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BENEFITS BRIEF

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DOL and SEC Opine on How Fiduciaries May React to Inside Information

On March 11, 2016, the Department of Labor ("DOL") and Securities and Exchange Commission ("SEC") each filed amicus briefs in *Whitley v. BP, P.L.C.* to clarify the responsibilities of a fiduciary under the Employee Retirement Income Security Act of 1974, as amended ("ERISA") with control of an employee stock ownership plan, as a company stock fund investment option of a 401(k) plan. The DOL outlined potential corrective actions a fiduciary can take when there is an ongoing fraud (i.e., false or misleading public statements) that would be consistent with a fiduciary's duty of prudence under ERISA. The SEC's brief discussed whether these approaches would be consistent with the federal securities laws.

Background

As discussed in our Benefits Brief of June 30, 2014, the Supreme Court in *Fifth Third Bancorp v. Dudenhoeffer* (134 S. Ct. 2459 (2014)) held that in order to argue that in order a fiduciary breached its duty of prudence by failing to act after being exposed to non-public information, plaintiffs must (1) articulate what course of action the fiduciary could have taken that would be consistent with the securities laws, and (2) show that a prudent fiduciary in like circumstances could not have believed that such an action would be more likely to harm rather than help the plan. The Court called on the SEC to weigh in on the interplay of these standards with "the complex insider trading and corporate disclosure requirements imposed by the federal securities laws or with the objectives of those laws." *Dudenhoeffer*, 134 S. Ct. at 2462.

The DOL's and SEC's analysis may be separated into several key topics:

1. ERISA Fiduciaries May Need to More Fully Understand the Anti-Fraud Provisions under the Securities Laws.

The DOL's brief states that ERISA requires "fiduciaries who learn of negative undisclosed information about the company, or who learn that that information the company has disclosed is inaccurate or misleading, to investigate the possibility that these misleading or incomplete disclosures violate the securities laws and then decide whether corrective action is warranted." This appears to require that a fiduciary first determine whether information in its possession is potentially negative, inaccurate or misleading and second undertake an analysis of whether such information is both "material" and capable of being corrected by the fiduciary, taking into account that its obligation is to act for the exclusive benefit of the plan and its participants – something that almost certainly requires the fiduciary to seek advice of counsel.

2. Blackouts Are a Viable Option

The DOL's brief stated that a suspension in trading company stock may be a prudent course of action in the face of a fraud, and the SEC's brief stated such a suspension would not violate the securities laws. Importantly, however, a suspension of *only* new purchases, while still allowing sales, on the basis of inside information, would violate the securities laws.

The DOL also opined that fiduciaries may choose to remove a company stock investment option entirely, or that a company may remove an employer match, but we note that the SEC did not appear to directly sanction such actions, and fiduciaries may want to consider with counsel whether fully liquidating investments in company stock, while in possession of material non-public information, would violate the securities laws.

3. Fiduciaries Should Be Careful When Attempting to Correct Prior Misstatements

The DOL stated that a fiduciary may publicly disclose information in response to a company's misrepresentation or omission of material fact "as a last resort." It is imperative that fiduciaries exercise great caution in issuing a corrective disclosure because such a disclosure would need to be "complete and accurate in all material respects" to avoid violating the securities laws. Further, a disclosure would need to be made to the public; it would be impermissible to selectively issue a correcting statement solely to plan participants. The SEC also noted that fiduciaries may have an independent duty to disclose under the securities laws, to the extent they make or cause misstatements or omissions.

4. Fiduciaries May "Urge" Company Insiders to Correct Incorrect/Misleading Disclosures

An ERISA fiduciary would be permitted to report fraudulent statements to the DOL or SEC. Additionally, a fiduciary could "urge" company insiders to correct false or misleading statements or omissions; as an example, the DOL suggested a fiduciary could question insiders on an investor conference call. We suspect most fiduciaries would be reluctant to take this approach.

Implications

To some extent, the DOL and SEC briefs raise more questions than they answer. The agencies' analyses suggest that fiduciaries may need a more nuanced understanding of the anti-fraud provisions of the federal securities laws to both identify potential misstatements (or omissions) and take corrective action consistent with the "complex insider trading and corporate disclosure requirements imposed by the federal securities laws." The extent of this duty is unclear, as is whether its scope is greater than that otherwise required of ERISA fiduciaries in respect of investment options that are not company stock. Fiduciaries may wish to review their current compliance mechanisms and, if necessary, work with counsel on next steps.