The Latest in Stable Value Fund Litigation

JOSEPH C. FAUCHER AND BRIAN D. MURRAY

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401(k) plan sponsors routinely offer stable value funds as conservative investment alternatives for their participants. Insurance companies that manage stable value funds invest in fixed income instruments, such as short- and intermediate-term government and corporate bonds and mortgage-backed securities. The funds are insured, so investors are generally protected from loss of capital or interest. In low interest rate environments, the returns offered by stable value funds are predictably low as well.

Insurance companies that offer stable value fund investment options to their plan clients typically declare, on a periodic basis, a rate that the fund will pay going forward for a specified period of time. For example, an insurer may declare on December 15 that, beginning on January 1, and for a six-month period thereafter, the company will credit all investments in the fund at a rate of 1% per annum. In that scenario, the insurance company will retain the "spread" between the earnings on its own investments and the promised rate of return. So, if the insurance company earns 2% on its investments, and its administrative expenses amount to .5%, its profit will amount to .5% (2% –1% –.5%).

This is the backdrop against which, in recent years, attorneys representing retirement plan participants who invest in stable value funds have brought cases against several insurance companies, challenging how these stable value funds are operated. The plaintiffs in these cases typically allege that the insurance companies, and not the fiduciaries affiliated with plan sponsors, effectively decide the amount of compensation that the insurance company receives. If that allegation were found to be true, plaintiffs argue, it would be tantamount to the insurance company exercising authority or control respecting management or disposition of the plan's assets — which would render the insurer a fiduciary of the plan. And if a fiduciary deals with a plan's assets in its own interest or for its own account, it breaches its fiduciary duties and engages in a transaction prohibited by ERISA.

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The results in some of these recent cases appear, at least at first, to be at odds with one another. We review those decisions here, because they highlight issues that plan fiduciaries should be aware of in reviewing plan investment options.

Teets v. Great-West Life & Annuity Ins. Co.

Great-West offers a stable value fund called the Key Guaranteed Portfolio Fund (the "Key Fund"). Some 270,000 participants across many plans invest in the Key Fund. John Teets, representing a class of those participants, challenged how Great-West operates the Key Fund and receives compensation for its services.

Great-West deposits money invested by plan participants in the Key Fund into conservative investments. It then sets a "Credited Interest Rate" quarterly, and announces that rate two days before the start of each quarter. Great-West guarantees that the Credited Interest Rate will never fall below 0%. Great-West retains the difference between the total yield on the Key Fund's investments and the Credited Interest Rate. Plans may withdraw from the Key Fund, but if they do, Great-West reserves the right to defer payment to the plan for up to 12 months. (Plaintiffs presented no evidence in the case that Great-West ever exercised that right.) Additionally, plans doing business with Great-West may not offer any other funds with similar risk profiles. Participants may withdraw their principal and accrued interest at any time without paying a fee.

Mr. Teets claimed that Great-West exercised authority or control over plan assets by setting the Credited Interest Rate and/or by determining its own compensation, and in so doing, became a fiduciary of the plan. He focused on Great-West's contractual right to impose a 12-month waiting period on plans seeking to withdraw from the Key Fund, and the prohibition on plans offering comparable investment options to participants.

Great-West presented evidence that over 3,000 plans had stopped offering the Key Fund as a plan investment option during the relevant time period, but it had never exercised its contractual right to impose the 12-month waiting period on plans that did so. On that basis, the United States Tenth Circuit Court of Appeals found that Great-West never "exercise[d] any discretionary authority or discretionary control over a plan or its assets" by imposing a waiting period.

The Court also disagreed with Mr. Teets' argument that by restricting plans from offering comparable investment options to the Key Fund, Great-West became a fiduciary. It emphasized that Mr. Teets presented no evidence to show that even one of the 270,000 persons invested in the Key Fund through their plans were affected by that provision. (That is, there was no evidence that any plan participant would have invested in a separate stable value fund if given the option to do so.) And finally, the Court found that Great-West did not have control over its own compensation, because participants could choose to discontinue their investments in the Key Fund after Great-West announced the Credited Interest Rate. On that basis, the Court found that Great-West was not a fiduciary by virtue of its administration of the Key Fund and the compensation it received.

Rozo v. Principal Life Ins. Co.

In contrast to the decision in the Great-West case, the U.S. Court of Appeals for the Eighth Circuit recently concluded that Principal Life Insurance Company is a fiduciary with respect to the stable value fund that it offers as an investment option to ERISA-governed plans.

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Every six months, Principal declares an interest rate to be paid during the ensuing six-month period. Principal typically declares that rate a month before it takes effect. Plan sponsors that want to reject the new rate have two options: (1) pay a 5% surrender charge, or (2) notify Principal and wait 12 months for assets invested in the fund to be released. Participants may withdraw without penalty, but they are prohibited from investing in other stable value options for the 90-day period following their withdrawal. (This is typically referred to as an "equity wash." The intent of equity wash provisions is to prevent investors from moving to competing stable value funds to obtain a higher rate of interest.) Consistent with the Tenth Circuit's decision in *Teets*, the district court held that, given these facts, Principal was not a fiduciary.

On appeal, the Eighth Circuit applied the same test that the Tenth Circuit had applied in *Teets*. Specifically, it noted that a service provider acts as a fiduciary if "(1) it 'did not merely follow a specific contractual term set in an arm's-length negotiation' and (2) it 'took a unilateral action respecting plan management or assets without the plan or its participants having an opportunity to reject its decision'." But in applying that test, the Eighth Circuit came to the opposite conclusion than the one the Tenth Circuit had reached in *Teets*. It held that in setting the interest rate to be credited to participant-investors, Principal does so "…with no specific contract terms controlling the rate" (unlike the situation in the Great-West case); and that "[w]hen Principal notifies a plan sponsor of the proposed [interest rate], the sponsor has not agreed to it."

Where *Rozo* appears to diverge from *Teets* is in the application of the second part of the test — whether plans and participants have the right to reject the insurer's declared interest rate without penalty. According to the Eighth Circuit's decision, Principal imposes the 12-month waiting period (or alternatively, the 5% surrender charge) upon plans that reject the declared interest rate. That would, according to the Court, also bind the plan to the new rate imposed at the next six-month period. Conversely, Great-West had the contractual *option* to impose the waiting period, but there was no evidence that it had actually ever exercised that right.

Principal argued that it was immaterial whether it imposed the waiting period on plans, because plan participants would still have the option to withdraw their own accounts' assets from the stable value fund, subject only to the equity wash provision. The Eighth Circuit concluded that it did not matter, because the test for whether a plan service provider is a fiduciary hinges on whether *either* the plan or the participants can reject the terms of the contract without penalty. According to the Court, since "… the sponsor here is impeded [from withdrawing plan assets immediately], the participant's ability to reject the [interest rate] does not negate Principal's fiduciary status."

Given the amounts invested by 401(k) participants in stable value funds, these cases are of obvious significance to the insurance company defendants. But plan sponsors should also take note of the decisions, and be aware of the restrictions placed upon them and their participants relating to these funds. Plan fiduciaries are charged with knowing and understanding the features of the investments they offer their plan participants, and the compensation that their service providers receive.

EMAIL JOE FAUCHER

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