

# Trends in Defined Contribution Litigation

Presented by:

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# Of Note

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We note that in this presentation we are only providing general information; the information contained in this presentation does not constitute legal advice. No attorney-client relationship has been created. If legal advice or other assistance is required, please contact us directly.

# Fiduciary Duties



# Who is a “Fiduciary”?

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- Although public 457(b) and 401(s) plan sponsors are not directly subject to the fiduciary responsibilities outlined in ERISA, similar state law rules apply
  - Many public plans use ERISA as a best practice
- **Generally, four ways to be a fiduciary under ERISA:**
  - Named in plan document
  - Authority to manage/dispose of plan assets & plan investments
  - Discretion over plan administration
  - Investment advice for a fee

# Investment Duties of Fiduciaries Under ERISA

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- Duty of prudence
  - Procedural prudence requires plan fiduciary to perform due diligence and gather all relevant information
  - Substantive prudence requires plan fiduciary to have necessary expertise or consult investment experts
- “Appropriate consideration” must be given
  - Role of proposed investment in portfolio
  - Risk of loss and opportunity for gain, and portfolio diversification
  - Liquidity and cash flow needs
- Instead of looking at a proposed investment in isolation, look at its relationship to the overall portfolio

# Investment Duties of Fiduciaries Under ERISA (continued)

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- *Tibble v. Edison Int'l*, 135 S. Ct. 1823 (2015)
  - Ongoing duty to monitor investments
    - ERISA's fiduciary duties are derived from the common law of trusts
    - Under common law of trusts, managing embraces monitoring of investments, and a fiduciary should systematically consider the investments at regular intervals
  - Excessive fees
    - Inclusion of retail class mutual funds with high fees held imprudent
    - Fiduciaries failed to investigate institutional class alternatives

# Other Related Duties Under ERISA

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- **Duty to Diversify**
  - Diversify investments so as to minimize risk of large losses
- **Participant Disclosures**
  - Must provide sufficient information on plan investment options
  - Detailed requirements under DOL's 404a-5 Regulations
  - Additional requirements for QDIA (Qualified Default Investment Alternative for plans with auto enrollment)

# History of DC Plan Litigation



# Participant Lawsuits

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- Recent lawsuits are very instructional
- 401(k) Plan Litigation – at issue is whether plan fiduciaries:
  - Acted prudently in selecting and monitoring plan investments and making changes when warranted
  - Understood service agreement, compensation arrangements
  - Ensured plan fees are reasonable and properly disclosed

# Participant Lawsuits

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- 403(b) Plan Litigation – at issue is whether plan fiduciaries acted in the best interest of participants when they allowed:
  - Multiple recordkeepers
  - Included too many and/or duplicative investment choices
  - Paid asset-based recordkeeping fees (vs. per participant charge)
  - Offered funds with high fees and/or restrictions

# Participant Lawsuits

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- Court decisions are based more on the process fiduciaries use rather than the particular result obtained
  - Increase of lawsuits since 2006 can be attributed to a multitude of factors, including “cookie cutter” nature of the complaints and the potential for high-dollar settlements
- Governmental plan sponsors should pay attention and learn from these court decisions and settlements

# What Prompted These Lawsuits?

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- Industry trends played a significant role
  - Popularity of participant-directed investments
  - Recordkeeping and other administrative fees increasingly borne by participants
- Repeated DOL initiatives to improve fee disclosures to plan sponsors and participants.
- Predictable outgrowth of increased public interest in retirement plan fees.
  - Plan fees and reporting on Form 5500
  - GAO reports

# Components of Excessive Fee Lawsuits

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- Excessive fee claims are well-suited for class-wide prosecution
- Many of the claims are brought by the same law firms
- Defendants include sponsoring employers, plans' investment and administrative committees, and employees (e.g., VP of HR)
- Claims require a breach of fiduciary duty and damages from that breach
- While each lawsuit makes claims based on the particular facts and circumstances of the plan, there are common themes

# Core Allegations in Excessive Fee Lawsuits

The Plans Had...	The Plans Should Have Had...
Multiple recordkeepers (some of whom charged for duplicative work)	One recordkeeper to keep fees lower
Revenue-sharing arrangement that resulted in excessive fees	Either no revenue-sharing or better controlled so service provider paid only a reasonable amount
Fees based on assets, resulting in excessive fees per participant	Flat fees per participant
No open, competitive bidding process for recordkeepers	Competitive bidding every 3 to 5 years
Conflict of Interest – Service providers selected because of relationship with fiduciary	Independent provider selected solely in the interest of participants
Too many core/window investment options that confused participants	Smaller number of options with varied risk/return

