

Fiduciary Responsibilities of 401(k) Plan Providers



Introduction

In March 2019, the judge's gavel came down for the last time on a historic case that had started in 2007. ABB Inc. lost a 12-year long lawsuit (the longest 401(k) fee lawsuit in the United States) and was ordered to pay a settlement of \$55 million to the defendants. This was the third highest settlement in a 401(k) fee lawsuit.

ABB Inc. stood accused of diverting employee contributions for their own benefit, failing to monitor revenue sharing and using that revenue share to pay for other services rendered to ABB Inc. All were judged to be in violation of the 401(k) plan sponsor's fiduciary responsibilities.

401(k) plans and why they are a benefit for employees

A 401(k) plan is meant to offer a participant a simple way to build a nest egg for their golden years.

For employers, as a plan sponsor, it is a great way to not just ensure their employees' future is being taken care of, but also to instill a sense of belonging and loyalty. Retention of key talent is critical to the success of an organization and offering a 401(k) can facilitate that. As a plan provider, employers also have the benefit of availing tax benefits by matching the employee's contribution to these plans.

While an employer's heart might be in the right place when offering such a plan, if a plan provider forsakes their fiduciary responsibilities, they might find themselves on the wrong side of the law. The case of ABB Inc., along with Boeing and Lockheed Martin (as elucidated later) before them, are the perfect examples of the importance of the fiduciary responsibilities of a plan sponsor.

Duties stated by ERISA types of fiduciaries

The Employee Retirement Income Security Act (ERISA) of 1974, is a companion federal law that governs 401(k) plans offered by individuals and entities (commonly referred to as “fiduciaries”) to follow certain rules and fulfill certain duties.

According to ERISA, the basic fiduciary duties of a plan provider include:

- Duty to act prudently with only the interests of participants and their beneficiaries in mind
- Duty to diversify the assets of the plan
- Duty to comply with the provisions of the plan and following the terms of its governing documents (This includes ensuring that a fidelity bond (a type of insurance that covers a plan’s assets) is in force in accordance with ERISA)
- Duty of loyalty and always acting with care, skill, prudence and diligence
- Duty to pay only reasonable plan expenses and always keeping it to a reasonable level
- Duty not to engage in certain prohibited transactions as specified by the IRS (and ERISA)

A named fiduciary (such as a plan provider) may designate other fiduciaries to oversee various parts of the plan. According to ERISA, the three different types of fiduciaries are identified as:

- **Section 3(16) - Plan Administrator:** The Plan Administrator (TPA) is responsible for keeping the plan in compliance with ERISA as well as handing reporting and disclosures to both participants and the IRS. TPA can avoid legal liability for the acts or omissions of designated fiduciaries by designating these duties to a third party and focus on their own fiduciary obligation of monitoring service providers.
- **Section 3(21) - Investment advisor or consultant:** The main role for an investment advisor or consultant is to serve as a subject matter expert. These fiduciaries provide investment advice to help the plan sponsor make better decisions, but the eventual responsibility remains with the plan sponsor.
- **Section 3(38) - Investment Manager:** Has complete control over a plan’s assets and investment choices. Investment managers take on the liability for investment management. Only Registered Investment Advisors (RIAs), banks, or insurance companies can take up this fiduciary role.

Notable settled 401(k) lawsuits against reputed American companies

1. **Company name:** Lockheed Martin

Duration: 2006-2015

Settlement amount: \$62 million and three initiatives to improve its retirement plan

Charges: The plaintiffs claim Lockheed Martin breached its fiduciary duty by allowing the retirement plans to pay excessive fees. They also claim the employer imprudently managed the stable value fund and a trio of company stock funds.

2. **Company name:** Boeing

Duration: 2006-2015

Settlement amount: \$57 million

Charges: The plaintiffs alleged that the Boeing plan administrators breached their fiduciary duties by causing or allowing unreasonable fees to be charged against assets of the plan. They also alleged that plan executives caused the plan to pay unreasonable administrative fees for record keeping.

3. **Company name:** ABB Ltd.

