FEATURE

Fiduciary Responsibilities for Church Plans

The second of a three-part series addresses the fiduciary responsibilities of non-ERISA plans established and maintained by churches.

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This article is the second in a three-part series that summarizes the fiduciary responsibilities for those who sponsor retirement plans that are not subject to ERISA. Part 1, published in the Fall 2014 issue, looked at non-ERISA 403(b) plans established and maintained by non-profit employers. This part addresses non-ERISA church plans; Part 3, set for the Spring 2015 issue, will cover non-ERISA governmental plans.

THE CHURCH PLAN EXEMPTION FROM ERISA

ERISA §4(b)(2) exempts church plans from most ERISA requirements.[1] The church plan exemption was created because the examination of a church's books by the government might be regarded as "an unjustified invasion of the confidential relationship that is believed to be appropriate with regard to churches and their religious activities."[2]

The definition of a church plan is found in Section 3(33) of ERISA. Originally, ERISA defined a church plan as "a plan established and maintained…by a church or by a convention or association of churches which is exempt from tax under section 501 of title 26."[3] The church plan exemption was amended in 1980 to read: "[a] plan established and maintained for its employees (or their beneficiaries) by a church or by a convention or association of churches includes a plan maintained by an organization, whether a civil law corporation or otherwise, the principal purpose or function of which is the administration or funding of a plan or program for the provision of retirement benefits or welfare benefits, or both, for the employees of a church or a convention or association of churches, if such organization is controlled by or associated with a church or a convention or association of churches."[4]

For those who want to establish and maintain a church plan, a private letter ruling may be obtained from the IRS under the parallel definition of church plan found in Internal Revenue Code Section 414(e)(1).[5]

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RECENT CHALLENGES TO THE CHURCH PLAN EXEMPTION

In the spring of 2013, a nationwide wave of class action lawsuits were filed against five large hospital systems claiming affiliation with the Catholic Church. The claims were all the same: the defined

1 Note, however, that a plan may decide to voluntarily comply with ERISA, usually to gain some of its protections. 26 U.S.C. § 410(d).
2 Report of Senate Finance Comm., No. 93-383 (Aug. 21, 1973).
3 29 U.S.C. § 1002(33)(A).
4 29 U.S.C. § 1002(33)(C)(i).
5 The IRS recently issued updated guidance on the necessary procedural steps to obtain a private letter ruling that a plan is a church plan. Rev. Proc. 2011-44. In the last 20 years, seeking church plan status has become more popular and often involved plans that had funding issues. The guidance is generally seen as providing greater protections to participants in the plans seeking the exemption.

benefit pension plans sponsored by the hospitals were not eligible for the church plan exemption under ERISA. The arguments of the plaintiffs can be summarized as follows:

1. None of the plans sponsored by the collective defendants are plans "established and maintained" directly by churches as defined by 29 U.S.C. §1002(33)(A) or "pension boards" as defined by 29 U.S.C. §1002(33)(C)(i);
2. Nor are the plans established or maintained by organizations that are "associated with" a church as defined by 29 U.S.C. §1002(33)(C)(ii)(II), such as a school or hospital, such that the employees of these organizations could be defined as employees of a church. To be "associated with" a church means the organization "shares common religious bonds and convictions with that church or convention or association of churches" as defined by 29 U.S.C. §1002(33)(C)(iv). The defendants that have been sued do not share these common religious bonds with the Catholic Church; and
3. Informal guidance by the IRS and the Department of Labor have incorrectly interpreted the statute to allow a non-church organization to sponsor its own church plan as long as the organization is controlled by or associated with a church. This violates the plain language of the statute, which only allows two types of church plans: those established or maintained by a church or by a pension board (see item 1 above).

The lawsuits have sought rulings that the hospitals are violating nearly every provision of ERISA because the plans are being operated as non-ERISA plans. In total, the cases alleged that the plans are underfunded on a combined basis of more than $3 billion that resulted

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from the plans not following ERISA's minimum funding rules. Since then, four additional cases have been filed.[6]

Decisions have been issued favoring both the plaintiffs and the hospitals. The decisions friendly to the hospitals have agreed with longstanding IRS interpretations that a church or an organization controlled by or associated with a church can establish and maintain a church plan. The decisions that favor the plaintiffs disagree and find that only a church can establish a church plan, while organizations controlled or associated with a church cannot establish church plans but can maintain them as long as the plans were first established by churches. As of the writing of this article, two decisions are currently on appeal to the 3rd and 6th Circuit Courts of Appeals, with the former favorable to the plaintiffs and the latter favorable to the hospitals.

It remains to be seen how these cases will ultimately be decided. It will eventually take a decision by the Supreme Court or an act of Congress to settle the issue appropriately. In the meantime, for the church plan fiduciary, due diligence should be done to ensure that it is well established how and why the plan is eligible for the church plan exemption. No decision yet is binding on any party other than the defendant in the case. Until such time that a decision does come out that affects plans across the board, these cases should be monitored closely.

