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ERISA: THOU SHALL NOT PAY EXCESSIVE FEES!

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About 12 years ago in 2006, there was a wave of class action lawsuits filed against giant corporations (such as Lockheed Martin, Northrop Grumman, Catepillar, General Dynamics, International Paper and Exelon) alleging the payment of excessive investment management and plan administration fees from the § 401(k) plan's investment options in breach of the Employee Retirement Income Security Act of 1974 ("ERISA"). While those types of cases are still popular, a new wave of cases have been filed against not-for-profit organizations, in particular schools and universities (such as Brown, Duke, Emory, Johns Hopkins, M.I.T., NYU, U. Penn., Vanderbilt, and Yale) sponsoring § 403(b) plans with thousands of participants and billions of dollars in assets.

While there have been recent, yet expensive, victories for not-for-profit plan sponsors in the § 403(b) space, plan fiduciaries should not get too comfortable. There were also early victories in the 401(k) cases that were filed in 2006. However, the tide turned and some of those § 401(k) cases ended up settling in the multi-million dollar range, such as:

- Citigroup (2018) $6.9 million
- Allianz (2018) $12 million
- American Airlines (2017) - $22 million
- Northrop Grumman (2017) - $16.75 million
- Mass Mutual (2016) - $30.9 million
- Novant Health (2016) - $32 million
- Boeing (2015) - $57 million
- Ameriprise (2015) - $27.5 million
- Lockheed (2015) - $62 million

In regards to § 403(b) settlements, the first one out of the gate is the University of Chicago for $6.5 million.

§ 403(b) LITIGATION

With increased government scrutiny (by the U.S. Department of labor, Employee Benefits Security Administration, the "DOL"), ERISA lawsuits at an all-time high, and the plaintiff's bar not only increasing in number but in sophistication, plan fiduciaries will continue to face high exposure if they fail to prudently select and then continue to monitor the investments options of their plans. Litigation is not limited to large plans, as plaintiffs and the DOL have found that smaller plans are "low hanging fruit" in terms of finding ERISA violations.

The individuals and entities responsible for § 403(b) plans, and frequently members of the board of directors, have been sued by § 403(b) plan participants under ERISA for breach of fiduciary duty. These fiduciary duties are the same as those imposed on § 401(k) fiduciaries. Usually the class action complaints allege:

- Failure to monitor service providers and fees in the plans;
- Recordkeeping fees are too high or paid through revenue sharing;
- Share of classes used are more expensive than others (retail vs. institutional); or
- Failure to conduct request for proposals to ensure reasonableness.

ERISA 101

ERISA is a complex statute to navigate. As one judge stated, "[i]n truth, [ERISA] is a veritable Sargasso Sea of obfuscation." Travelers Ins. Co. v Cuomo, 14 F3d 708, 717 (1993). What? Complying with ERISA is no easy task given the complexity of the statute and the continuing rapid development of the law due to a number of factors. Difficulty in meeting your fiduciary duties stems from fact-intensive circumstances and the law may vary depending on the particular area of the country (jurisdiction) within which a lawsuit is brought. It is thus often difficult to predict whether a particular course of action will shield the fiduciary from liability or make the fiduciary an easy target for the DOL or plaintiff's bar.

Fiduciaries

The first crucial step is determining who are the plan fiduciaries. A fiduciary under ERISA is someone who has the discretionary authority or control over the management of assets or the administration of the plan. ERISA § 3(21). One either can become a fiduciary by designation such as a "named" fiduciary or can inadvertently become a fiduciary by virtue of having such discretion or control over a plan, known as a "functional" or "de facto" fiduciary.

Fiduciary Duties

Being a fiduciary requires you to follow certain duties; such duties are considered the highest known to law. Failure to follow to fulfill these duties exposes fiduciaries to personal liability. ERISA § 409. ERISA requires that fiduciaries (i) act for the "exclusive purpose" of the plan, (ii) act with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in like capacity and familiar with such matters would

use under the circumstances; (iii) “diversify” plan investments, and, (iv) act in accordance with the “terms of the plan.” ERISA § 404.

While no one can predict exactly which investments will out-perform other investments or which decision is the best, prudence requirements may be met by examining investments for appropriate factors such as the risk of loss, the opportunity for return, diversification, liquidity, current return and projected return. DOL guidance states that appropriate consideration or alternatively, procedural due diligence, means ensuring investment decisions are reasonable, and applicable to the plan’s design:

Appropriate consideration shall include, but is not necessarily limited to, (i) A determination by the fiduciary that the particular investment or investment course of action is reasonably designed, as part of the portfolio (or, where applicable, that portion of the plan portfolio with respect to which the fiduciary has investment duties), to further the purposes of the plan, taking into consideration the risk of loss and the opportunity for gain (or other return) associated with the investment or investment course of action.