Duration: 2006-2019

Settlement amount: \$55 million

Charges: The plaintiffs alleged multiple breaches of fiduciary duty under ERISA, by subsidizing its corporate expenses with fees paid out of its employees' retirement assets. ABB allegedly engaged in self-dealing by using Fidelity for record keeping for both the 401(k) and corporate plans, which included a corporate pension plan, the health and welfare plan, and payroll processing.

4. **Company name:** CIGNA Corporation

Duration: 2011-2013

Settlement amount: \$35 million

Charges: The plaintiffs alleged that Cigna, along with a retirement investment unit of Prudential, violated their fiduciary responsibilities by taking excessive fees from participant accounts and failing to put plan services out for competitive bids. Cigna had sold its retirement division, including the plaintiffs' 401(k), to Prudential in April 2004 for more than \$2 billion. The suit claimed plan participants received none of Cigna's profit from that sale after providing capital for the company's retirement business that it sold.

Changing emphasis on fulfillment of fiduciary duties

At the beginning of every year, a plan provider must make it their responsibility to revisit their list of fiduciary responsibilities as defined by ERISA and see if there are any infringements occurring (or in the offering). This broadly includes being mindful of ERISA policies, defined duties and keeping the interest of employees before their own. When scrutinized in detail, it could mean changing investment strategies periodically to stay within the ideal expenses limit and achieve the return promised to plan participants. With more than 80,000 lawsuits relating to fiduciary duties of plan sponsors filed in federal district court since 2009, it is advisable to enlist the services of a Section 3(38) fiduciary (Investment Manager). Any oversight in fiduciary duties nowadays could lead to losses or worse still, lawsuits that can tarnish the organization's reputation.

In recent years, there have been a swathe of lawsuits related to 401(k) plan fees and fiduciary responsibilities of plan sponsors across the country. With prominent global names (L Brands, Mercedes Benz, Coca Cola) being pulled in to answer for the violation of their responsibilities, it is imperative that every organization should take its fiduciary responsibilities seriously.

According to Deloitte's 2019 Defined Contribution Benchmarking survey report, 59% of plan sponsors utilize an ERISA 3(21) advisor, a fiduciary consultant/advisor who makes investment recommendations to the plan sponsor and 25% of plan sponsors cited fees as the reason for changing plan providers, up from 7% in 2017. This indicates the rising importance attached to quality investment options, rather than a fund that may benefit only the plan provider and the sponsor. According to Willis Towers Watson's 2020 Defined Contribution Plan Sponsor Survey, 15% of the respondents noted having entered 3(38) relationships, up from 6% three years earlier – a 250% increase.

Characteristics of a quality investment option

- 1. Low Expense Ratio:** The expense ratio is probably the most important consideration while considering an investment option. This is the fee an investor pays every year to stay invested. A high expense ratio is always something to worry about and an indicator that it may not be best investment option
- 2. Proven fund performance history:** A proven track record is an important factor as over a 10 year period, about 58% of all US equities based mutual funds stay in business. A fund without a long and proven performance history can be a risky investment.
- 3. Realistic long term returns:** As an investor planning for retirement savings, the intention is to stay invested for a long time. In this consideration, the long term returns of an investment option must be duly considered and weighed against the opportunity cost of investing in other long term (or short term) options
- 4. Volatility in comparable to risk tolerance:** When considering a fund to invest in, one's risk tolerance should play a pivotal role in deciding the right investment choice. The investment choice should match the risk tolerance level of an investor or else it could trigger untimely, emotional investment decision.

Ways to limit liability for fiduciaries

A fiduciary may limit their scope of fiduciary functions in several ways. They may delegate certain functions to others by, for instance, appointing an investment manager. The design of the plan can also limit the fiduciary scope. In addition, a fiduciary may hire experts to educate and advise them regarding different aspects of the plan.

