National Litigation Trends Against Public Retirement Systems, and How Fiduciaries Can Effectively Mitigate that Risk

NCPERS Annual Conference & Exhibition
May 23, 2023
Fiduciary Litigation Trends Against Pension Plans (both Governmental and Non-Governmental)

1. Actuarial equivalence challenges by participants
2. Benefit changes/limitations challenges by participants
3. Objections to contribution assessments by employers and others
4. Inadequate funding challenges by participants
5. Investment-related claims by all
6. Significant rise in participant appeals of denial of early retirement disability claims
Litigation Trend No. 1 Against Pension Plans: Actuarial Assumptions and Equivalence

• Since 2019, approximately 20 class action lawsuits filed against plan sponsors and fiduciaries, primarily of ERISA plans, alleging that the plans use “unreasonable” actuarial equivalence factors, primarily “outdated” mortality tables, when calculating the benefits of class members (i.e. plan participants and beneficiaries)
Actuarial Assumptions and Equivalence litigation

• Plaintiffs allege that older mortality tables (e.g., 1951 GAM, 1971 GAM, 1984 Unisex) result in optional forms of benefits, such as joint and survivor annuity or early retirement benefits, that are allegedly not “actuarially equivalent” to their plans’ normal retirement benefits, either in violation of ERISA or a governmental plan’s statutory requirement.

• Plaintiffs further allege that using “current” mortality tables, class members would receive greater monthly benefits.
How Fiduciaries May Effectively Mitigate Risk of Actuarial Assumptions and Equivalence litigation

• IDENTIFY plan provisions regarding “actuarial equivalence” and determine whether such provisions specify mortality tables, or other specific factors, to be used for such calculations

• QUESTION which mortality tables, and any other pertinent factors such as RMD ages, are used by your system for actuarial equivalence determinations
How Fiduciaries May Effectively Mitigate Risk of Actuarial Assumptions and Equivalence litigation (cont.)

• ASSESS whether your system has, or might consider having, an actuarial equivalence policy to identify the mortality tables, RMD ages, et al., to be used for such calculations, including rationale for difference between those tables or other factors, and those used for valuation purposes, if any

• ASK system CEO, actuary, and/or pension software administrator to report whether/how such tables and other factors are addressed for your retirement system
Litigation Trend No. 2 Involving Pension Plans: Challenges to Benefit Changes/Limitations

• Many changes resulted from legislative changes to aspects of retirement benefit calculations, mostly for active and some for retired members, such as
  • Limitations on items of pay that were pensionable
  • Limitations on service credit that could be purchased
  • Expansion of felony forfeiture rules
  • COLA changes

• Some changes resulted from fiduciaries/trustees determining benefits or contributions had either been erroneously calculated, or that system administration reflected practices that should be improved
Examples of Challenges to Benefit Changes or Limitations

1. Retirement Board limits pensionable compensation to “base pay” rather than statutory alternative “normal monthly rate of pay.”

2. Board also limits prospective accrual of service credit to one year for a single year of service (changing longstanding Board policy of permitting excess accruals for those on 7/12 schedules)

- Trial court concludes: because statute authorized (though did not require) both limitations, no breach of fiduciary duty or other abuse of discretion by limiting retirement allowances in these ways. (SCDSA v. SCERS, Sacramento County Superior Court Case No. 34-2019-80003132)
Examples of Challenges to Benefit Changes or Limitations (cont.)

3. In 2010, City replaced market-driven post-retirement COLA with tiered COLA.

- **Maryland Court of Appeal**
  - upheld determination that City breached its contract with retirement system members who already had retired, and those who were eligible to retire as of the effective date of the change
  - determined the City did not breach its contract with members who were working as of that date and were not yet eligible to retire.

