

DOL Provides Guidance to Plan Fiduciaries in the Wake of Madoff Scandal

by Neal S. Schelberg and Charles F. Seemann III

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Plan fiduciaries are continuing to come to grips with losses in employee benefit plans that were invested with Bernard L. Madoff, who pled guilty in March to running the biggest investment fraud in Wall Street history. This article discusses the actions that the U.S. Department of Labor suggests fiduciaries take in handling Madoff-related losses in order to protect plan participants and beneficiaries.

News of the ever-growing Bernard L. Madoff investment scandal¹ has created many questions for plan fiduciaries attempting to address the significant investment losses that are either known or are likely to be incurred by their employee benefit plans. Recently, the Employee Benefits Security Administration of the U.S. Department of Labor (DOL) issued its first guidance on the duties of ERISA fiduciaries in handling Madoff-related losses.² Issued on February 5, the guidance emphasized ERISA fiduciaries' duties of "prudence and loyalty" to plan participants and beneficiaries in connection with their assessing and addressing material risks and losses that might result from the Madoff scandal.

While lacking in specifics, the DOL guidance provides a useful framework for assisting fiduciaries in fulfilling their duties and in protecting the interests of the plan participants and beneficiaries to whom they are responsible. The DOL advises the following actions.

Requesting disclosures from investment managers, fund managers and other investment intermediaries regarding the plan's potential exposure to Madoff-related losses

Many of the affected funds selected Madoff investment strategies on the recommendation of investment managers or consultants contracting with those funds to provide investment-related services. In addition, many funds have delegated discretionary investment authority to investment professionals who, in turn, invested plan assets directly in Madoff vehicles, or indirectly through so-called feeder funds.

The DOL guidance makes it clear that plan fiduciaries should seek complete information from these providers to determine the existence and extent of losses suffered by plan assets invested in Madoff strategies. In connection with such inquiries, plan fiduciaries should review the contracts, prospectuses and other instruments governing their plans' relationship with these providers. These instruments will often define the provider's duties to furnish information and, in some cases, may help fiduciaries identify actionable shortcomings in the services rendered. These instruments may also require the provider to take specific actions in connection with actual or potential losses and the resulting legal claims. In such cases, plan fiduciaries should also under-

take appropriate steps for monitoring whether or not the provider has fully satisfied its legal and contractual responsibilities.

Seeking advice regarding the likelihood of losses due to investments that may be at risk

In addition to obtaining more complete information, the DOL states that plan fiduciaries must obtain appropriate professional guidance regarding Madoff-related losses that their inquiries uncover. This means that fiduciaries should evaluate both the nature and the scope of potential losses, as well as the possibility that the fiduciaries' actions might diminish or avoid losses. This likely includes not only legal advice regarding plans' rights against fiduciaries and third parties, but tax and actuarial advice designed to diminish the impact of the Madoff scandal on the plan participants and beneficiaries.

Making appropriate disclosures to other plan fiduciaries and plan participants and beneficiaries

The Employee Retirement Income Security Act (ERISA) requires plan fiduciaries to provide material information to participants and beneficiaries. In the

context of the Madoff-related losses, this may include communication to participants and beneficiaries regarding the extent of the plan's investment losses; any potential impact that the investment losses could have on the operation of the trust fund, including its ability to continue providing plan benefits; and other material plan changes that the investment losses might require, and the steps being taken to protect the plan's interests and to limit the impact of the losses on the trust fund. In some situations, it may be appropriate for plan fiduciaries to identify to the other plan fiduciaries the potential breaches of fiduciary duty, such that all fiduciaries may assess the corresponding rights and responsibilities between and among those involved. The advisability of any disclosures must, however, be made on a case-by-case basis.

Considering whether the plans have claims that are reasonably likely to lead to recovery of Madoff-related losses that should be asserted against responsible fiduciaries or other intermediaries who placed plan assets with Madoff entities, as well as claims against the Madoff bankruptcy estate

One obvious step fiduciaries must take is to determine whether a plan has any legal remedies available against plan fiduciaries or parties in interest, such as investment managers and consultants, or third parties such as fund managers, fund auditors and the like. This will include legal counseling to help fiduciaries weigh the legal relief available, the likelihood of meaningful recovery and the costs associated with obtaining any such relief. The types of claims can include legal actions under ERISA or securities laws, as well as legal actions under the plans' contractual agreements with investment managers, investment consultants and other service providers.

Numerous class actions have already been filed. Plan fiduciaries should consider whether it serves the interests of the trust fund to join such a class action as a member of the class or to commence their own action and whether doing so could unnecessarily duplicate the costs and efforts associated with asserting such claims. In the event that fiduciaries conclude that passive participation in class litigation is advisable, steps should be taken to ensure the continuous monitoring and ongoing evaluation as to whether

such a course of action remains in the best interests of the plan participants and beneficiaries.

