sue can possibly foreclose Section 502(a)(2) fiduciary claims.

The practical importance to particular litigants in a fiduciary class action of the scope of a release and covenant not to sue may be on the plaintiff’s ability to continue a fiduciary claim. If the plaintiffs are held to be ineligible to serve as class representatives, that result may be sufficient for the defendant.

However, the details of the courts’ analyses may have broader implications for the question of whether and how a release and covenant not to sue can more fundamentally block the claim itself. Clearly, a defendant would prefer to be in the position of being able to prevail in the defense that the plaintiffs’ claims are altogether barred, as opposed to in the more nuanced defense that the plaintiffs, even if they have live claims, are nevertheless inappropriate class representatives.

What does seem to be emerging is the notion that, if there will be a contractual bar to the bringing of an ERISA fiduciary claim, the bar might not emanate from a basic release, regardless of how broad, of the individual’s own claims.

The Section 502(a)(2) fiduciary claim, conversely, would appear to be the plan’s, and the inquiry therefore turns to whether the bringing of the plan’s claim by particular individuals can be foreclosed and, if so, how. If ERISA does not supply a policy ground for invalidating a participant’s release and covenant not to sue in the context of bringing a plan’s fiduciary claim, as some courts have indicated, then it becomes unclear why a covenant of adequate scope should fail to block the participant’s bringing of the claim. With the issue viewed in this light, the LaRue-type characterization of the claim as being a claim on behalf of the plan thus becomes an element of the inquiry of what a covenant not to sue would need to contain in order to reach and block an ERISA fiduciary claim, not a basis for concluding that a release and covenant not to sue cannot reach the claim.

Thus, to the extent that an individual can waive his or her own ERISA claims, it might be expected that one can also agree not to cause a plan to bring the plan’s claims. Where any particular individual has indeed so agreed, the plan may simply have to wait for some other aggrieved party to make its case. In this way, the covenant not to sue essentially acts in the same way as a customary release might be expected to act in a non-LaRue setting.

It is submitted here that such a result should not be viewed as inconsistent with ERISA, if ERISA is not viewed as requiring the preservation for each and every participant of the right to cause a plan to pursue its claims. Arguably, a seminal idea behind the procuring of a general release, and the paying of consideration for the same, is that the released party is free of litigation from or instituted by the releasor. The payor of consideration – for example, an employer – does not want to make the payment only to turn around and see the payee in court asking for more. If the proposed payee – for example, the employee - wants to retain possible claims, then so be it; as is the case generally, the employee is then free not to take the consideration from the employer, or to try to negotiate a more limited release. If one accepts the premise that the policies informing ERISA are not contravened by giving effect to an agreement not to bring future ERISA litigation, then this result may indeed not be troubling in the least.