*(Cherry, Jr. v. Mayor and City Council of Baltimore, No. 1, Court of Appeals of Maryland, August 16, 2021.)*
How Fiduciaries May Effectively Mitigate Risk of Litigation Regarding Challenges to Benefit Changes or Limitations

• IDENTIFY plan provisions that the system is enforcing
• ANALYZE legislative and/or fiduciary rationale for the change or limitation
• DETERMINE the discretionary authority the Board and retirement system may, or may not, have with respect to the particular change under state law
• DOCUMENT legislative and/or fiduciary rationale for the changes, assessing whether change is consistent with the theory and successful operation of the plan, and thus consistent with duties of prudence and loyalty to members and beneficiaries
Litigation Trend Against Pension Plans No. 3: Objections to contribution assessments

• These claims are being made in some instances by active members, and in other instances by participating employers

  • Challenges illustrate interplay of statutory authority and actuarial framework required to fund defined benefit retirement plans
Examples of Objections to Retirement System’s Contribution Assessments

1. *City of Chicago v. The Chicago Policemen’s Annuity and Benefit Fund, et al.*, Case No. 2019CH05526 (Circuit Court of Cook County, Illinois – filed August 29, 2019) – the City of Chicago filed for injunctive relief to stop the interception of state grant funds based on assessments by governmental plans involving city employees.

2. *Dekalb County School District v. Gold*, S18G1419 – teacher participants sued the DeKalb County School District in 2011 for $250m for allegedly breaching an agreement to provide two-years advance notice prior to suspending contributions to their DeKalb County Tax-Sheltered Annuity Plan. The case settled in July 2020 for $117.5m in pension contributions to be paid over five years, after the Georgia Supreme Court upheld the appellate court’s reversal of the trial court’s grant of summary judgment.
Examples of Objections to Retirement System’s Contribution Assessments

3. Participating employer and two of its employees sued retirement board and system claiming that employer was paying an unfair percentage of unfunded liability, which allegedly hurt its budget and prevented it from providing higher salaries to its employees.

- Petitioners challenged board’s chosen “percentage of pay” actuarial methodology, rather than “percentage of liability” methodology, arguing that it unfairly disadvantaged an employer with higher payroll growth relative to other employers.

- Petitioners alleged “improper motive” of board members to “favor” plan sponsor county

- Summary judgment granted May 3, 2022 – currently on appeal (Alameda Health System v. Alameda County Employees Retirement Association, First District Court of Appeal Case No. CPF-19-516795)
How Fiduciaries May Effectively Mitigate Risk of Challenges to Retirement System’s Contribution Assessments

• IDENTIFY legal and/or actuarial authority for contribution assessments
• ANALYZE fiduciary rationale for methodology and assessments
• CONSULT with experts regarding methodology and obtain recommendations
• DOCUMENT process and fiduciary rationale for maintaining or changing approach
Litigation Trend Against Pension Plans No. 4: Inadequate Funding Claims

1. *Overstreet v. Mayberry, as Member and Beneficiary of Trust Funds on behalf of the Kentucky Retirement Systems*, No. 2019-SC-000041-TG (decision July 9, 2020):

   • Participant class alleged that between 2011 and 2016, KRS plan fiduciaries knew that the plan faced an appreciable risk of running out of plan assets, but concealed the true state of affairs from KRS members and the public.

   • Plaintiffs alleged that KRS trustees and officers “recklessly gambled” their way out of the actuarial shortfall by investing $1.5 billion of KRS assets in the high-risk “fund of hedge funds” products that ultimately lost more than $100 million by 2018, contributing to a now $25 billion funding shortfall in the KRS general pool of assets.

   • Kentucky Supreme Court dismissed lawsuit challenging the state public pension system’s use of “risky” hedge fund investments.
Litigation Trend Against DB Plans No. 4: Inadequate Funding Claims

2. Singing River Health System (SRHS) Pension Plan

- Settlement announced in 2016 relating to alleged underfunding of community-owned, non-profit healthcare system in Mississippi.

