The Fiduciary Breach Lawsuits: Lessons Learned

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With more than 100 lawsuits filed against the fiduciaries of defined contribution retirement plans for breach of their responsibilities, litigation has plagued the retirement plan industry for the past decade. While the issues of these suits are varied and complex, most focus on actions taken or not taken that may have limited the potential growth of retirement plan participants' account balances.

Over the past few months, we launched an in-depth exploration into the claims of these lawsuits, highlighting the issues, the litigation outcomes and the key take-aways for retirement plan sponsors. Below is a recap of our Fiduciary Breach Lawsuit Series.

1. ACTIVE VERSUS PASSIVE INVESTMENTS

In many of the lawsuits filed against the fiduciaries of defined contribution retirement plans, there have been claims that the plan sponsor included one or more investments in the plan lineup that underperformed the particular benchmark for the fund's asset class.

While passive investments seek to mirror the asset class index holdings, active managers try to surpass the index, net of fees. In practice, consistently beating the benchmark is a challenge that many managers fail to overcome. Actively managed funds also cost more than index options in the same asset class, due to the research and analysis required of actively-managed fund managers. This results in some active managers underperforming their asset class benchmark while charging higher fees to participants.

Some of the fiduciary breach lawsuits state that the manager failed to competently select the underlying holdings, which cost the participants potential for investment return, and that participants are not receiving any value for these higher fees. Thus, the claims argue that fiduciaries should have used passive investment options instead of active ones in the plan.

However, based on the outcomes of the litigation surrounding this issue, it seems clear that plan fiduciaries can include actively-managed investment options in their plans. There is nothing in the ERISA regulations that requires a plan to include any index investment options, or to select passive funds instead of active options in any particular asset class. However, it will likely help lessen the chances of being sued on this issue if there are at least some index funds included in the investment lineup. In addition, it will be helpful for plan fiduciaries to be able to demonstrate that the retirement plan committee periodically debates the merits of active versus passive investments, particularly as it considers changes to any of the plan options. As long as there is a reasonable basis for the ultimate investment selection, and the foundation for that decision is documented, the committee should be protected. To learn more about this issue, please click here.

2. ASSET-BASED FEES VERSUS PER-PARTICIPANT FEES

Another claim asserted by plaintiffs in many of the lawsuits is that retirement plan fiduciaries allow recordkeepers to charge fees based on the assets in the plan, when they should charge a flat-dollar amount per participant. The argument behind this claim is that the cost for providing recordkeeping services to participants should be roughly the same, regardless of the amount of assets a participant has in his/her account.

The overriding message from the litigation proceedings is that there is no right or wrong way to charge plan fees. Both asset-based fees and per-participant fee methods are used by many plans. The retirement plan committee should explore the options and understand how each method may impact their plan's participants, documenting the decision and rationale behind it.

Regardless of which method is selected, it is important for plan committees to regularly review plan fees and note growth over time. Conducting periodic fee benchmarking analyses will give plan fiduciaries a better sense of the competitiveness of their asset-based or per-participant fees, particularly when accounting for the value of the services provided. Finally, conducting a recordkeeper RFP periodically will also help gauge what other recordkeepers would charge to service the plan, and thus assist the plan sponsor in negotiating the most competitive fees. To learn more about fee allocation as a fiduciary breach lawsuit topic, click here.

3. TOO MANY INVESTMENT OPTIONS

A frequent issue cited in the lawsuits is that the retirement plan offers too many investment options. In the lawsuits where this issue has been identified, there has been a consistent claim that "Defendants provided a dizzying array of duplicative funds."[1]

In addition to causing confusion for participants, too many investment choices can lead to "analysis paralysis," ultimately reducing participation. Also, since some investment managers offer a better pricing structure to retirement plans as more assets are allocated to their investments, the distribution of plan assets among a large number of investment options can mean that the plan and participants do not receive the benefit of these price breaks within the funds.

