InvestmentNews

Excessive-fee litigation in retirement plan market moving downstream

What small-plan advisers can do to minimize fiduciary liability risk

Marcia S. Wagner, Nov 22, 2017

A series of civil actions filed against the sponsors of 403(b) plans last summer named as defendants several large universities, including the Massachusetts Institute of Technology, Yale, New York University, Duke, Vanderbilt, University of Pennsylvania, Emory, Johns Hopkins, Cornell, Harvard, Northwestern, University of Southern California and Columbia. These actions were brought by the law firm Schlichter Bogard & Denton, the same firm that on Sep. 11, 2006, filed lawsuits against Exelon Corp., Northrop Gruman Corp., General Dynamics, Lockheed Martin, International Paper and Caterpillar.

Sponsors of mega-sized plans such as these, with several billion dollars in assets, continue to be targets of 401(k) litigation, as evidenced by recent suits against Verizon, Chevron, Intel, Oracle and American Airlines. It's not surprising these firms are targets of litigation brought under the Employee Retirement Income Security Act of 1974 — the settlements and accompanying legal fees they can generate are large, such as a $62 million settlement with Boeing, a $57 million settlement with Lockheed Martin and a $31 million settlement with MassMutual.

Recent examples

While sponsors of mega plans continue to be targets, there is evidence that substantially smaller plans are in the crosshairs of excessive-fee suits, too. The case of Bernaola v. Checksmart Financial, brought in 2016, involved a plan with $25 million in assets; in Damberg v. Lamettry's Collision Inc. (also a 2016 case, which was ultimately voluntarily dismissed) the plan assets were slightly in excess of $9 million. Earlier this year, in Schmitt v. Nationwide Life Insurance Co., the plan had 27 participants and plan assets were $1.1 million.

Obviously, three cases do not establish a trend, but those cases clearly put on shaky footing the premise that some plans are too small to sue. What makes such plans potentially inviting litigation targets is that a plan fiduciary's obligations under ERISA are not scalable: The same fiduciary duties of prudence, loyalty and diversification, and the same prohibited transactions, apply to small and large plans alike.

The only recognized adjustment is smaller plans don't need to devote the same time and resources to compliance as would a substantially larger plan. Also, because of their needs to focus upon their business, owners of small businesses are likely to pay less attention to their plans or the selection of a vendor: They may, for example, simply ask their bank if there is a plan that is essentially a turnkey program they can adopt.

Best practices

In such an environment, what are best practices a retirement plan adviser can follow to minimize the risk of fiduciary liability?

• It is important that the services agreement established with a plan specify as precisely as possible the services the adviser is performing for the plan. Even under the Department of Labor fiduciary rule, which expands the definition of fiduciary investment advice, it remains a basic principle of ERISA that a party is only a fiduciary to the extent that it performs certain functions. Thus, if a financial adviser is reviewing a proposed investment menu, the services agreement should specify that another party is actually making the final investment decision.

• While a financial adviser who is a fiduciary cannot contractually modify the circumstances under which it could have co-fiduciary liability, the services agreement should make clear that the adviser has no responsibility to monitor the conduct of other fiduciaries, and that it has no obligation to use reasonable care to prevent another fiduciary from breaching its fiduciary responsibility.

• If the services agreement provides for cross-indemnification, the circumstances under which the indemnification obligation will be triggered should be narrowly defined.

• The adviser should obtain fiduciary liability insurance.

• From an operational perspective, if the plan is operating under an investment policy statement, it should be sure its activities are limited to those set forth in the IPS.

• The adviser should ensure that any activities he/she undertakes are documented to the fullest extent possible.

• While past errors and violations may not always be corrected, the adviser should at least review current practices to determine if any fixes are in order. Some potential violations can be cured easily and quickly, such as moving to a lower-cost available share class. If fees and investment performance have not been benchmarked, be sure the issue is timely addressed.

• Be transparent in your communications with plan sponsors. A 408(b)(2) disclosure statement (a fee disclosure statement) should not be opaque with numerous cross-references and understandable only by experts in the field.

Following these steps will reduce the risk of exposure in connection with advising small retirement plans.

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