CAMMACK RETIREMENT

Dissecting Retirement Plan Lawsuit Issues

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The stream of lawsuits filed for alleged mismanagement of retirement plans has been a cause for concern for plan sponsors of all different sizes and industries across the country. Over the last decade, there have been approximately 100 lawsuits filed by retirement plan participant plaintiffs against plan fiduciaries. While the initial lawsuit defendants were all large public corporations, more recently, the defendants have been not-for-profit organizations, such as large higher education and healthcare institutions. The claims incorporated into these complaints cover a broad spectrum, but there are some that are common across many of these lawsuits. Below, we explore the more frequently cited issues, focusing on the recent lawsuits filed against higher education and healthcare institutions[1]. We also provide some thoughts on how retirement plan sponsors can prepare their plans and protect fiduciaries.

PAYING TOO MUCH FOR RECORDKEEPING SERVICES

All of the lawsuits filed for breach of fiduciary responsibility incorporate some element of plan fees being too high. Frequently, the complaint indicates that the fees paid to the plan recordkeeper are higher than they should be, given the size of the plan, as compared to fees paid by other similarly-sized plans. The language in some of these complaints details the comparison completed by the plaintiffs and the source of the information showing plans of similar size and their fees.

However, two plans of similar asset size do not necessarily have the same associated costs for recordkeeping. There are many factors that influence the plan servicing fee. Assets per participant is a particularly important plan statistic. If two plans have the same amount of assets, but one plan has half the number of participants (meaning the assets per participant for that plan is twice as high), the cost for recordkeeping should be less for that plan.

The services being provided to the plan also have a large impact. For example, if two plans have the same level of assets, but one plan has no on-site education provided, whereas the other has two days per month of on-site education, the latter plan is going to cost more to service.

Even plan design can play a part. If one plan allows an unlimited number of loans, for example, and the other does not have a loan provision; or if one plan has multiple contracts, versus the other plan having only one contract, these elements will cause the former plan to cost more to service.

Despite all of the factors that affect the cost of recordkeeping a plan, these lawsuits rarely provide any details beyond asset size. Plan sponsors should conduct benchmarking comparisons of their fees. And while it is important to compare your plan with those of other similarly-sized plans as a starting point, plan sponsors must also understand what is driving the cost of the plan's recordkeeping.

For example, it is possible that a plan may have fees below the median cost for plans of similar size, and yet the fees might still be too high, depending on plan design, services, assets per participant, and other details. Understanding the full picture is the only way a plan sponsor can truly determine whether or not their plan fees are reasonable and competitive, and that they are receiving value for those fees.

LESS EXPENSIVE SHARE CLASSES AVAILABLE

Most of the referenced lawsuits claim that the plan sponsor included more expensive share classes of investments in the plan's lineup than necessary. Many mutual fund providers offer multiple share classes of the same mutual fund. They typically offer one share class for retail investors and/or small plans, and then one or more other share classes for larger plans. The underlying investments and allocations within these share classes are largely identical, but they differ in the amount of associated fees. As plans grow larger, they are able to qualify, or negotiate, to use the less expensive share classes of their plan's investments.

Different plans will have different service models regardless of the plan asset size. The cost for plan investments depends in part on plan size, assets per participant, and how the plan sponsor pays for plan services. If revenue sharing is used, the fees will naturally be higher than if the plan sponsor or participants pay directly for plan services. The fact that one plan may be able to obtain less expensive share classes of a fund than another plan, even though the two plans have similar assets, may be the result of the services provided by the recordkeeper and the model for how plan fees are paid.

However, paying too much for plan investments is a potential fiduciary concern. Some of the complaints indicate that the plan sponsor did not ask if less expensive share classes would be available for their plan; they just accepted what the recordkeeper offered. It is important for plan sponsors to be able to demonstrate that they requested the lowest cost share classes available to their plan from their recordkeeper. The plan sponsor should document that request, as well as the recordkeeper's response and any subsequent decisions or actions taken by the plan sponsor.

MULTIPLE RECORDKEEPERS

In a number of the plans that have claims filed against them, the plan offered multiple recordkeepers. In those plans, participants have the option to select one or more recordkeepers to which to direct either their own salary reduction contributions and/or contributions from their employer.

