

Error Correction Redux

The ING settlement reveals DOL views on erroneous gains

In the beginning of February, the Department of Labor (DOL) announced a settlement with ING Life Insurance and Annuity Company in the amount of approximately \$5.25 million over that company's error-correction policies. This is the DOL's first attempt to deal with this complex issue, and, because the department's approach to solving this problem is reliant on the exemption under Employee Retirement Income Security Act (ERISA) Section 408(b)(2), plan sponsors need to pay attention.

The fundamental legal question addressed involves the plan assets or nonplan assets status of the erroneous gains under ERISA. If the gains are ERISA plan assets, then under what theory, if any, may they be retained by the recordkeeper? And since ERISA requires plan assets to be used exclusively for the benefit of the plan to which they belong, what basis might there be to support the "netting" of gains and losses across multiple plans?

Judging by the ING settlement, from an enforcement perspective it appears that the DOL believes that erroneous gains are the plan's assets. Not surprisingly, the DOL also takes the view that erroneous losses belong not to the plan but to the recordkeeper. That said, the settlement allows ING to continue to retain erroneous gains *as recordkeeping compensation*, subject to the condition that the company's error-correction policy be disclosed and agreed to by its plans.

On that basis, the settlement seems to follow a theory similar to the one the DOL has held regarding the retention of "float" income. Namely, that a service provider does not exercise discretion over the amount and timing of its compensation when it discloses the source of income to an independent plan fiduciary and the fiduciary authorizes the service provider's retention of the income as compensation.

A written policy attached to the ING settlement indicates that, on a go-forward basis, ING will report any gains it receives as compensation under the Section 408(b)(2) rules. Not only is ING obligated to track its net financial experience across its book of business, it also must track "the effect of the corrections for each affected plan on an annual basis and will make that information available under ERISA Section 408(b)(2)." That language raises a number of intriguing questions.

One issue is whether the company is truly obligated, as it would appear to be, to track gains on a plan-by-plan basis

and report the total gains, annually, as compensation. What might the rules be to calculating those gains? The written policy describes some participant-level transaction corrections as examples. But what happens when errors occur upstream, at the omnibus account level? If a recordkeeper submits the trading activity of 100 different plan customers through a single omnibus account and then corrects an error, resulting in a gain, is it even possible to figure out how to allocate that gain among all of the plans involved?

Another question is the issue of "phantom" gains. Let's say that Plan A submits a purchase order to buy 100 shares of Fund X on the same day Plan B submits an order to sell 100 shares of the same Fund X to a common recordkeeper that trades through an omnibus account. Due to its own error, the recordkeeper fails to process the trades on the day they are received, in good order, requiring it to make an "as of" date trade on the next business day. If the price of Fund X has increased by \$1 per share in the interim, the make-whole transaction on Plan A's account would indicate a recordkeeping loss absorption of \$100, and Plan B's account would indicate recordkeeping gain retention of \$100. Yet, because the trades were submitted through an omnibus trading account, and therefore net against one another at that level, the recordkeeper makes no cash outlays and receives no cash compensation in correcting the respective transactions.

Yet another question is what the recordkeeper's plan customers, who will presumably be receiving erroneous gain reporting on an annual basis under 408(b)(2), are to do with this information. The ING settlement leaves these and other questions unanswered. Given that the DOL has opened the door to treatment of error-correction gains as compensation under Section 408(b)(2), the framework of a solution to the treatment of gains and losses on the correction of errors should be forthcoming.

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