Multi-Elert® **Volume 2 • Issue 5**

A Service of the NCCMP **October 8, 2002**

TOPIC: DEPARTMENT OF LABOR ISSUES ADVISORY OPINION IN LIMITATION OF ACTUARIAL LIABILITY AND INDEMNIFICATION PROPOSALS.

EXECUTIVE SUMMARY OF:

PURSUANT TO A REQUEST FILED BY THE CENTRAL PENSION FUND OF THE INTERNATIONAL UNION OF OPERATING ENGINEERS AND JOINED BY THE NCCMP, THE DEPARTMENT LABOR HAS ISSUED AN ADVISORY OPINION ON THE PERMISSIBILITY OF FIDUCIARIES ENTERING INTO AGREEMENTS WITH ACTUARIAL FIRMS THAT LIMIT THE ACTUARY'S LIABILITY AND / OR INDEMNIFY SUCH FIRMS FROM TRUSTEE AND / OR PARTICIPANT SUITS STEMMING FROM ERRONEOUS ACTUARIAL CALCULATIONS MADE BY SUCH FIRMS. THE OPINION AND A COMMENTARY ARE SET FORTH BELOW.

PURPOSE: TO COMMUNICATE THE CONTENT AND RELEVANCE OF THE DEPARTMENT OF LABOR'S RECENT ADVISORY OPINION CONCERNING FUND FIDUCIARIES' RESPONSIBILITIES WHEN FACED WITH ACTUARIAL SERVICE PROVIDER CONTRACTS THAT SHIFT POTENTIAL LIABILITIES FROM THE ACTUARY TO THE FUND AND ITS PARTICIPANTS.

CATEGORY: REQUEST FOR ADVISORY OPINION

ISSUER: OFFICE OF REGULATIONS AND INTERPRETATIONS, DIVISION OF FIDUCIARY INTERPRETATIONS, PENSION AND WELFARE BENEFITS ADMINISTRATION, U.S. DEPARTMENT OF LABOR

TARGET AUDIENCE: TRUSTEES AND PROFESSIONAL ADVISORS, ALL BENEFIT FUNDS

INPUT REQUESTED: CONTACT NCCMP IF ACTUARIAL SERVICE PROVIDERS PROPOSE LIMITATION OF LIABILITY AND/OR INDEMNIFICATION LANGUAGE AS PART OF A RETAINER OR OTHER BUSINESS AGREEMENT

OFFICIAL COMMENT PERIOD ENDS: N/A

NCCMP DEADLINE: ONGOING

FORWARD COMMENTS TO: *Multi-elert@nccmp.org*

REFERENCE: VOL. 2, ISSUE 5

FOR ADDITIONAL BACKGROUND SEE: *MULTI-ELERT ® VOLUME 2, ISSUE 2, MAY 7, 2002* DOL ADVISORY OPINION NO. 2002-08A

DOL Advisory Opinion Directs Fiduciaries to Evaluate Plan's Ability to Obtain Actuarial Services at Comparable Costs Without Agreeing to Limitation of Liability and/or Indemnification Agreements

Stops Short of Complete Ban on Such Provisions

In response to a request by the Central Pension Fund of the IUOE as to whether limitations of liability provisions included in actuarial service provider agreements are permissible under the fiduciary provisions of ERISA, the U.S. Department of Labor Office of Regulations and Interpretations issued its answer in Advisory Opinion No. 2002-08A dated August 20, 2002. That Opinion strongly suggests that fiduciaries have an obligation to look to actuaries who do not place such restrictions on their business arrangements in determining the reasonableness of their compensation arrangements. The Advisory Opinion also stressed that fiduciaries must also evaluate the impact of indemnification provisions in assessing the protections against potential loss that would be available to the plan. However, the opinion stopped short of issuing an outright ban on such provisions.