# Core Allegations in Excessive Fee Lawsuits

The Plans Had...	The Plans Should Have Had...
Actively managed funds with higher expenses that had no actual performance benefit	Passively managed funds with lower expenses that performed just as well
Investment options with severe restrictions on liquidity and penalties for early withdrawal	Investment options that allowed participants to move and withdraw funds without penalty or restriction
Duplicative investment options with different expense ratios (retail v. institutional classes)	One option for a target index with the lowest expense ratio
Particular investment management company funds that were more expensive than competitor fund	The cheapest available with comparable performance
Historically underperforming funds	New funds introduced when funds underperform

# Requests for Relief and Settlements

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- Restoration of losses (establishment of a settlement fund)
- Declaration that defendant(s) breached fiduciary duties
- Accounting of all transactions in connection with plan assets
- Require a competitive bidding process for a new recordkeeper
- Attorneys' fees and costs
- Review and reformation of the plan's investment options
- Retention of an independent investment consultant

# Call to Action

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- Litigation related to excessive plan fees and fiduciary duties is rapidly growing and expanding into new areas
  - These cases are not only expensive to defend, but are also expensive to settle
- Fiduciary liability insurers and underwriters are reacting and costs are increasing
- Plan sponsors should consider best fiduciary practices
- Plan sponsors should establish, follow and document a prudent process for retaining recordkeepers and determining their fees, as well as for selecting and regularly reviewing plan investments and investment expenses

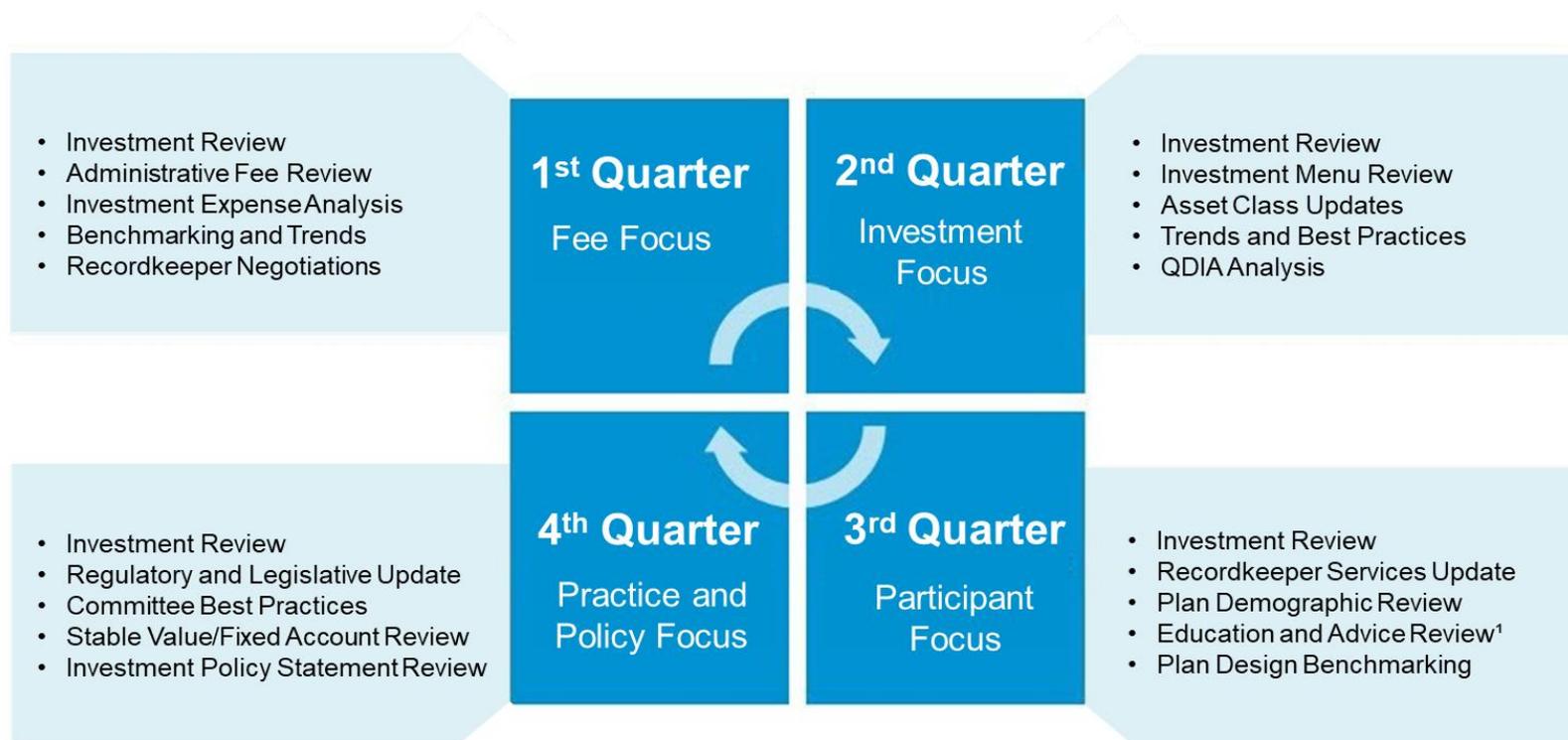
# Call to Action

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- Plan sponsors should retain qualified, independent experts to assist with fiduciary decisions
- Plan sponsors should document the process and rationale behind any fiduciary decision, being “particularly meticulous” when deciding to use more expensive products or services, or when going against expert advice

