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Lawsuit Rulings Provide Hope for Plan Sponsors

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The retirement plan industry has seen many lawsuits in the past several years. Plan sponsors have been repeatedly accused of not fulfilling their fiduciary responsibility to their plans and participants. The first lawsuits were filed against large corporate 401(k) plans. However, in the past 8-12 months, lawsuits have been filed against more than a dozen large not-for-profit organizations' retirement plans. Most of these have been filed against the fiduciaries of large private higher education retirement plans, but there has been one claim against a healthcare 403(b) plan as well.

One of the main themes common to all of these lawsuits, both with the fiduciaries of for-profit and not-for-profit retirement plans, is that the plan sponsor selected funds for the investment lineup that included fees significantly higher than what they should have been. In each case, the claim cites that participants were forced to pay these higher fees, thus lowering their investment return and causing their account balances to have lesser long-term accumulations.

There are many reported analyses on how the fees incorporated into the investments of a retirement plan impact the long-term accumulation of a participant's balance. Vanguard conducted a study showing how a $100,000 investment with an annualized 6% return is impacted over a 30-year investment period. A 0.25% fee leads to a reduced account accumulation of $41,500 over the 30-year timeframe. A 0.90% fee leads to more than $135,000 in lost earnings over the same period. These long-term account reductions can lead to a lesser standard of living in retirement or the need to work longer to achieve a sufficient retirement balance. Due to the potential harm they can cause to plan participants, the issue of fees has been raised in every one of the lawsuits claiming that plan fiduciaries did not perform their due diligence to achieve lower costs.

One of the results of the fee claims in these lawsuits is that plan sponsors throughout all industries have become very cautious about the fees included in their plans. There has been a shift to incorporate more index funds in the plan lineups. As noted by the researchers in a study conducted by Cerulli Associates, "A significant consequence of this focus on fees is an increased interest in passive investing." These passively managed investments generally have lower associated fees, which reduce the cost to participants; and, in theory, will protect plan fiduciaries in any potential lawsuits.

However, it is important for plan sponsors to understand that it is not their responsibility to include only the lowest cost investments in each asset category within their retirement plan. It is not required, and it should not be the case, that plan fees are the sole determining factor when selecting investments. In Hecker v. Deere & Co., the 7th Circuit Court stated, "The fact that it is possible that some other funds might have had even lower ratios is beside the point; nothing in ERISA requires every fiduciary to find and offer the cheapest fund possible (which might, of course, be plagued by other problems)."

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Cost should be a consideration in the decision process, but it is only one factor. Each investment must be evaluated in the context of its overall performance, cost, and the value received through its role in the plan portfolio. Plan sponsors using cost as the only factor are potentially failing to fulfill their responsibility to finding investments that are reasonable and competitive.

In a recent case, Brotherston et al v. Putnam Investments, the U.S. District Court of Massachusetts ruled on the comparison of fees in determining whether the Putnam fees were reasonable. The Plaintiffs, using the expert testimony of Dr. Steve Pomerantz, had compared the fees of actively managed Putnam funds with those of passively managed Vanguard funds. The court's opinion included the following statement: "Dr. Pomerantz's comparison is flawed. Vanguard is a low-cost mutual fund provider operating index funds 'at-cost.' Putnam mutual funds operate for profit and include both index and actively managed investment. Dr. Pomerantz's analysis thus compares apples to oranges."

This ruling is significant because many of the lawsuits that have been filed against the fiduciaries of retirement plans have included Vanguard as the standard by which the fees of the investments in question have been compared. By acknowledging the difference in both the type of investment, active versus passive, and the model used by the investment provider, the District Court's opinion should be helpful to the defendants in these lawsuits.

Another District Court recently ruled in favor of the defendants, covering similar issues. In Rosen v. Prudential Retirement Insurance & Annuity Company et al, the Plaintiffs claimed that the plan, sponsored by Ferguson Enterprises, using CapTrust Financial Advisors as the investment advisor, offered too many high-cost investment options. The plan held sixteen investment options, including three index funds, with a variety of associated fees. The District stated that, "Taken as a whole, the total menu of investment options resulted in expense ratios ranging from 0.04% to 1.02%," and ruled that "The inclusion of these lower cost alternatives undermines the Plaintiffs assertions that Ferguson and CapFinancial (CapTrust) breached their fiduciary duties by charging excessive fees." This opinion supports the concept that plan sponsors do not need to offer only low-cost index funds, but can include a variety of actively and passively managed options with a range of associated fees.

These latest outcomes from the fee lawsuits against Putnam and Prudential should provide plan sponsors with some encouragement. It is clear from these rulings that courts are acknowledging that active fund management has a role in the investment lineups of retirement plans. Plan sponsors should not feel compelled to offer only low-cost index funds to protect themselves and the plan fiduciaries. Fees are important and should be closely scrutinized to affirm that there is value received by participants for the fees associated with the investments. However, the cost of the investments remains only one of several components of investments that must be considered when evaluating funds for a retirement plan lineup.

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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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