The Hot Issues for Retirement Plan Sponsors and Providers, Including the Transfer of Responsibility to Providers

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Role of Provider in 401(k) Plans

Service providers for 401(k) plans have increasingly taken on responsibility for the plans. In most cases today, 401(k) plans border on “plug-and-play” with service providers handling or advising on all of the operational issues.

What are the consequences?
Reliance on Providers

The case of Tussey v. ABB is a lesson for Plan Committees.

In that case, the participants sued the plan sponsor—ABB, Inc., the plan committee members, the recordkeeper and others.
Overview of Court Holdings

At the end of a lengthy trial, the court found:

“(1) ABB Defendants violated their fiduciary duties to
the Plan when

• they failed to monitor recordkeeping costs,

• failed to negotiate rebates for the Plan from either
Fidelity or the other investment companies . . . ,

• selected more expensive share classes...when
less expensive share classes were available, . . . .”

...
The First Court Holding

"(2) ABB, Inc., and the ... Committee violated their fiduciary duties to the Plan when they agreed to pay [the recordkeeper] an amount that exceeded market costs for Plan services in order to subsidize the corporate services provided to ABB by [the recordkeeper], such as ABB's payroll and recordkeeping for ABB's health and welfare plan and it's defined benefit plan; ..."

Questions:
- Who assessed the charges?
- Who had superior knowledge?
- Was the reliance justified?
Application of Holding

Failure to Monitor Recordkeeping Costs:

- The ERISA section 404(a) fiduciary duty to pay only reasonable expenses from plan assets.

- The ERISA section 408(b)(2) prohibited transaction duty to pay only **reasonable compensation** to service providers.

**Question:** What are the legal responsibilities of fiduciaries and non-fiduciaries?
The Second Court Holding

Failure to Negotiate Rebates:

This duty flows from conclusions under 404(a) and/or 408(b)(2) that the compensation of a service provider is “unreasonable.”

Questions:
- How were the expenses and compensation set?
- How is “reasonable” determined?
The Third Court Holding

Selected More Expensive Share Classes:
Criteria for appropriate “share classes:”

- Average expense ratio.
- The concept of plan purchasing power.

See the Wal-Mart, Ameriprise, and Edison International cases.

Question:
- Who “recommended” the investments?
- Who is legally responsible?
Increasing Threats to Service Providers

- DOL investigations
  - Morgan Keegan
  - ING
  - USI Advisors

- Litigation
  - ABB decision
  - Fidelity class action
  - American United Life lawsuit

- Possible expansion of definition of “fiduciary”
Disclosures by Providers

The 408(b)(2) regulation requires that covered service providers make disclosures. That change is a recognition of the role of service providers and of the complexity of some financial arrangements.

These disclosures impose legal obligations on:

- Providers; and
- Plan sponsors/committees.
408(b)(2): Prohibited Transaction Issues

The failure to provide the disclosures results in the arrangement becoming a prohibited transaction for the adviser (or other covered service provider).

The failure to receive the disclosures will also result in a prohibited transaction for the plan fiduciaries unless they take specified steps.

Prohibited Transaction

The preamble to the final regulation explains the DOL view:

“The Department does not believe that . . . fiduciaries should be entitled to relief . . . absent a reasonable belief that disclosures . . . are complete . . .

Fiduciaries should be able to, at a minimum, compare the disclosures . . . to the requirements of the regulation and form a reasonable belief that the required disclosures have been made.”

- Note: Accountants’ audits of large plans.
408(b)(2): Prohibited Transaction Issues

The steps are:

- Determine if any “covered” service providers failed to deliver the disclosures.
- Determine if the disclosures were adequate.*
- Request in writing that any missing or inadequate disclosures be made.
- If the covered service provider refuses to provide the disclosures or does not provide them in 90 days, terminate the service provider and report to the DOL.

*Note: Use of checklist.
"Another advantage of increased regulations is creating thousands of jobs for lawyers."

