

# Ethical Considerations

Understanding the limitations with which advisers operate



Professionals who advise defined benefit (DB) plans must adhere to the ethical codes of their professions, such as the American Bar Association (ABA)'s Model Rules of Professional Conduct, as adopted by each state, for legal counsel and the Code of Professional Conduct promulgated by the American Academy of Actuaries for actuaries. Plan sponsors should be aware of the limitations under which these advisers operate and adjust their expectations for the service to be provided.

**Q:** In what situations are ethical problems likely to arise?

**A:** Ethical matters crop up in a wide variety of scenarios and much more frequently than you would think. Most people are aware there is an attorney-client privilege that relates to lawyers and that this gives rise to the expectation that information imparted to a lawyer is confidential. We also know that a lawyer-client relationship should be free of conflicts of interest. Because the interests of the plan sponsor and the plan may diverge, it is important for employers to understand those situations in which a lawyer represents the employer and those where the plan is the client.

Now let's consider the example of a significantly underfunded multi-employer plan whose funding needs to be dramatically increased. The plan's trustees are appointed by both labor and management; co-counsel for the plan, who also represents a contributing employer, is asked by this employer for advice on withdrawing from the plan. ABA Rule 1.7 provides that, generally, a lawyer may not represent a client if this will involve a concurrent conflict of interest. Such a situation exists if one of two conditions is met: 1) the

representation of one client will be directly adverse to another client, or 2) there is a significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client.

Dual representation is permitted where the lawyer reasonably believes he or she will be able to provide competent and diligent representation to each client—e.g.,

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the employer and the plan—and where certain other conditions are satisfied, including that each client give informed consent in writing. Even assuming this consent were obtained from the plan's labor trustees, however, dual representation may not be undertaken if there is a significant risk that the lawyer's ability to consider, recommend or carry out an appropriate course of action for a client will be materially limited as a result of the lawyer's other responsibilities or interests.

As a result, the attorney may not render advice on how to reduce the employer's plan withdrawal liability, as this would be detrimental to the plan. By the same token, the attorney may not advise the plan on how to maximize withdrawal liability.

**Q: Can you give an example of an ethical dilemma faced by a plan actuary?**

**A:** Consider another underfunded pension plan. In this case, the plan is sponsored by a corporate subsidiary being acquired in a transaction where buyer and seller are represented, respectively, by two large actuarial firms. The actuarial issue is the magnitude of the plan's underfunding, as it will reduce the purchase price.

The buyer's team determines that underfunding is \$20 million lower than the seller's team believes. Recognizing that it is getting a bargain, the buyer instructs its team to run with the numbers determined by the seller's team but then discovers the disparity was caused by a programming error in the calculation of a grandfathered benefit. Fixing this mathematical mistake would eliminate the buyer's advantage.

Different actuarial teams represent the old and new plan sponsors, but there may be other issues at stake, even though the plan is not a client.

The seller's team has made a mistake that appears to violate the competence requirement of Precept 1 of the actuaries' Code of Professional Conduct. Annotation 1-1 under this precept states: "An Actuary shall perform Actuarial Services with skill and care," and the programming error likely constitutes a breach of this duty by the seller's actuary.

A lawyer must be truthful but has no affirmative duty to inform an opposing party of relevant facts. The actuaries' code, however, creates a duty to uphold the reputation of the actuarial profession. Therefore, if the buyer's actuarial team obeys the buyer's instruction not to correct

the error made by the other side, this may also violate another mandate of Precept 1, specifically that an actuary should act in all matters with honesty and integrity.

The duty to disclose the mistake may be reinforced by Precept 8 of the actuaries' code, which indicates that an actuary should take reasonable steps to ensure that actuarial services are not used to mislead other parties. In addition, Annotation 8-1 includes an admonition to present actuarial communications clearly and fairly. Precept 8 seems to place limits on taking an all-out adversarial stance on behalf of the actuaries' respective clients.

Precept 13 of the actuaries' code provides additional guidance for determining what to do in this situation. This precept provides that, where an actuary has knowledge of an unresolved, material violation of the code of conduct by another actuary, the first actuary should discuss the situation with the second and attempt to resolve the apparent violation. (I have heard this described as the "If you see something, say something" rule.)

Here, the calculations of the seller's team seem to have violated the skill and care requirements of Precept 1. Precept 13 does not absolutely require the seller's actuaries to address the error with the buyer's actuaries. For example, an actuary is not expected to discuss a violation with another actuary if doing so would be prohibited by law or the actuary is acting, as here, in an adversarial environment. But if no discussion of the mistake occurs, the matter must be disclosed to the Actuarial Board for Counseling and Discipline. This reporting mechanism is the way the actuarial profession polices itself.

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**Marcia Wagner** is a specialist in pension and employee benefits law, and is the principal and founder of The Wagner Law Group, one of the nation's largest boutique law firms specializing in the Employee Retirement Income Security Act (ERISA), employee benefits and executive compensation. A summa cum laude and Phi Beta Kappa graduate of Cornell University and a graduate of Harvard Law School, she has practiced law for more than 28 years, 19 with her own firm. She is recognized as an expert in a variety of employee matters, including qualified and nonqualified retirement plans, fiduciary issues, all forms of deferred compensation, and welfare benefit arrangements.