The argument for consolidating to one recordkeeper is that a single provider is able to offer its best deal to the plan sponsor since no competing recordleeper is in the plan. If there are multiple recordkeepers, inevitably, the contributions will be split amongst the providers in some percentage; no one provider will receive all of the flow to the plan, and thus will not gain the most economy of scale with that plan. In addition, the recordkeepers may need to spend more resources putting representatives on-site to compete for the contributions and assets, thereby increasing their internal costs. If there is only one provider, these concerns go away, and the recordkeeper can offer a more cost-effective service model. In order for the lowest-cost model to be offered, the competition among recordkeepers needs to be kept at the plan sponsor level (where they decide among vendor proposals), as opposed to the participant level.

Nevertheless, there may be good reasons for offering multiple recordkeepers. Perhaps one provider offers 80%-90% of what a plan sponsor is seeking, but cannot provide certain service elements or investment products that the plan sponsor deems critical to their participants. In the initial reviews by judges in the lawsuits, there have been mixed results. Some of the judges have thrown out the claim that participants are hurt by having multiple recordkeepers, whereas other judges have allowed those claims to proceed.

For those plan sponsors offering multiple recordkeepers in their plan, it is worth reviewing the current service model to ensure that it is serving the best interests of participants. This may include learning what types of offers are available if the plan were to consolidate to one vendor, and evaluating the impact that the removal of one or more providers would have on fees, plan participants and the service model. Whatever the outcome from that evaluation, plan sponsors should document the review and decision process.

TOO MANY INVESTMENT OPTIONS

Several of the 403(b) plan lawsuits incorporate into the complaint that the retirement plan offered too many investment options. This is often a result of having multiple recordkeepers available, each maintaining an extensive array of investments (if not their entire set of proprietary funds) for the plan. In some of the cases, this led the total number of investment options to exceed a few hundred choices.

The lawsuits claim that having so many investment choices can cause participant confusion. The thought is that this confusion leads to reduced plan participation through "paralysis by analysis"; with too many choices, a participant is unable to make any decision, and thus does not participate in the plan.

In addition, the inclusion of so many investments can also lead to a deterioration of the plan benefit. Certain fund families maintain minimum asset thresholds for access to cheaper share classes of their funds, as referenced earlier. As more assets from the plan accumulate in an investment, the investment company lowers the cost of the fund through a different share class. Thus, if all assets for one asset class were directed to one investment option in that asset class, rather than being spread out among two, three or more investments in that asset class, the investment is more likely to meet the minimum asset threshold, and participants would experience reduced fees.

The rulings on these have also been mixed thus far. In one case, the judge indicated that the plan, which had over one hundred investments, was giving participants sufficient opportunities to make their investment decisions, and was not hurting them by offering a vast array of funds. Thus, the claim was dismissed. In another lawsuit, the judge agreed with the plaintiffs' argument and has allowed the claim to move forward to trial. In this latter case, there are over four-hundred investments available.

It remains to be seen how different judges will adjudicate this issue. However, since it has been a topic of such discussion, it is certainly prudent for plan sponsors to consider the extent of the investments offered in their plan, and make determinations as to whether there is a reason for allowing so many investments to be included. This discussion should be documented to provide evidence of a thoughtful consideration of the impact.

NO RECORDKEEPER SEARCH CONDUCTED

In many of the complaints, the plaintiffs argued that the plan sponsor had not conducted a comparative search for

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recordkeeper services, such as through a request for proposal (RFP) process. The complaints claim that RFPs should be conducted every five years, or in some of the claims, every three years.

An RFP is certainly a good tool to force a plan sponsor's recordkeeper to enhance its current offering. With the imminent prospect of losing the business, the incumbent recordkeeper may be inclined to make a better offer than straight negotiating might yield by itself.

However, there is nothing in ERISA that states that an RFP must be conducted every so often, or even at all. ERISA dictates that the fees in the plan must be reasonable and competitive for the services being provided. If the plan sponsor can achieve that without conducting an RFP, and can show that the plan fees meet this standard, that should be considered satisfactory. Nevertheless, an RFP is a good process to undergo periodically. The plan sponsor should maintain the results from this process to help demonstrate that the fiduciaries are completing their due diligence.