Schwadron
408(b)(2): Fiduciary Issues

Plan committees also must engage in a prudent process to evaluate the 408(b)(2) disclosures and decide:

- Are the services adequate/appropriate?
- Are the conflicts manageable?
- Is the compensation reasonable?
  - “Market data”—ABB case.
  - Requests for proposal.
  - Benchmarking.
“Let’s never forget that the public’s desire for transparency has to be balanced by our need for concealment.”
Possible Consequences of Fiduciary Review

- Re-negotiate fees and/or services.
- Lower cost share classes.
- Expense recapture accounts.
Duty to Monitor

“Finally, although this proposal looks to disclosures made at the time a service contract or arrangement is entered into or renewed, responsible plan fiduciaries must continue to monitor service arrangements and the performance of service providers.”

Preamble to the DOL’s proposed regulation under ERISA §408(b)(2).
Revenue Sharing

There is no explicit guidance on how revenue sharing should be evaluated or how it should be allocated among participant accounts.

However, what is settled is that fiduciaries must engage in a prudent process to make decisions about these questions.

- Providers’ systems.
- Plan provisions.
Allocation of Expenses

Revenue sharing is, in effect, a “negative expense.” That is, it is a payment that is “sourced” in expenses paid by a plan. As a result, the DOL’s guidance on the allocation of expenses is instructive.

The DOL has said that the allocation of expenses among participant accounts is a fiduciary act, which requires fiduciaries to act prudently. [Field Assistance Bulletin (FAB) 2003-03.]
Allocation of Expenses

The FAB lays out the following principles:

- The fiduciaries must engage in a deliberative, prudent process;
- They must weigh the interests of different classes of participants and the effect the method of allocation they choose has on those participants;
- The method of allocation must have a reasonable relationship to the services being provided to the participants;
- The fiduciaries must avoid conflicts of interest.
Threats to Plan Sponsors

DOL Investigations:
- 408(b)(2) disclosures.
- Evaluation of expenses and compensation.

Litigation:
- ABB decision.
- Edison International decision (and the duty to ask).
- Wal-Mart decision and settlement.
Fiduciary Protections

To provide comfort to plan sponsors and committees, the 401(k) industry is taking on greater fiduciary responsibility.
Fiduciary Alphabet Soup

However, ERISA has three types of fiduciaries . . . and the definition is “functional.”

ERISA section 3(21)(A) defines all three . . . a “person is a fiduciary with respect to a plan to the extent . . .”
Fiduciary Alphabet Soup

“(i) he exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets,

- 3(21) investment managers
- Prudent selection and monitoring
Fiduciary Alphabet Soup

(ii) he renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so, or

- 3(38) investment adviser
  - Plan level
  - Participant level

- Prudent selection and monitoring
Fiduciary Alphabet Soup

(iii) he has any discretionary authority or discretionary responsibility in the administration of such plan.”

- 3(16) administrator
- Prudent selection and monitoring
401(k) Trends and Developments
Participant Outcomes

Plan sponsor interest in measuring participant retirement readiness will surge. Service providers will respond with planning tools, participant-level indicators, and plan-level reports that help advisors monitor progress.

➢ Benchmarking

Participant Outcomes

“Retirement income planning, [and] guaranteed lifetime income solutions . . . are among the topics for which advisors anticipate demand will grow the fastest.”

“Meetings will be reserved for those ages 50 and older to help with later years, accumulation, and retirement planning.”

continued . . .
Participant Outcomes

“Automated and targeted education, online/smartphone resources.”

“Strong technology to attract and engage young employees; innovative income solutions for older employees.”
How can you know?

"The good news is you can retire at 65. The bad news is that it's 2065."
Deferrals

Gap analysis:

- Projects the results of the participant’s current behavior—in terms of retirement income.
  - DOL initiative.
- Provides reasonable benchmarks for comparing those results to typical needs.
- If the participant is falling short, provides guidance about how to close the “gap.”