Some of the more reasonable ways to do so are as follows:

- 1. Insurance and indemnification:** Fiduciary liability insurance is the first line of defense in limiting liability. Insurance may cover liability or loss resulting from the fiduciary's acts or omissions. Be sure to review the policies and exclusion to ensure proper coverage. Insurance should be in addition to the required ERISA bond, which only protects the plan

- 2. Procedural process:** There is no liability under ERISA for a procedurally prudent decision, even if the outcome turns out poorly. The ultimate outcome will be relevant in determining damages, when the decision-making process is flawed. Establishing a procedurally prudent decision-making process limits a fiduciary's liability

- 3. Delegation of responsibilities:** Plan documents must expressly permit such a delegation of responsibilities to another identified fiduciary and provide a procedure for it. Delegation itself is a fiduciary task, and the named fiduciary must act prudently and in the interests of plan participants and beneficiaries in selecting and monitoring the performance of the person selected to perform fiduciary duties. A fiduciary will not be responsible for acts or omissions of a properly and prudently selected (and monitored) designee, unless co-fiduciary liability applies.

- 4. Plan governance:** Draft the plan language to avoid having a court fill in gaps if any issues arise. Make sure all plan documents, including the plan, any investment policy, the trust, committee charters, and delegations, are consistent with each other and with actual practice. Consider appropriate administrative changes, such as providing investment education and advice and seeking a qualified fiduciary advisor. Also consider operating the plan in strict compliance with ERISA code 404(c) and offer a Qualified Default Investment Alternative (QDIA) to ensure safe harbor relief from fiduciary liability for investment outcomes.

- 5. Investment Policy Statement (IPS):** Keep the IPS current to ensure investments are made in a rational manner and further the purpose of the plan and its funding policy. If the IPS contains a policy for monitoring managers or placing them on a "watch list," follow that policy and document any actions taken.

6. Monitoring performance of investment funds and managers: Monitoring the funds and any designees is crucial. Periodically review the plan's cash management and short term investment procedures. Monitor the fund's or manager's brokerage and trading practices: verify the manager's fee computations, consider the quality of securities transaction executions, and be aware of the portfolio and turnover of investments.

7. Protecting against fee litigation: Consider a legal audit of the plan, as well as an ERISA code 404(c) compliance audit to flag potential issues. Periodically review all aspects of fund selection and negotiate the best deal for participants while considering fees, returns, and performance, and document these efforts. Disclose fees required by participant-level fee disclosure regulations, and comply with fee disclosure requirements for Form 5500. Do not let the plan enter into a contract with a service provider without a complete ERISA code 408(b)(2) fee disclosure. Always document compliance with fee disclosure rules.

***Voluntary Fiduciary Correction Program:** *The Department of Labor offers the Voluntary Fiduciary Correction Program as a vehicle for voluntary self-correction of various fiduciary breaches. The program offers several potential advantages for self reporters: the receipt of a "no action" letter upon satisfaction of prescribed conditions, no assessment of an ERISA code 502(l) penalty, and potential waiver of the excise tax under the IRS. In the case of delinquent or non-filers of Form 5500, the program offers significantly reduced penalties. However, if the department rejects the correction and assesses a penalty, a notice of the violation must be given to participants by fiduciaries if seeking a waiver of the excise tax, and the "no action" letter does not preclude civil action or criminal investigation.*

All evidence points to taking up fiduciary responsibilities more seriously by providing cost-efficient and well managed plans to employees. As a plan provider, it might be wise to periodically scrutinize the 401(k) plans and see if it is attuned to the best interests of the employees and the best practices as prescribed by ERISA.

By understanding the essence of some of the recent lawsuits (like ABB Ltd.) and what the defendants were accused of, organizations can have a handy case study on what not to do when it comes to offering DC plans to employees and the management of those funds. Subsequently, also reviewing the most relevant options to mitigate and protect against potential claims made by plan participants about excessive fees, unsound investment decisions or any other reason. This further emphasizes the importance of periodically confirming this by comparing it with general plan fees. Employing a thorough selection and review system for record keepers and their recommendations could be the handiest safeguard against any untimely, unpleasant surprises like a fiduciary breach lawsuit. One step further would be to appoint a Section 3(38) fiduciary (Investment Manager) to oversee, manage and rebalance the funds, while staying in compliance with all the regulatory requirements specified by ERISA and the IRS.

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OPT-GR-WP1F052021-22

