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Early Returns on Actuarial Equivalence Cases

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Many employers have been keeping a close eye on a recent set of lawsuits challenging the methodology defined benefit plan administrators use to calculate alternative forms of payments. These various lawsuits have as a common theme, a challenge to the particular method used to determine the amounts of optional forms of benefits paid in place of a single life annuity (*e.g.*, forms of payment that include surviving spouse benefits, or lump sum payments). The plaintiffs in these cases contend that the calculation methodology employed, which is typically prescribed by plan documents, results in inappropriately low benefit payments, typically because mortality tables used in the calculation are alleged to be outdated.

These lawsuits have gotten employers' attention by focusing on a part of the benefits calculation process that, until now, has been largely uncontested, but that impacts the amount of benefits paid to large swaths of employees. Although the challenged calculation may have a small impact on the size of any one participant's benefit payments, across the entire participant population of a large plan over an extended period, it has the potential to materially increase the total dollar amount of plan benefits – which seems to be what the plaintiffs' attorneys bringing these lawsuits are counting on.

In the first two decisions on motions to dismiss these lawsuits, federal district courts for the District of Minnesota and the Northern District of Texas have concluded that two different sets of claims are sufficient to survive past the pleadings stage.[1] These rulings all but guarantee that more similar complaints will be filed. Worse, from the employers'

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perspective, they provide no guidance about how employers might avoid being targeted in similar cases.

Smith v. U.S. Bancorp

At issue in *Smith*, U.S. Bancorp's pension plan provides that participants who elected to commence pension benefits before age 65 had their monthly benefit reduced by an early commencement factor that was set forth in the governing plan documents.[2] The plaintiffs allege that those factors "result in benefits that are not actuarially equivalent to the retirement benefit they would have received at age 65," in violation of ERISA.[3] "Simply put, Plaintiffs argue that Defendants are paying retirees who retire before the age of 65 an unreasonably low percentage of their annuity benefit based on unreasonable actuarial calculations."[4] Based on these allegations, plaintiffs asserted claims under ERISA to enforce 29 U.S.C. § 1054(c)(3), which requires actuarial equivalence, and alleged that the plan's fiduciaries breached their duties by applying the early commencement factors set forth in the plan documents.[5] Plaintiffs also argued that the calculation violated ERISA's anti-forfeiture provision.[6] In so doing, plaintiffs referenced tax code and Treasury regulation provisions.

In their motion to dismiss, defendants argued that no private right of action existed for plaintiffs' claims, that ERISA does not impose a reasonableness standard on the actuarial equivalence calculation, that plaintiffs' breach of fiduciary duty claim was insufficiently pled, and that plaintiffs' claims were time-barred.[7] The district court rejected each of these arguments, and held that, although the referenced tax code and Treasury regulations may not provide a private right of action, ERISA does. With respect to plaintiffs' other arguments, the district court held that plaintiffs had pled enough to state a plausible claim. Specifically, the court held that although ERISA does not impose a "reasonableness" standard, it nevertheless requires actuarial equivalence, and that plaintiffs had pled enough to allege that U.S. Bancorp had failed to meet that requirement.

Torres v. American Airlines, Inc.

The *Torres* plaintiffs' claims are similar to the *Smith* plaintiffs', with an additional challenge to the interest rates used to calculate joint and survivor annuities under the American Airlines pension plan as outdated.[8] In that case, the defendants argued that the plans complied with ERISA's statutory and regulatory provisions, and used a mortality table that was reasonable as a matter of law because Treasury regulations designate it as a standard mortality table.[9] It appears that, unlike the *Smith* defendants, the *Torres* defendants did not dispute that they were legally required to make a "reasonable" calculation of actuarial equivalence.[10]

The district court rejected defendants' argument, holding that the Treasury regulation to which they referred applied to analysis of the nondiscrimination requirements of the tax code, rather than to ERISA's actuarial equivalence requirement.[11] It therefore concluded that plaintiffs had stated claims for violations of ERISA's actuarial equivalence and anti-forfeiture requirements. It also noted that the defendants had not specifically addressed plaintiffs' breach of fiduciary duty argument, and concluded that plaintiffs had stated that claim as well.[12] Finally, like the *Smith* court, the *Torres* court concluded plaintiffs had stated a claim for violation of ERISA's anti-forfeiture provisions.[13]