…At a minimum, compliance with these standards would require that a fiduciary assess the plan's ability to obtain comparable services at comparable costs either from service providers without having to agree to such provisions, or from service providers who have provisions that provide greater protection to the plan…

…U.S. Department of Labor

The Advisory Opinion clearly spells out the obligation by fiduciaries to explore the marketplace to see whether such services could be obtained without such limitation of liability provisions, or with less restrictive provisions. In pertinent part, the opinion urges fiduciaries to carefully ***"…assess the plan's ability to obtain comparable services at comparable costs either from service providers without having to agree to such provisions, or from service providers who have provisions that provide greater protection to the plan…"***

The opinion went on to say that fiduciaries must also ***"assess the potential risk of loss and costs to the plan that might result from a service provider's act or omission subject to a proposed limitation of liability or indemnification provision. In making such an assessment, a fiduciary should consider the potential for, and outside limits of, such a loss, as well as any additional actions that might be available to the plan to minimize such a loss...."*** In other words, Trustees must understand that by agreeing to reduce the financial risk to its actuary for errors that may be committed by the actuary, that potentially enormous risk is ultimately transferred to the fund, its participants and to the Trustees themselves.

… Trustees must understand that by agreeing to reduce the financial risk to its actuary for errors that may be committed by the actuary, that potentially enormous risk is ultimately transferred to the fund, its participants and to the Trustees themselves.

…NCCMP

Despite the seriousness of these issues and the forceful and compelling arguments of the Central Pension Fund, the Department stated its view that in and of themselves most limitation of liability and indemnification provisions in a service provider contract are neither *per se* imprudent, nor*per se* unreasonable under ERISA.In the NCCMP's view, however, fiduciaries faced with a proposal that includes limitation of liability or indemnification provisions would be hard-pressed to accept it without first ruling out competitive bids from other qualified firms in the marketplace that do not place such restrictions on their clients.

In the course of examining this subject over the past several months, the Central Pension Fund, the NCCMP and many of its member funds that previously had been approached by their actuaries to sign these agreements, have found a ready supply of actuarial firms that have publicly stated that they do not require limitation of liability or indemnification provisions. Therefore, in applying these standards in the current competitive market it appears that any fiduciary who agrees to these limitations would open himself and his plans to significant exposure in the event the actuary makes a major error. In essence, the actuary can escape any responsibility for his actions through the very limitation of liability loophole he created, leaving the plan and its trustees with a major loss and no source of recovery.

…any fiduciary who agrees to these limitations would open himself and his plans to significant exposure in the event the actuary makes a major error. In essence, the actuary can escape any responsibility for his actions through the very limitation of liability loophole he created, leaving the plan and its trustees with a major loss and no source of recovery.

...NCCMP

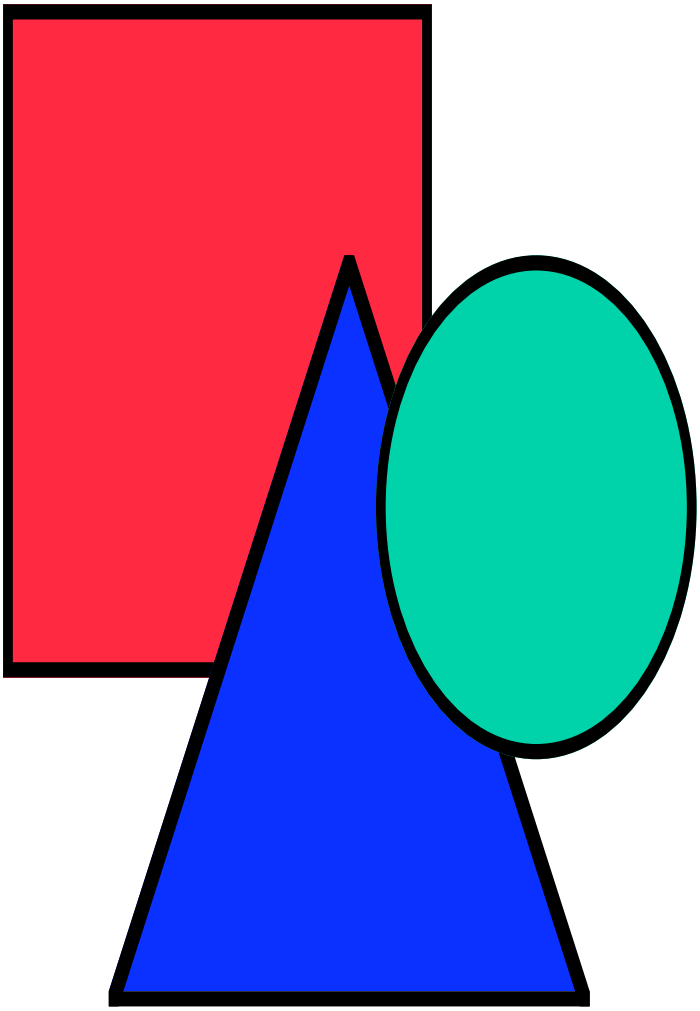
Because the Department of Labor did not find these clauses to violate ERISA per se, we are concerned that the actuarial firms who decide to seek these clauses will attempt to portray them to clients as legally acceptable and install them as industry standards. Ideally, the marketplace might stop this practice – our members may not choose to retain firms that insist on these provisions. But because this issue has such important implications for multiemployer plans of all types, the NCCMP does not want to rely solely on the market. For these reasons we invite any member plan that is approached by its current actuarial firm to consider such a proposal, to contact the NCCMP. We will closely monitor this situation. Should a broad cross-section of firms insist on these limits, the NCCMP may consider seeking legislative relief.