# Steps to Mitigate Risk

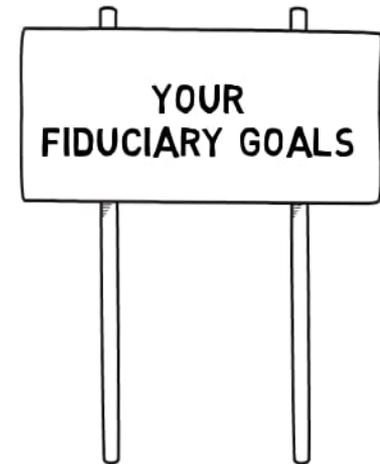
## Consider Establishing A Fiduciary Framework



# Steps to Mitigate Risk

## Focus On Creating The **RIGHT** Fiduciary Trail

- Consider drafting Fiduciary documents that help to outline your process and educate new committee members
- Designate a committee member or invited guest to record meeting minutes
- Ensure written records capture spirit of discussions/decisions (and are written appropriately)



# Steps to Mitigate Risk

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“...he couldn't see the forest for the trees”

- Consider your plan's unique demographics and circumstances when making decisions
- Be informed about changes in regulations impacting your plan
- Be intentional when designing your plan, selecting investments and allocating plan fees
- Seek expert help when needed



# Steps to Mitigate Risk

## Analyze Facts To Form **YOUR** Opinion

“Failure by the Plan to use lowest fee share classes”

Are the “net lowest” fee share classes more appropriate?



“Fees based on assets, resulting in excessive fees per participant”

Will a per capita fee allocation negatively impact my participants?

“Failure by the Plan to take steps to attempt to reduce recordkeeping fees”

Will participant (and plan sponsor) services suffer as a result of lower fees?

“Actively managed funds with higher expenses that had no actual performance benefit”

Are there asset classes in the plan where we have high conviction in active management?

# Case Study #1

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- City worked with 3 recordkeepers and had 102 total investment options
- Total weighted investment costs were 0.53% and total weighted recordkeeping costs were 0.34%
- The City was receiving mixed services from the various providers.
- The City had no documentation on recordkeeper selection or investment selections

## Litigation Risks

- Multiple recordkeepers (some of whom charged for duplicative work) (common in 457(b) plans)
- Revenue-sharing arrangement that resulted in excessive fees
- No open, competitive bidding process for recordkeepers
- Actively managed funds with higher expenses that had no actual performance benefit
- Investment options with severe restrictions on liquidity and penalties for early withdrawal
- Duplicative investment options with different expense ratios (retail v. institutional classes)
- Recordkeeper investment management company funds that were more expensive than competitor fund
- Historically underperforming funds

# Case Study #1 (Continued)

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## Actions to mitigate risk

- City conducted a public RFP following purchasing procedures
- Total weighted investment costs went to 0.39% and total weighted recordkeeping costs went to 0.06% through a single recordkeeper (\$250,000 in savings to employees per year).
- Conducted a full review of investment menu and selected best in class investments that streamlined the investment menu.
- Offered a Brokerage Window to allow employees select familiar funds.
- The City created a committee to monitor ongoing performance of funds, fees and recordkeeper.

# Case Study #2

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- City worked with 1 recordkeeper and had 45 total investment options all proprietary (many passive/index options)
- Total weighted investment costs were 0.30% and total weighted recordkeeping costs were 0.30%
- The City was receiving mixed services from the various providers.
- The City had no documentation on recordkeeper selection or investment selections.
- The City had a fraud breach of a participants account.

## Litigation Risks

- No open, competitive bidding process for recordkeeper
- Duplicative investment options with different expense ratios (retail v. institutional classes)
- Recordkeeper investment management company funds that were more expensive than competitor fund
- Recordkeeper fees were higher than benchmarks, very little service was received.

# Case Study #2 (Continued)

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## Actions to mitigate risk

- City conducted a public RFP following purchasing procedures.
- Significant focus was on cyber-security and fraud protection.
- Total weighted recordkeeping costs were reduced by 80%.
- Conducted a full review of investment menu and selected best in class investments that streamlined the investment menu.
- Education and Communication resources were significantly increased.
- The City created a committee to monitor ongoing performance of funds, fees and recordkeeper.

# Questions?

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