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Negative Consent

When avoiding fiduciary status might not be an option

The Department of Labor (DOL) recently filed an amicus brief in a case on appeal within the 7th Circuit, *Leimkuehler v. American United Life Insurance Co*. The case considers whether an insurance company managing separate account products for Employee Retirement Income Security Act (ERISA)-covered plans becomes a fiduciary when it retains, but does not use, the authority to change the mutual funds initially approved by the plan sponsors. The brief raises significant obstacles to the use of "negative consent" procedures in implementing fiduciary directions in 401(k) plans.

The case was brought by the trustee of the Leimkuehler Inc. Profit Sharing Plan, which entered into a group variable annuity contract with the American United Life Insurance Company (AUL). Under the contract, the Leimkuehler plan invested in separate accounts maintained by AUL. Each separate account, in turn, invested in mutual funds. As is typically the case, the plan sponsor approved the separate account's initial lineup of mutual funds by approving a list of funds in which the separate account would invest. The contract between AUL and the Leimkuehler plan provided that, where required by applicable law, AUL would not substitute any shares attributable to the plan's interest in any investment account without notice or the approval by the plan or participants.

In the lower court, AUL argued that it was not a fiduciary with respect to the selection of mutual funds and revenue sharing payments received from those funds. The district court agreed and reasoned, under H*ecker v. Deere & Co.*, that AUL was free to limit the universe of mutual funds and share classes it would make available to the Leimkuehler plan without assuming fiduciary status for the plan's selection of the funds for the investment lineup. The court concluded that AUL's initial practice of investing in the same funds did not make it a fiduciary and it would not become a fiduciary, so long as it continued to comply with participants' directions for the allocation of the investments among the funds AUL made available. The plaintiffs have since appealed this decision to the 7th Circuit.

The DOL argued in its amicus brief before the 7th Circuit that AUL was a fiduciary to the Leimkuehler plan when it simply retained discretion to substitute funds under the contract. Importantly, the DOL said that the arrangement did not fall within the 1997 Advisory Opinion. The department further distinguished AUL from the Hecker case by arguing that AUL did not merely present investment options to an independent fiduciary for independent approval but rather retained unilateral authority over plan investments and used that authority to receive undisclosed compensation. In sum, the DOL argued that by failing to provide specific negative consent procedures in the contract, AUL became a fiduciary, notwithstanding the disclosures made to the plan sponsor and the sponsor's non-objection to the proposed change.

The DOL's brief can be viewed as particularly troublesome and as a significant departure from the procedures it laid out several years ago in Advisory Opinion 97-16A. Many in the retirement services industry have relied on these procedures, mainly for the proposition that if they are properly implemented, then service providers may avoid fiduciary status through the use of negative consent.

The department's brief argued that insurers and recordkeepers—specifically those who have reserved the right to change the options within an investment platform offered to its customers and who have not incorporated into its underlying contract all of the requirements for obtaining negative consent under Advisory Opinion 97-16A—are fiduciaries with respect to the platform's investment options. The DOL's brief makes clear that it does not matter if the recordkeeper ever used the contractual authority to change the platform.

It is unclear at this time whether the 7th Circuit will accept the arguments laid out by the Department of Labor in its brief. Even if the 7th Circuit rejects the arguments and affirms the lower court's decision, this is a disturbing circumstance. And while we concede that a DOL brief, in and of itself, has no legal precedence, it is nevertheless a departure from established precedent. Both plan sponsors and service providers should take heed of its implications in regard to the use of negative consent procedures.

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