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A New Litigious Era for ERISA and How a Retirement Plan Sponsor Can Protect Itself

Enacted in 1974, the Employee Retirement Income Security Act (ERISA) was designed with the goal of protecting the interest of participants and their beneficiaries in employee benefit plans. Prior to ERISA, the IRS was the primary regulator of private retirement plans. ERISA is now divided among the IRS, Department of Treasury and Department of Labor, broadening the power and scope which gave American workers a sense of security as they prepared for retirement. After 41 years, however, commentators highlighting ERISA's successes, have paid little attention to the newfound focus on fiduciary responsibility, resulting from an increase in litigation from alleged fiduciary breaches, particularly from 401(k) defined contribution plans.[1]

401(k) class action suits exploded in 2006, with over 20 law suits filed across the country, many of which resulted in substantial plaintiff settlements. Today, there are 10 pending cases accusing companies of failing to act in the best interest of employees who participant in their 401(k) plans, with one case that's made its way to the Supreme Court. We will examine this case and others as we provide a brief overview of the lawsuits that are shaking the retirement landscape. We will also offer general guidance that plan fiduciaries can take to help minimize legal risk.

Fiduciary breaches commonly fall into two categories: revenue sharing and excessive fees.

Revenue Sharing

Revenue sharing violations occur when agreements among service providers do not compensate for legitimate services, but rather provide for improper payments made by third-party financial institutions in exchange for being included as plan investment options. Revenue sharing can often occur under "bundled" service arrangements, which are common with large 401(k) providers. In these circumstances, it can be extremely difficult to monitor hidden revenue sharing fees and compensation. Moreover, as more recordkeeping service providers become vertically integrated, defining and reporting costs for each service can quickly become blurred. Revenue sharing violations are the most common claim among the majority of 401(k) ERISA litigation.

<u>**Tussey v. ABB, Inc.**</u>

On December 29th, 2006, a suit was filed against ABB, Inc. claiming a breach of fiduciary duty. In one count, the plaintiffs accused ABB of paying an amount that exceeded market costs for plan services in order to subsidize other corporate services provided to ABB by Fidelity, such as managing its health and welfare plans and recordkeeping of its nonqualified plans. Evidence included an email from Fidelity to an ABB employee responsible for negotiating Fidelity's service fees reminding ABB that Fidelity provided services for the health and welfare pans at below market cost and did not charge administration fees for the nonqualified plans, but rather, Fidelity "absorbed" those fees. On March 19th, 2014, the 8th Circuit Court of Appeals affirmed the lower court's ruling, stating ABB violated its fiduciary duties by failing to monitor and control recordkeeping fees, resulting in a $13.4 million dollar settlement with the plaintiffs.

Excessive Fees
While the Department of Labor (DOL) does not define an amount or percentage that constitutes excessive fees, there are some general guidelines which help define this fiduciary breach. Choosing a higher cost fund, when lower cost funds are available may be a breach of fiduciary responsibility. For example, a plan with availability to a bond fund with 50 basis point fees should not be offering a similar bond fund with 70 basis point fees. The second example that may constitute excessive fees is when participants are paying for actively managed funds that behave similarly to index funds. Plaintiffs contend that the fees imposed for these funds are excessive and that the plan sponsors and plan administrators breached their fiduciary duty by accepting these purportedly actively managed index funds as part of the plan menu offered to participants.[3] Excessive fees can also result in subsidized costs for other products, violating ERISA guidelines.

Abbott v. Lockheed Martin Corp.

Filed on September 11th, 2006, plaintiffs accused the plan sponsor of the 5th largest 401(k) in the country, Lockheed Martin, of imprudently managing employee retirement savings in funds that charged high fees, allowing a high level of employee savings to be held in low-yielding money-market funds and paying excessive recordkeeping fees. While Lockheed denied the allegations, on February 20th, 2015, Lockheed settled paying $62 million in plaintiff damages, making it is the largest settlement reached of its kind.

Tibble v. Edison International

One famed case currently pending, Tibble v. Edison, just made its way to the Supreme Court. While Tibble v. Edison settled in 2010, plaintiffs argue that the continued inclusion of the higher-cost funds in the benefit plan was a “continuing violation” of ERISA and, as such, the six-year statute of limitations should not apply. U.S. Solicitor General Donald B. Verilli stated, “plan fiduciaries have a ‘continuing fiduciary duty’ to review plan investments and eliminate imprudent ones." If the court rules in favor the plaintiffs, this would mean that fiduciaries and advisors will have ongoing responsibility for these plans, an outcome that will rock the retirement landscape and set off a domino effect of changes.

With a record number of lawsuits and multimillion dollar settlements across the country, what actions can employers take to reduce legal risk? As one popular 401(k) plaintiff attorney, Jerry Schlichter, stated, “The sponsor must always act with the strict guide that what it does must be based on the standard of one familiar with industry practices, investment management, and financial matters, while acting solely in the interests of plan participants.” Moreover, fiduciaries should always put participants’ interests first and avoid all situations which may result in self-dealing. Lastly, plan sponsors should acquire a fully informed understanding of industry practices and reasonableness of service providers’ fees.

Regarding fair market service provider fees, the fiduciary should take the right measures to ensure they are choosing a qualified service provider at reasonable market costs. The DOL’s Field Assistance Bulletin 2002-3 recommends that a fiduciary:

> *Engage in an objective process designed to elicit information necessary to assess the qualifications of the provider, the quality of services offered, and the reasonableness of the fees charged in light of the services provided.*

This is important guidance because often revenue sharing arrangements are made by providers to benefit each other and, as such, a “bundled” record keeper provider may have an incentive to “push” a certain investment manager if they know they are going to receive “soft dollars” of “revenue sharing” unbeknownst to the plan fiduciaries. These deals are often cut between the providers themselves outside of the presence of the plan fiduciaries and are not disclosed to the employees or employer plan sponsor.[4]

Fiduciaries do not have to select the lowest cost record keeper to satisfy prudence requirements; however, if recordkeeping services are offered under a bundled arrangement, fiduciaries should closely examine individual costs for each service, to ensure each service is being provided at a reasonable cost, and that one service is not subsidizing another. Plan fiduciaries should periodically benchmark the current market price of each individual service by conducting a request for service proposal from firms that specialize in each plan type, be it qualified, nonqualified, or health and welfare plans, to ensure that the bundled costs are reasonable. Other recordkeeping considerations should include: system capabilities and software systems, disaster recovery plan, communication (boilerplate or custom), implementation team, and system controls.

Alternatively, an unbundled approach may allow a plan sponsor to receive "best-in-class" service for each plan type from service providers that have specialized expertise and recordkeeping systems specific to each plan. The unbundled approach also eliminates the fiduciary liability risk of the qualified plan subsidizing the cost of the nonqualified and health and welfare plans and the potential litigation that may follow as a result.

With qualified defined contribution plans dominating the marketplace and holding over $4.5 trillion dollars in plan assets, attention to these accounts will continue to increase. As Jay Sushelsky, senior attorney for AARP stated, "All of these lawsuits have awakened the plan sponsors to the fact that they are under a lot of scrutiny. That's a good thing."

If you have additional questions or thoughts about this report or nonqualified plans, please do not hesitate to reach out to us.

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