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Retained asset accounts under ERISA allowed

No breach of fiduciary duty by life insurance co.

By: Eric T. Berkman

A life insurance company's disbursement of death benefits under certain employee-benefit plans via the use of "retained asset accounts," or RAAs, did not violate its duty of loyalty under ERISA, the 1st U.S. Circuit Court of Appeals has ruled.

The disbursement method involved defendant Unum Life Insurance Co., which, upon approving a claim, established an unfunded account — the RAA — for the beneficiary at an intermediary bank, credited with the full amount of the benefit owed.

The beneficiary could then withdraw either the entire amount of the benefit or increments of at least $250. As long as funds remained credited to the RAA, the insurer would hold them in its general account, crediting the RAAs with a 1-percent interest rate while apparently earning a higher rate of return on the funds for itself.

A U.S. District Court judge found that, by doing so, the insurance carrier had failed to discharge its obligations solely in the interest of plan participants and beneficiaries as required under ERISA's duty-of-loyalty provision, Section 404(a).

But the 1st Circuit reversed.

"The centerpiece of [Unum's] challenge is the assertion that, by establishing the RAAs in accordance with … plan documents, the insurer fully discharged its fiduciary duties," Judge Bruce M. Selya wrote for the court.

"Consequently, the subsequent relationship between the insurer and the beneficiary was in the nature of a debtor-creditor relationship, governed not by ERISA but by state law," Selya said. "In other words, when the insurer invested the retained funds and paid interest to the beneficiaries, it was not acting as an ERISA fiduciary. The insurer's position makes sense, and it is bulwarked by relevant authority."

Meanwhile, the 1st Circuit also affirmed the trial judge's finding that Unum's use of RAAs did not constitute self-dealing in violation of Section 406(b) of ERISA.

The 29-page decision is Merrimon, et al. v. Unum Life Insurance Company of America, Lawyers Weekly No. 01-175-14. The full text of the ruling can be found by clicking here.

Donald R. Frederico

'Common, convenient and secure'

Unum's attorney, Donald R. Frederico of Pierce Atwood in Boston, said the decision is important to the insurance industry because it preserves the ability of employers to offer plans providing what he described as a "common, convenient and secure payment method" to beneficiaries.

A decision affirming the U.S. District Court judge's finding that Unum breached its duty of loyalty by using RAAs would have introduced significant uncertainty to a statutory regime that is supposed to be predictable, he added.

"It would have discouraged the many insurers that pay group life benefits via RAAs from continuing to do so, and so likely would have deprived countless beneficiaries of the advantages that RAAs offer," Frederico said.

Stuart T. Rossman of the National Consumer Law Center in Boston, one of the plaintiffs' attorneys in the case, said his clients were disappointed in the outcome of their appeal. He declined further comment pending a determination whether to seek a rehearing or further appellate review.

But ERISA lawyer Stephen D. Rosenberg, of the McCormack firm in Boston said the ruling reflects the reality that a service provider needs to be able to structure an ERISA plan in such a way that it is possible to do that kind of business.

"The plaintiffs' bar is looking for ways defendants are making money or making these services profitable and calling them prohibited transactions or breaches of fiduciary duty," Rosenberg said. "But this case, which falls in line with cases in other contexts, is saying that as long as the plan beneficiary is getting everything he or she is supposed to be getting under the plan, it's OK that the insurance company or other service provider is also making a profit."

Marcia S. Wagner, who heads the Wagner Law Group in Boston, said Merrimon is the third federal circuit-level case in a row in which insurers have withstood class-action challenges to RAAs. However, that does not mean the issue has been laid to rest.

For one thing, the plaintiffs in a 3rd Circuit case, Edmonson v. Lincoln National Life Insurance Company, have appealed to the U.S. Supreme Court, Wagner said.

Meanwhile, the plaintiffs in Merrimon tried to argue that the life insurance policies themselves were plan assets and that the insurer's exercise of control over the assets by setting up retained asset accounts was a fiduciary act.

The 1st Circuit rejected that argument because it had not been raised in the District Court. But because of the procedural basis

of the rejection, Wagner said she could foresee the plaintiffs' bar trying again on that point.

