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DB suits claim companies use faulty data to figure benefits

By: Robert Steyer
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Nancy Ross said the suits touch on an 'unexplored area' of the law.

In rapid-fire succession, participants in corporate defined benefit plans at four companies have sued fiduciaries for short-changing them by using out-of-date mortality tables and/or inaccurate methods to calculate certain types of benefits.

The lawsuits' general theme is that the plan executives used improper formulas for calculating alternate benefits, such as joint and survivor annuities or early retirement benefits. These alternate benefits aren't "actuarially equivalent" to each retiree's pension benefit, thus violating plan executives' fiduciary duties under the Employee Retirement Income Security Act, the participants allege.

For some ERISA attorneys who represent plan sponsors, the lawsuits could signal the first volley in a new approach to ERISA litigation.

"This a relatively unexplored area of law," said Nancy Ross, a Chicago-based partner for Mayer Brown LLP, who declined to discuss specific lawsuits and whose firm isn't involved in the cases. "I fear we are entering into expert-laden disputes."

"The similarities in the complaints — and the fact that the same two law firms filed all of the complaints — suggest that additional lawsuits against other large pension plan sponsors may soon follow," said a recent report by The Groom Law Group, Washington. The firm represents one of the defendants, whose name wasn't disclosed.

The lawsuits were filed in early to mid-December against Metropolitan Life Insurance Co., New York; American Airlines Inc., Dallas; PepsiCo Inc., Purchase, N.Y.; and U.S. Bancorp, Minneapolis. All plaintiffs are seeking class-action status.

Companies' representatives declined to comment or didn't respond to a request for comment. Plaintiffs' attorneys Gregory Porter and Mark Boyko, partners at Bailey & Glasser LLP, Washington, didn't respond to a request for comment. Plaintiffs' attorney Robert Izard, a partner at Izard, Kindall & Raabe LLP, West Hartford, Conn., declined to comment.

Ms. Ross and ERISA attorney Marcia Wagner, whose firm doesn't represent companies in these cases, said the lawsuits fall into certain gray areas for DB plan sponsors' responsibilities in calculating certain benefits.

The frequency with which mortality tables must be updated "is an open question," said Ms. Wagner, founder and managing partner of The Wagner Law Group, Boston, who declined to discuss specific cases.

"Even the IRS has not updated its life expectancy tables for purposes of required minimum distributions, based upon a 2000 mortality table, since 2002," Ms. Wagner said.

"Even if a plan's mortality assumptions are outdated and needed to be updated, there is no requirement under either ERISA or the (IRS) code that they be updated to the most current mortality table," Ms. Wagner explained. "For purposes of non-discrimination testing under the code, the IRS permits 1971 mortality tables to be used."

Old table cited

The use of a 1971 mortality table was cited by participants in the MetLife case. The plaintiffs are two retirees who, with their spouses, are receiving a joint and survivor retirement annuity.

MetLife's use of the 1971 table contributed to its "failure to pay the alternate benefits" under its DB plan "in amounts that are actuarially equivalent to the plan's default benefit under ERISA and the terms of the plan itself," the lawsuit said.

Alternate annuity benefits — amounts paid to participants who retire before the standard retirement age, usually 65 — are a dominant theme in all four lawsuits.

"Using an older mortality table with accelerated death rates decreases the present value of the alternate annuity benefit and, ultimately, the monthly payout that retirees receive under that alternate annuity benefit," the lawsuit said. Even when combined with a 6% interest rate, participants said the benefits formula didn't provide their fair share, it said.

The lawsuit listed several examples of alternate benefits such as joint and survivor annuities, first-to-die annuities, single-life annuities and qualified preretirement survivor annuities. The company had $9.4 billion in U.S. pension plan assets as of Dec. 31, 2017, according to its latest 10-K statement.

Federal law and regulations can be unclear on benefits calculations, ERISA attorneys said.

"The law says only that in calculating joint and survivor annuities under a DB plan, the annuities must be the actuarial equivalent of a single-life annuity for (the) life of the participant," Ms. Ross said.

"The Treasury regulations say that actuarial equivalence must be based on 'consistently applied reasonable factors,'" she added. "That subjective requirement leaves room for debate, and hence litigation, that the interest rate and mortality tables applied to arrive at the actuarial equivalence were unreasonable."

What got blamed

Interest rates and a 1984 mortality table were blamed in the American Airlines case. The plaintiffs are wives of two deceased employees. They are receiving a preretirement survivor's annuity.

"By not offering actuarially equivalent pension benefits, American is causing retirees to lose part of their vested retirement benefits in violation of ERISA," said the lawsuit, which challenged four American Airlines pension plans. The aggregate DB assets were $11.3 billion as of Sept. 30, according to *Pensions & Investments* data.

Each plan offers joint and survivor annuities and "each plan specifies the use of the same actuarial assumptions when calculating those benefits," the lawsuit said. Each plan uses a 5% interest rate and the 1984 mortality table.

The 5% rate "could be reasonable," but when combined with the 1984 mortality table, the result was unfair to participants, the complaint said. Using the 1984 mortality table "is inherently unreasonable because of its outdated accelerated mortality rates," the complaint said.

In the PepsiCo case, three retirees who, with their spouses, are receiving a joint and survivor annuity, allege the formula for these benefits is "not actuarially equivalent" to a single-life annuity. The latter benefit "is based on their wages and years of service with PepsiCo, not with life expectancies or interest rates," the suit said. U.S. pension plan assets were $13.7 billion as of Sept. 30, according to *P&I* data.

U.S. Bancorp was sued by five retirees who began receiving pension benefits before the age of 65, contending that the early retirement formula wasn't actuarially equivalent to the formula for the DB plan's normal retirement age of 65. The DB plan had assets of $5.5 billion as of Dec. 31, 2017, according to its latest 10-K statement.

The conundrum for defined benefit plan sponsors in calculating benefits is that different rules apply to different benefits.

For example, the IRS requires sponsors to use specific mortality tables when funding their plans and calculating lump-sum equivalent benefits, Ms. Wagner said.

However, "no mortality assumptions are specified," for example, in "adjusting benefits commencing before normal retirement age," she said.

And no specific mortality assumptions are required for "converting a plan's normal form of benefit, say a straight life annuity, into an optional form," she added.

Only general guidance

Although regulations require that optional benefits "be actuarially equivalent" to the defined benefit pension, the IRS offers only general guidance, she said. "Namely, that the actuarial assumptions used for this purpose — the interest rate assumption and the mortality table, in combination — be reasonable."

Many older pension plans "still utilize factors that were adopted decades ago," said the recent Groom Law Group report on the four lawsuits.

"This practice maintains the original design of the plan and may be consistent with a general desire not to make changes, especially for pension plans with traditional benefit formulas that have been frozen or phased out in favor of a different retirement program for the current workforce," the report said.

Given the legal and regulatory uncertainties, ERISA attorneys recommend that clients explain — and document — what they did and why they did it.

"Fiduciaries need to be able to show careful monitoring and where appropriate, revision of the factors applied," said Ms. Ross, adding sponsors should seek the help of "a respected actuary who has knowledge of what factors comparable plans are applying."

Ms. Wagner said the different status of a DB plan — such as active or frozen — might require different responses from fiduciaries.

ERISA attorneys should tell clients that "it would be a best practice to update a plan's mortality assumptions," Ms. Wagner said. "But they could not definitively advise clients at any particular time that they were no longer in compliance with the (IRS) code's tax qualification issues."

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