USE OF ASSET-BASED FEE RATHER THAN FLAT DOLLAR AMOUNT

Some of the complaints indicate that the fiduciaries breached their responsibility by allowing the plan to pay asset-based fees for recordkeeping services, as opposed to flat dollar fees. The implication is that as plan assets grow, the total dollars collected will grow proportionately under asset-based fees, whereas with flat dollar fees, they will only grow with an increase in the number of participants.

Under the assumption that investment markets will generally increase, the latter model should lead to the plan paying lower fees because the increase in cost based on the number of participants will rise more slowly than the growth of plan assets. Naturally, this is not always the case. But it does emphasize the importance of plan sponsors regularly reviewing plan fees. Conducting an annual benchmarking of plan fees is a good way to maintain a gauge of where the market value resides for plan services. This is true whether a plan is paying asset-based or flat dollar fees.

With documentation of regular fee reviews, and taking action when fees appear higher than necessary, plan fiduciaries should have the supporting information to defend their plan fee models, whether that be asset-based or a flat dollar amount. It does not seem reasonable to state that allowing asset-based fees for plan service costs is a breach of responsibility, given that mutual fund managers almost always charge asset-based fees for their investment management services (and their fees are typically significantly higher than the recordkeeping fees). Nevertheless, plan sponsors should have their recordkeeper provide their fees both ways, as a flat dollar charge and an asset-based fee, so that they can decide which model makes the most sense for their organization. As always, plan sponsors should document that decision.

CONCLUSION

Certainly, the latest spate of lawsuits filed against the retirement plans of healthcare organizations and higher education institutions is getting the attention of these plan sponsors. And, if the plaintiffs are successful in some of these claims, there will likely be many more similar claims filed against other plans.

The common theme through all the above-mentioned issues is that plan sponsors need to have thoughtful discussions about the various alternatives and make conscious choices about their plan features. Why does the plan need multiple recordkeepers? Why does the plan need so many investment options? How should the plan pay for plan services? Different plan sponsors will come to different conclusions on these questions based on the facts and circumstances of their plans. Documenting how they reached their decision in each case is part of how they can defend themselves against potential claims.

Unlike the lawsuits against many of the corporate plans, the defendants are not settling out of court; every one of these healthcare and higher education plan sponsors is fighting the suit. In addition to sending a message to potential plaintiffs' attorneys that they should proceed cautiously, as winning the lawsuit is going to be a battle and will cost resources to bring to trial, the fact that these lawsuits will be adjudicated in court provides plan sponsors with more guidance for the future. While it is likely that some claims will be successful in certain courts, but denied in others, the rulings that come out of these decisions will help plan sponsors develop a better roadmap to fulfill their fiduciary responsibilities—and ultimately help them in offering the most competitive program to participants while simultaneously protecting the plan, the organization, and its fiduciaries.

[1]Healthcare Organization & Higher Education Institution Lawsuits:

Larson v. Allina Health System, No. 0:17-cv-03835
Morin v. Essentia Health, No. 0:16-cv-04397
Disselkamp v. Norton Healthcare, No. 3:18-cv-00048
Short v. Brown University, No. 1:17-cv-00318
Cates v. Trustees of Columbia University, No. 1:16-cv-06524
Cunningham v. Cornell University, No. 1:16-cv-06525
Clark v. Duke University, No. 1:16-cv-01044
Henderson v. Emory University, No. 1:16-cv-02920
Wilcox v. Georgetown University, No. 1:18-cv-00422
Kelly v. Johns Hopkins University, No. 1:16 -cv-02835
Tracey v. Massachusetts Institute of Technology, No. 1:16-cv-11620
Divane v. Northwestern University, No. 1:16-cv-08157
Sacerdote v. New York University, No. 1:16-cv-06284
Sweda v. University of Pennsylvania, No. 2:16-cv-04329
Nicolas v. Trustees of Princeton University, No. 3:17-cv-03695
Daugherty v. University of Chicago, No. 1:17-cv-03736
Munro v. University of Southern California, No. 2:16-cv-06191
Cassell v. Vanderbilt University, No. 3:16-cv-02086
Davis v. Washington University in Saint Louis, No. 4:17-cv-01641
Vellali v. Yale University, No. 3:16-cv-01345

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For more information on our services, please contact **Earle Allen,** Partner, at **646.839.8206** or **eallen@cammackretirement.com**.

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