Nonetheless, Wagner said the courts do not appear particularly sympathetic to the cases "because the life insurance beneficiaries always have the option of drawing down the retained asset account and requiring the insurance companies to fully fund the account."

Class action

Plaintiffs Denise Merrimon and Bobby S. Mowery represent a class of beneficiaries of ERISA-regulated employee benefit plans funded by certain guaranteed-benefit group life insurance policies issued by Unum.

In 2007, they each submitted a claim for benefits under their respective plans.

Once Unum approved the claims, it established, through a contractor, "retained asset accounts" at State Street Bank for each named plaintiff and credited $51,000 to Merrimon's account and $62,300 to Mowery's account, which represented the full amount of benefits owed under each plan.

Unum also mailed books of drafts to each plaintiff. The drafts allowed the plaintiffs to withdraw all or part of the corpus of their RAAs as long as each withdrawal was for at least $250.

The plaintiffs quickly liquidated their accounts in full. Before that happened, though, Unum retained the credited funds in its general account while paying the plaintiffs interest at the rate of 1 percent, which the plaintiffs contended was significantly less than the return the insurer earned on the funds.

In October 2010, the plaintiffs filed a putative class action in U.S. District Court for the District of Maine, alleging that Unum's method of redeeming their claims violated ERISA Sections 404(a) and 406(b).

U.S. District Court Judge Nancy Torreson granted summary judgment to Unum on the Section 406(b) claim, finding that Unum's use of RAAs did not constitute self-dealing in violation of ERISA, but she granted summary judgment to the plaintiffs on the Section 404(a) claim, finding that the RAAs violated Unum's duty of loyalty.

Torreson then certified a plaintiff class and, after a bench trial, awarded the class more than $12 million in damages. Unum appealed.

Meanwhile, the plaintiffs appealed the summary judgment on their Section 406(b) claim.

Discharged duty

On appeal, the 1st Circuit rejected the plaintiffs' contention that the insurer violated ERISA's prohibition against self-dealing in plan assets by retaining and investing RAA funds for its own enrichment.

Though the plaintiffs conceded that funds in an insurer's general account are not plan assets, they argued that once a death benefit accrues and is redeemed via the establishment of an RAA, such funds become plan assets if retained in the insurer's general fund and remain as such until the RAA is fully liquidated.

"This argument lacks force," Selya said. "There is no basis, either in the case law or in common sense, for the proposition that funds held in an insurer's general account are somehow transmogrified into plan assets when they are credited to a beneficiary's account."

The court was similarly unconvinced that the insurer violated a duty of loyalty under ERISA by using RAAs.

"Although fiduciary duties do encompass some acts connected to the distribution of plan benefits, such fiduciary duties relate principally to ensuring that monies owed to beneficiaries are disbursed in accordance with the terms of the plan," Selya wrote, noting that both plans at issue in the case provided that the insurer would, upon proof of claim, pay the death benefit by making an RAA — described in each plan as an interest-bearing account established through an intermediary bank — available to the beneficiary.

"The insurer followed this protocol precisely," Selya said. "Once the insurer fulfilled these requirements, its duties as a ERISA fiduciary ceased."

Any additional obligation the insurer may have had constituted a straightforward creditor-debtor relationship, the judge continued.

The plaintiffs also failed to convince the 1st Circuit that Unum's setting of the interest rate to the RAAs constituted a fiduciary act that the insurer failed to carry out solely in the beneficiaries' interest.

"The RAAs were not plan assets and the setting of an interest rate for use in connection with the RAAs thus did not implicate any ERISA-related fiduciary," Selya stated.

Accordingly the 1st Circuit declared the District Court trial a "nullity" and ordered that it be vacated.

CASE: Merrimon, et al. v. Unum Life Insurance Company of America, Lawyers Weekly No. 01-175-14

COURT: 1st U.S. Circuit Court of Appeals

ISSUE: Did a life insurer's disbursement of death benefits under certain employee-benefit plans via the use of "retained asset accounts" violate its duty of loyalty under ERISA?

DECISION: No