Challenges for Defendants

Both decisions spotlight the challenges posed to defendants by the pleading standard that plaintiffs in federal court must meet in order to defeat a motion to dismiss. As both district courts noted, that standard is "facial plausibility," meaning that the plaintiff must only plead "factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged."[14]

That standard, however, is often ill-fitting when applied to ERISA plan sponsors and fiduciaries. Notwithstanding the Supreme Court's much-quoted observation that ERISA is a "comprehensive and reticulated statute,"[15] as a practical matter and by design, it leaves many important decisions up to plan sponsors and fiduciaries. Implicit in ERISA's fiduciary structure is the notion that, in the context of decisions about how to provide entirely voluntary benefits to their employees, employers ought to be given wide latitude in making decisions, so long as they use a framework that is fundamentally fair to employees.

How to calculate benefits is near the top of the list of decisions largely left up to employers. Even where ERISA appears, at first glance, to be relatively specific – here, by requiring the definite-sounding "actuarial equivalence" – in many cases, all of the details are left up to plan sponsors and administrators. And in this case, even the reams of regulations attendant to ERISA do not provide explicit direction about how employers should measure whether their approach complies with ERISA. Structurally, ERISA seeks to fill this gap by imposing fiduciary responsibility on plan administrators, who are given wide latitude to make decisions that is tempered by the serious obligations imposed by their fiduciary status.

These two district court decisions illustrate the way in which courts appear to be hesitant, at the pleading stage, to give plan fiduciaries the benefit of the doubt when it comes to these decisions. That hesitation gives employers a distinct and difficult to untangle conundrum regarding what to do about actuarial equivalence calculations, and similar administrative items, going forward.

Challenges for Plan Sponsors

These decisions also reflect that ERISA is coming of age as a statute, and that plan design decisions made shortly after it was enacted in 1974 may need to be revisited to ensure they remain appropriate for the modern era, and in particular, the litigation climate that currently prevails. But changing actuarial equivalence calculations poses a significant challenge for employers that, if overlaid against the general trend away from defined benefit plans in favor of defined contribution plans, has the potential to be a net negative, in the long term, for employees as well. If these lawsuits require employers to recalculate the cost of continuing to offer defined benefit plans upward, they may well push even more employers toward freezing and eliminating those plans in favor of the administratively simpler defined contribution model. That move, in turn, subjects employees not only to the risks of investment markets, but also to the day-to-day challenge of finding sufficient funds to save for retirement on an ongoing basis. Minimizing or eliminating that challenge is one of the primary benefits defined benefit plans offer to employees.

These lawsuits also fail to offer employers any sort of safe harbor alternative, because it remains entirely unclear what type of approach to actuarial equivalence is safe from a challenge through litigation. A midstream change in calculation methodology, besides being extremely complex logistically, may be just as likely to draw a lawsuit as to avoid one.

Conclusion

Of course, whether any of these challenges will be able to make it past the summary judgment stage remains to be seen. Until then, however, we expect to hear more about actuarial equivalence litigation and the challenges it poses to plan sponsors offering defined benefit plans.

Notes

1. Smith v. U.S. Bancorp., Case No. 18-cv-3405, 2019 WL 2644204 (D. Minn. June 27, 2019); Torres v. American Airlines, Inc., Case No. 18-cv-983 (N.D. Tex. August 7, 2019) (slip opinion at Dkt. 31).

2. *Smith*, 2019 WL 2644204, at *1.

3. *Id*.

4. *Id*.

5. *Id*. at *2-*4.

6. *Id*. at *3-*4.

7. *Id.* at *1.

8. *Torres*, No. 18-cv-983, at 6.

9. *Id.* at 7.

10. *See, e.g.*, *id.* at 12 ("Defendants do not dispute that they are required to use 'reasonable' actuarial assumptions for their actuarial equivalence calculation.").

11. *Id.*

12. *Id* at 16.

13. *Id.* at 15-16.

14. *Id.* at 8 (quoting Ashcroft v. Iqbal, 556 U.S. 662, 678 (2009); *Smith*, 2019 WL 2644204, at *1 (same).

15. Mertens v. Hewitt Associates, 508 U.S. 248, 251 (1993).