…The NCCMP invites any member plan that is approached by its current actuarial firm to consider such a proposal, to contact the NCCMP…

...NCCMP

Plan trustees and plan sponsors should rely on their own attorneys and other professional advisors for advice on the meaning and application of Advisory Opinion No. 2002-08A with respect to their funds.

If you have questions about the NCCMP, or about this or other issues of Multi-Elert, please contact Randy G. DeFrehn, Executive Director, NCCMP, by phone at (202) 737-5315, or by e-mail at rdefrehn@nccmp.org.



the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of like character with like aims. The prohibited transaction provisions state, in section 406(a)(1)(C) and (D) of ERISA, that a fiduciary with respect to an employee benefit plan shall not cause the plan to engage in a transaction if he or she knows or should know that such transaction constitutes a direct or indirect furnishing of services between the plan and a party in interest with respect to the plan, or transfer to, or use by or for the benefit of, a party in interest, of any assets of the plan. Section 408(b)(2) of ERISA provides a statutory exemption from the prohibitions of section 406(a) for contracting or making reasonable arrangements with a party in interest, including a fiduciary, for office space, or legal, accounting, or other services necessary for the establishment or operation of the plan, if no more than reasonable compensation is paid for such services.

With regard to the selection of service providers under ERISA, the Department has previously indicated that the responsible plan fiduciary must engage in an objective process designed to elicit information necessary to assess the qualifications of the provider, the quality of services offered, and the reasonableness of the fees charged in light of the services provided. In addition, such process should be designed to avoid self-dealing, conflicts of interest or other improper influence. What constitutes an appropriate method of selecting a service provider, however, will depend upon the particular facts and circumstances. Soliciting bids among service providers is a means by which a fiduciary can obtain the necessary information relevant to the decision-making process, including information about contractual provisions such as those identified in your letter relating to limitations of liability and indemnification.

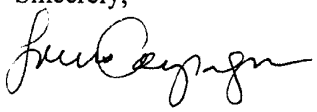
The Department does not believe that, in and of themselves, most limitation of liability and indemnification provisions in a service provider contract are either *per se* imprudent under ERISA section 404(a)(1)(B) or *per se* unreasonable under ERISA section 408(b)(2). The Department believes, however, that provisions that purport to apply to fraud or willful misconduct by the service provider are void as against public policy and that it would not be prudent or reasonable to agree to such provisions. Other limitations of liability and indemnification provisions, applying to negligence and unintentional malpractice, may be consistent with sections 404(a)(1) and 408(b)(2) of ERISA when considered in connection with the reasonableness of the arrangement as a whole and the potential risks to participants and beneficiaries. At a minimum, compliance with these standards would require that a fiduciary assess the plan's ability to obtain comparable services at comparable costs either from service providers without having to agree to such provisions, or from service providers who have provisions that provide greater protection to the plan.

In the Department's view, compliance with ERISA's fiduciary provisions, including section 408(b)(2), also would require that a fiduciary assess the potential risk of loss and costs to the plan that might result from a service provider's act or omission subject to a proposed limitation

of liability or indemnification provision. In making such an assessment, a fiduciary should consider the potential for, and outside limits of, such a loss, as well as any additional actions that may be available to the plan to minimize such a loss.

This letter constitutes an advisory opinion under ERISA Procedure 76-1. Accordingly, this letter is issued subject to the provisions of the procedure, including section 10 relating to the effect of advisory opinions.

Sincerely,



Louis Campagna
Chief, Division of Fiduciary Interpretations
Office of Regulations and Interpretations