SOURCES OF NON-ERISA FIDUCIARY RESPONSIBILITY

Assuming that a plan is eligible for the church plan exemption, the following is a shortened summary of the applicable laws discussed Part 1 of this series (published in the fall 2014 issue of *Plan Consultant*) that should be reviewed by the church plan fiduciary. The reader should refer to Part 1 for a more thorough analysis.

1. Perform a Search of State Laws

The first thing an employer must do to understand which laws apply is to perform a search of the laws in their state. No two states have identical laws, either because different statutes have been passed or case law has developed differently over time. A qualified attorney can perform this search if the employer is unable to do so.

2. State Common Law of Trusts and the Restatement of Trusts

Common law, also known as case law or precedent, is law developed by judges through decisions of courts and similar tribunals, as opposed

6 *Rollins v. Dignity Health*; (2) *Kaplan v. Saint Peter's Healthcare System*; (3) *Overall v. Ascension Health*; (4) *Chavies v. Catholic Health East*; (5) *Medina v. Catholic Health Initiatives*; (6) *Stapleton v. Advocate Health Care Network*; (7) *Owens v. St. Anthony Medical Center, Inc.*; (8) *Lann v. Trinity Health*; and (9) *Morris v. Daughters of Charity Health.*

to statutes adopted through the legislative process or regulations issued by the executive branch. Such legal practices have the same legal force as if they were passed into law by a state's legislative body.

Responsibilities are most likely to arise under the common law of trusts. Due to a multitude of state variations, the Restatement of Trusts has typically been used to represent the prevailing developments in the common law. Under the Restatement, the trustee's duty to administer the trust commences when the individual accepts the appointment.

The standards governing the trustee's duties include "diligence" and "good faith in accordance with the terms of the trust and applicable law." The Restatement sets forth that the trustee's responsibilities when administering the trust and execution of the following functions:

- ascertaining the duties and powers of the trusteeship, and the beneficiaries and purposes of the trust;
- collecting and protecting trust property; and
- managing the trust estate to provide returns or other benefits from trust property.

The trustee under the Restatement has "core" and "ancillary" fiduciary responsibilities they must follow with regard to plan administration. The Restatement contains three fiduciary duties classified as core duties:

- Duty of Prudence (Restatement §77)
- Duty of Loyalty (Restatement §78)
- Duty of Impartiality (Restatement §79)

The Restatement contains five duties classified as ancillary duties:

- Duty with Respect to Delegation (Restatement §80)
- Duty with Respect to Co-Trustees (Restatement §81)
- Duty to Furnish Information to Beneficiaries (Restatement §82)
- Duty to Keep Records and Provide Reports (Restatement §83)
- Duty to Segregate and Identify Trust Property (Restatement §84)

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3. Uniform Trust Code

Check to see if your state has passed a version of the Uniform Trust Code (UTC). The UTC typically codifies longstanding common law in a state. Additionally, the UTC closely follow the Restatement of Trusts, but often makes important changes and adjustments, which is why it is important to have a qualified party review the law.

4. The Restatement's Prudent Investor Rule and the Uniform Prudent Investor Act

The Restatement also provides duties specific to investing. The General Standard of Prudent Investment (Restatement §90) incorporates some of the earlier duties such as prudence and loyalty. Additionally, the Restatement §91 requires adherence to investment provisions found in the trust itself or in a statute.

Similar to the adoption by states of the UTC, the Uniform Prudent Investor Act (UPIA) has been adopted with modifications by a limited number of states. The UPIA attempts to provide a model statute for adoption that strongly correlates to the Prudent Investor Rule.

5. Other State Common Law or Statutes

Even if a state's specific fiduciary trust laws will not apply to an employer's actions, other state law claims may be asserted. For example, if a plan participant files suit for benefits allegedly owed under a plan, that claim may be brought as a breach of contract claim. Depending on the state, the law governing the plan could be found in common law or the state may have adopted the Uniform Commercial Code (UCC), which may have applicability, again, depending on how the state crafted the law when it was adopted.

Alternatively, claims can be brought under an agency/principle theory if the facts support it. Claims have also been brought as tort claims for negligence. Finally, more and more claims are being brought under a state's consumer protections laws. If this type of law arguably applies in your state, make sure to fully understand the types of claims and damages that can be sought, as typically these laws include provisions for punitive damages or double/triple damages if the facts support it.

CONCLUSION

Church plan employers have a challenging landscape ahead as the contours of the exemption from ERISA play out in the courts and possibly in Congress. Nonetheless, the church plan fiduciary should continue to operate their plans with the best interests of the plan participants in mind.



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