- Under the settlement, SRHS agreed to pay $149,950,000 to the trust over time; and Jackson County, Mississippi was to pay $13,600,00 to SRHS over eight years to prevent default on a bond issue by supporting the operations of SRHS.
How Fiduciaries May Effectively Mitigate Risk of Inadequate Funding Claims

• MONITOR system funding on a regular basis, with modeling of short and long term projections for investments and cash-flow needs

• CONSULT with investment and financial experts (in-house, and outside, advisors) regarding system funding through asset-liability studies and otherwise

• ANALYZE recommendations received and options presented to address any current and/or future anticipated funding challenges

• DOCUMENT funding goals, methodologies and approaches in valuation and/or separate Board funding policy
Litigation Trend Against Pension Plans No. 5: Investment-related challenges

• These challenges are most frequently asserted against defined contribution (DC) plans, particularly after U.S. Supreme Court’s Thole v. U.S. Bank, 140 S.Ct. 1615 (2020) resulted in many dismissals of imprudent investing based claims (no standing when plan sponsor solves for underfunding)

• Nevertheless, substantial amounts of litigation continues to focus on this aspect of fiduciaries’ responsibilities
Examples of Challenges on Investment-related Matters

1. Challenge to Illinois law requiring police and fire benefit plans to transfer their investment authority, securities, funds, and assets to the Police Officers’ Pension Investment Fund and the Firefighters’ Pension Investment Fund (Arlington Heights PPF v. Pritzker, No. 21-CH-000055 (Circuit Ct. 16th Judicial Circuit) – appellate court upholds Circuit Court’s finding that the law is constitutional: 2023 Il App (2d) 220198 (Feb. 07, 2023).
Examples of Challenges on Investment-related Matters

2. Challenges regarding environmental, social and/or governance-related considerations when investing – twenty-five states have sued the Department of Labor to block the DOL rule that allows fiduciaries to consider environmental, social and governance (ESG) factors when retirement investments.

   • Governmental plans are caught in political challenges with
     • certain states banning ESG investments by public plans, and
     • other states requiring investments or divestments to address ESG-related topics
Examples of Challenges on Investment-related Matters

3. Challenge the “extremely high cost investments that carry greater risk than comparable lower cost investments”

   • Challenge to tax deferred annuity programs offered by Aetna Life Insurance and Annuity Company—the Opportunity Plus and Opportunity Independent programs. Factual crux of plaintiffs’ complaint is based on alleged exclusive endorsement relationship between NYSUT and ING. [Montoya v. New York State United Teachers, 754 F. Supp. 2d 466 (E.D.N.Y. 2010).]
How Fiduciaries May Effectively Mitigate Risk of re Challenges on Investment-related Matters

• UNDERSTAND state law applicable to your retirement system’s investments
  • Limited “list” of permitted investments? Diversification mandate? Modern portfolio theory predicate?
• CONSULT with state law counsel on other fiduciary considerations applicable to system investments
• OBTAIN recommendations from Chief Investment Officer and Investment Consultant on investment opportunities and risks
• DOCUMENT rationale for decision-making, ensuring that rationale is consistent with fiduciary responsibilities of trustees regarding the purpose of the trust that they are administering
Litigation Trend No. 6: Examples of participant appeals of denial of early retirement disability claims

• The highest frequency of fiduciary claims facing governmental benefit plans are appeals of denials of disability pension benefits. By some measures, the number of such appeals has more than doubled in the last five years. Examples include:

  • *Stephen P. Hull v. Village of Wheeling Police Pension Fund*, No. 2021CH02756: appeal of denial of non-duty disability pension benefit based on participant claim that he was no longer able to perform his job duties he sustained as a result of a motor vehicle accident he was involved in that occurred while he was performing the job duties of a police officer for the Village of Wheeling Police Department.

  • *Bradley Hutchinson v. Board of Trustees of the Peoria Police Pension Fund*, Case No. 20 MR 00813: appeal of denial of line-of-duty disability pension benefit based on accident off duty that exacerbated during on-duty arrest.
How Fiduciaries May Effectively Mitigate Risk of re Challenges on participant appeals of denial of early retirement disability claims

• OBTAIN comprehensive medical record as to alleged disability

• CONSULT with medical advisors who are qualified to opine on disability eligibility under applicable state law

• OBTAIN recommendations from independent medical examiners and other medical advisors regarding merits of application

• ENGAGE in thorough administrative hearing process, if warranted, for development of evidence and application of legal analysis to determine eligibility, or not, for requested disability retirement