

LEGAL UPDATE

Whither Float?

Marcia S. Wagner, Esq.

Having recently passed the 40th anniversary of ERISA's enactment, it is surprising that certain basic questions have yet to be resolved. Two such questions are whether 401(k) funds awaiting disbursement to participants are plan assets and to whom does the interest on these funds belong.

DOL Float Guidance. In ERISA Advisory Opinion 93-24A, the DOL rejected the assertion that once a check is written to a participant corresponding to the liquidation of plan benefits, the plan funds transferred to a bank administrative account cease to be plan assets. As a result, receipt by a plan fiduciary related to the bank of income from the so-called "float" on benefit checks under a repurchase agreement with the bank was potentially a prohibited transaction. Nearly a decade later, the DOL followed up on this issue with Field Assistance Bulletin 2002-3 warning that plan fiduciaries had a duty to evaluate float to ensure that the overall compensation of a plan service provider receiving it is reasonable. Accordingly, it was something of a surprise when last year's Eighth Circuit Court of Appeals decision in *Tussey v. ABB* reversed a lower court verdict that Fidelity Investments breached its fiduciary duties by failing to pay float income to the ABB plan.

Disbursement Procedure. Fidelity's process for liquidating a plan's mutual fund investment was to move funds from the investment to a redemption account maintained with a bank from which funds were withdrawn for the benefit of participants who elected to be paid by electronic funds transfer. For participants not electing electronic disbursement, funds were transferred to a disbursement account which issued a check to the participant. Interest on these funds while they were in the

redemption or disbursement accounts (the registered owner of which was the investment option, not the plan) was either used by Fidelity to pay for banking services or allocated to the investment option. The Eighth Circuit held that the float on the redemption and disbursement accounts was not a plan asset because the participant plaintiffs were unable to point to any evidence in the record that the ABB plan, as opposed to the investment options, owned the funds in the account.

Float on Funds Awaiting Distribution. The same float issue, also involving Fidelity Investments, was raised again in a recent decision by the Massachusetts federal district court in *In re Fidelity ERISA Float Litigation*, a consolidation of four cases, all of which were dismissed because the redemption and disbursement accounts were held not to hold plan assets. The new ruling, which relied on *ABB v. Tussey*, as well as First Circuit Court of Appeals precedent involving welfare benefits, potentially could undermine fiduciary obligations relating to plan distributions.

The plaintiffs in the new float case alleged that Fidelity "owned and controlled" the bank accounts that funded disbursement checks, but that the plans were the "beneficial owners" of the accounts. This argument was based on the fact that the cash proceeds that funded the redemption and disbursement accounts were generated by the sale of mutual fund shares owned by the plans.

Effect of Retained Asset Account Cases. The beneficial ownership argument was rejected, however, based on the court's analysis of what constitutes plan assets. For this purpose, the court relied on First Circuit cases concerning when assets held in an insurance company's general account become the assets of a welfare plan. This body of case law involves so-called

retained asset accounts which are unfunded accounts established by an insurance company with a third party from which the beneficiary of a life insurance policy can withdraw policy death benefits. The insurer credits these accounts with the death benefit and interest at a minimal rate, but the actual funds remain in the insurer's general account where they generally earn more than the interest credited to the retained asset account. The earnings in the general account are retained by the insurer, and plaintiffs have argued, generally unsuccessfully, that this is a fiduciary breach that should be remedied by disgorgement of the insurer's profits. For the plaintiffs to be successful in these cases, they must show either that the assets held by the insurers are plan assets or that the insurers themselves are plan fiduciaries by virtue of their control over plan assets or their role in plan administration.

The First Circuit has held on at least two occasions that the general account assets of insurers that have established retained asset accounts are not plan assets. Further, it has held that the insurance companies fulfill their fiduciary duties by setting up the retained asset account and, thereafter, the relationship between an insurer and a life insurance beneficiary is only that of debtor and creditor. In other words, it is not a fiduciary relationship, and once the retained asset account is established, fiduciary responsibility ceases. Appellate courts in the Second and Third Circuits have issued similar rulings. Applying these principles to the retirement plan in the case at hand, the district court in the new *Fidelity* case concluded that Fidelity's fiduciary duties were discharged once assets were withdrawn from a plan and the redemption and disbursement accounts set up. Further, absent documentary evidence showing that these accounts were plan assets, the DOL's float guidance was held to be inapplicable.

DOL Position. Although the DOL filed an amicus brief in the *ABB* case, the brief did not address the float issue.

Moreover, in a 2011 amicus letter brief filed in one of the retained asset account cases, the DOL agreed that there were no plan assets after a retained asset account was created. However, the 2011 brief made a distinction between welfare plans and retirement plans, such as a 401(k) plan, noting that "ERISA imposes fewer constraints on a welfare plan's authority to structure and define the benefits that the plan provides and the means by which they will be distributed."

While both welfare and pension plans can fulfill their obligations by giving participants a set of rights against a financial institution rather than conveying title to the institution's underlying assets, in the pension context this process is regulated heavily. An example of this is the DOL rule that prevents taking retirement benefit protections away from a participant until those benefits have been guaranteed by a licensed insurance company selected pursuant to a process compliant with fiduciary standards. It is likely then that the notion that a fiduciary's obligations cease once funds are deposited in a distribution account will be contested vigorously by the DOL.

Going Forward. It is perhaps inevitable that financial institutions will strive to capture float while shedding fiduciary responsibility for their actions. Whether or not float generated by funds awaiting disbursement is treated as a plan asset, plan sponsors and their advisors should be aware that this float will continue to be viewed as a component of a service provider's compensation. Accordingly, plan sponsors always will have a duty to ensure that this compensation, including float, does not exceed reasonable levels.

Marcia S. Wagner is the Managing Director of The Wagner Law Group. She can be reached at 617-357-5200 or Marcia@WagnerLawGroup.com.