While the lawsuit claims have largely failed to implicate the plan sponsor for imprudent oversight of the plan, they raise reasonable questions about whether or not having too many investment options could reduce participation or force the plan to use higher cost share classes of investments. If the plan sponsor's objective is to provide employees with an opportunity to accumulate assets for

[1]*Cates v. Trustees of Columbia University*

retirement through a competitive program, limiting the number of investments to a reasonable range (typically, fewer than thirty) can enable participants to have a better understanding of their options and empower them to make thoughtful allocation decisions. To read more about this issue, click here.

4. MULTIPLE ACTIVE RECORDKEEPERS

Another common thread among the institutions sued over their retirement plans is that they had multiple recordkeepers available for active participant contributions. According to the lawsuits, having multiple providers allegedly led to significantly higher recordkeeping fees and subsequently lowered the account accumulations for the plan participants.

In general, retirement plans may experience higher fees as a result of using multiple recordkeepers. In a single recordkeeper environment, the provider receives all the contributions to the plan. However, in a multiple vendor environment, neither vendor collects the full amount. Additionally, the vendor needs to send representatives onsite more often to sell its services, in order to convince participants to use its program. As a result, in a multi-vendor environment, each vendor must spend more resources to collect fewer contributions. This typically leads to the recordkeeper charging higher fees than if they were the exclusive provider.

For the participant, having multiple recordkeepers servicing the plan adds to the decision-making process. In addition to deciding whether or not to participate, determining how much to contribute, and in which options to invest their assets, they must also choose from the available recordkeepers. Additional decision points can cause confusion and potentially lower participation.

The claim that offering multiple recordkeepers for a retirement plan is a breach of fiduciary responsibilities has met with mixed results. There may be reasons why it is beneficial to offer more than one provider. If one provider is unable to deliver all the services sought by a plan sponsor, it may be necessary to contract with two or more recordkeepers. However, based on the results of these lawsuits, plan sponsors should closely examine their reasons for including more than one provider in their plan. Given the potential for higher fees to be charged by the recordkeepers when more than one is present, the plan sponsor must be able to explain how the multiple provider structure benefits participants, and should be able to demonstrate a regular review of these recordkeepers to show that a multiple provider arrangement remains necessary for the plan. Read the full piece by clicking here.

5. NO REGULAR RECORDKEEPER RFPs

A claim incorporated into several of the retirement plan lawsuits is that the plan sponsor did not conduct a regular competitive bidding process through a Request for Proposal (RFP) to obtain the most competitive recordkeeping and administrative services for the plan. An example of the specific language in the claim, which is repeated verbatim in many of the lawsuits, reads, “Defendants also failed to conduct a competitive bidding process for the Plan's recordkeeping services. A competitive bidding process for the Plan's recordkeeping services would have produced a reasonable recordkeeping fee for the Plan."[2]

Among the issues we have examined thus far, the claim about fiduciaries failing in their duty of prudence by not conducting RFPs has had the most success for plaintiffs, proceeding past the motion to dismiss more than 70% of the time. While ERISA does not specify the need to conduct an RFP every certain number of years - or ever - the courts have generally acknowledged that competitive bidding processes are good mechanisms for plan sponsors to benchmark the plan and confirm whether or not the fees are appropriate for the services provided.

In light of this, plan sponsors should consider conducting an RFP for their plan if one has not been done in the last several years, both to protect themselves from a fiduciary perspective, but also to ensure they are receiving value for their plan fees and delivering enhanced benefits to their participants. To read the article in its entirety, click here.

CONCLUSION

With the reach of litigation expanding to include organizations of different sizes across a variety of industries, plan sponsors should be cognizant of the issues raised by the lawsuits and stay abreast of developments. By carefully examining their plans, addressing any issues, and ensuring a proper, well-documented fiduciary process is in place, plan sponsors may be able to protect themselves from becoming the next retirement plan lawsuit target.

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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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[2]*Clark v. Duke University, et al*