Ensuring claims are filed in accordance with applicable filing deadlines such as those applicable to bankruptcy claims and for coverage by the Securities Investor Protection Corporation (SIPC)³

SIPC has issued customer-claim packets to the investors it was able to identify from Madoff's records, including numerous ERISA plans. However, there are substantial questions regarding the completeness and accuracy of Madoff's records. Therefore, fiduciaries should undertake to determine whether they have accounts that are eligible for SIPC protection but which SIPC has not already identified. As noted above, fiduciaries have a duty to inquire about the nature and extent of Madoff-related losses with outside service providers. Depending on the nature of the plan's exposure to Madoff strategies, it may fall to these providers to make a timely claim for SIPC protection. Although maximum SIPC protection required a claim submission by March 4, 2009, there may be protection available to claimants filing after this date.

The DOL has provided the Web site of the court-appointed trustee for the liquidation of Bernard L. Madoff Investment Securities LLC (www.madofftrustee.com). This Web site contains the liquidation notice, claim forms and related claims information, and deadlines for the filing of claims with the trustee.

Several conclusions can be reached from the DOL's guidance.

First, it would appear that the mere fact the DOL issued this release is a fairly good indicator that the Madoff-related losses incurred by employee benefit plans must be significant and widespread.

Second, the DOL affirms that the plan fiduciaries' duties of prudence and loyalty should influence the approach that the fiduciaries must take in discerning and then addressing their employee benefit plans' exposure to Madoff-related losses. These steps include initiating lawsuits against service providers that were responsible for the employee benefit plans' investment with the Madoff entities, pursuing claims with insurers and filing claims in the Madoff entities' bankruptcy and liquidation proceedings. As

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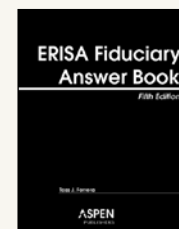
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Tess J. Ferrera. Aspen Publishers. 1,014 pages. Item #8541. \$265 (I.F. Members \$255). For details, view www.ifebp.org/books.asp?8541.

an example, the Pension Benefit Guaranty Corporation itself, acting as a successor trustee of a terminated pension plan, became a creditor in the liquidation proceedings of Madoff's investment firm.

Finally, the DOL guidance makes it clear that plan fiduciaries have a responsibility to disclose to other plan fiduciaries and to plan participants and beneficiaries the potential exposure to Madoff-related losses. Presumably, in the DOL's view, the obligation to disclose will make it more likely that if the plan incurred Madoff-related losses due to the action or inaction of any party, such party will be held accountable and the plan will be in the best position to recover its losses.

Endnotes

1. On December 11, 2008, the Securities and Exchange Commission (SEC) charged Bernard L. Madoff and his investment firm, Bernard L. Madoff Investment Securities LLC (collectively "Madoff"), with securities fraud in a multi-billion-dollar Ponzi scheme perpetrated on Madoff's clients. The SEC's complaint alleged, among other things, that Madoff acknowledged that his investment advisory business was a fraud and that it was "basically, a giant Ponzi scheme" (i.e., he had for years been paying returns to certain investors out of the principal received from other investors). Madoff admitted that the firm was insolvent and had been for years. On March 12, 2009, Madoff pled guilty to 11 criminal counts of running the biggest investment fraud in Wall Street history, drawing in as much as \$65 billion over 20 years. He is scheduled to be sentenced on June 16, 2009 when he could be imprisoned for the rest of his life.

2. Statement of Employee Benefits Security Administration: "Duties of Fiduciaries in Light of Recent Events Regarding Bernard L. Madoff Investment Securities LLC" (February 5, 2009).

3. The Securities Investor Protection Corporation provides protection to investors when a brokerage firm is closed due to bankruptcy or other financial difficulties and cash and securities are missing from customers' accounts. In such a case, SIPC usually asks a federal court to appoint a trustee to liquidate the firm and to protect its customers. The statute that created SIPC provides that customers of a failed broker-

age firm receive all nonnegotiable securities that are already registered in their names or in the process of being registered. All other so-called street name securities are distributed on a pro-rata basis. At the same time, funds from the SIPC reserve are available to satisfy the remaining claims of each customer up to a maximum of \$500,000. This figure includes a maximum of \$100,000 on claims for cash. Recovered funds are used to pay investors whose claims exceed SIPC's protection limit of \$500,000. However, SIPC does not compensate victims in the event of a loss due to investment fraud. **B&C**



Neal S. Schelberg is a partner in the law firm of Proskauer Rose LLP, where he practices exclusively in the employee benefits area. He provides legal counsel to single employer and multiemployer pension and welfare funds and their sponsors. Schelberg is listed in the 2007 *New York Super Lawyers* and the *Euromoney Legal Group Guide to the World's Leading Labour and Employment Lawyers*. He has served on various committees of the International Foundation of Employee Benefit Plans. Schelberg is a graduate of Hofstra University School of Law and the Georgetown University Law Center.



Charles F. Seemann III is a senior counsel in the New Orleans, Louisiana office of Proskauer Rose LLP. His practice emphasizes ERISA and employee benefits law, labor and employment law, and commercial litigation. Listed in the *Best Lawyers in America*, Seemann was named as a fellow in the Louisiana Bar Foundation in 1997 and has served on its Judicial Liaison Committee since 2000. He earned his J.D. degree from Louisiana State University and a B.A. degree from Emory University.