29 C.F.R. 2550.404a-1.

Furthermore, note that fiduciary duties do not end at the selection process. There is a continuing duty to monitor investments or service providers after the selection process. Tibble v. Edison, 135 S. Ct. 1823, 1829 (2015) (“This continuing duty exists separate and apart from the trustee’s duty to exercise prudence in selecting … at the outset”). Under Tibble, ERISA does not require the cheapest investment, but if a more expensive investment is selected, fiduciaries must document (in the minutes, consultant reports and graphs, emails, etc.) their consideration of both investments and state the reasons why a more expensive investment is in the plan’s overall best interest.

Prohibited Transactions

ERISA also dictates what you cannot do. For example, a fiduciary cannot enter into a transaction between the plan and a party in interest for the furnishing of goods and services. ERISA § 406(a). What does that mean? It means that a fiduciary cannot contract with a service provider for services. Other prohibited transactions are more obvious, such as self-dealing or receiving kickbacks. ERISA § 406(b).

How is it that all plans have contracts with service providers? ERISA provides carve outs or "exemptions" from certain of the prohibited transaction rules. ERISA § 408. Thus, you can contract with a service provider but only if the following conditions are met: (1) the contract is reasonable; (2) the services are necessary for the operation of the plan; and (3) reasonable compensation or fees are paid. ERISA § 408(b)(2). The DOL has opined that to determine reasonableness a fiduciary should conduct an analysis of the quality of the services in light of the fees being charged. The DOL has explicitly stated that the lower cost provider is not necessarily the best for the plan. Like the saying goes---, you get what you pay for!

RECENT § 403(b) DECISIONS

In one of the recent decisions regarding § 403(b) plans, Sweda v. University of Pennsylvania, 2017 WL 4179752 (E.D. Pa., 2017), the court dismissed the action at an early stage, highlighting that: locking in rates and the plan to a service provider alone is insufficient to create a plausible inference of a breach of fiduciary duty; plaintiffs must allege something more than that there were cheaper investments available; plaintiffs need to allege that the participants did not have a reasonable alternative investment option to choose from; retail shares are not per se illegal as institutional shares pose their own risks, such as lower liquidity; and, there cannot be an ERISA claim based solely on the fact a fund is underperforming.

The court in Divane v. Northwestern University, 2018 WL 2388118 (N.D. Ill, 2018) also dismissed the ERISA suit in its entirety. The court found that participants had alternative options to choose from other than the fund that was underperforming and charging excessive record-keeping fees. The court also noted that no ERISA violation arises from using revenue sharing for plan expenses or an obligation to find the lowest cost provider (citing to Hecker v Deere & Co., 556 F.3d 575 (7th Cir. 2009)("nothing in ERISA requires every fiduciary to scour the market to find and offer the cheapest possible fund (which might, of course, be plagued by other problems"). The court concluded that it did not matter that there were more expensive retail shares because the plan also offered low-cost index funds and the participants were free to choose those index funds.

In Short v. Brown University, 2018 WL 3377702, (D. RI., 2018), the court dismissed only a few claims including an imprudence claim for offering too many investment options. However, the court did allow the following claims to proceed to the next stage of litigation: imprudence for having multiple record-keepers, imprudence for failing to conduct a competitive bidding process via a Request for Proposal ("RFP"), and imprudence for having consistently underperforming funds.

Recently, after the expensive and administratively burdensome process of litigating a motion to dismiss, class certification, and an 8-day bench trial, NYU fiduciaries were found not to have breached ERISA. In Sacerdote v. New York University, the court analyzed claims for imprudence regarding record-keeping fees due to the failure to conduct more RFPs, engage in a timely decision-making process, and uncapped revenue sharing. The court found that "NYU had particular needs, a particular technological environment, and infrastructure that made the frequency of its RFP process adequate." Sacerdote v. New York University, 2008 WL 3629598 at *17 (S.D.N.Y. 2018). The court further found that the fiduciaries negotiated and decreased fees over time. Lastly, as to record-keeping fees, the court was not persuaded that a flat fee would be more prudent than revenue sharing.

The also court found that sufficient evidence to dismiss the plaintiff's failure to monitor claim because the plan fiduciaries reviewed and analyzed their expert's detailed report on the investment options, the minutes reflected the fiduciaries deliberation over keeping certain investment options, and that on a quarterly basis the fiduciaries reviewed their investment

policy statement and the funds that were on the "watch list." Lastly, the court held that the funds did not underperform significantly enough to prove that the fiduciaries acted imprudently by keeping them as investment options.

FIDUCIARY LIABILITY INSURANCE

Unlike a fidelity bond, ERISA fiduciary liability insurance is not required by ERISA. However, for the reasons stated above, you must pay careful attention and consideration into your fiduciary liability coverage. You must understand clearly who and what is covered under the policy.

Who? Usually, insureds under the policy are the sponsoring organization of the plan, the plan itself, executives, board members, and employees of the sponsoring organization. Independent contractors and third party service providers are not covered under the policy.

What? The policy covers demands for monetary, non-monetary or injunctive relief; lawsuits and arbitrations; formal civil administrative or regulatory proceedings; and, notice of a DOL or similar governmental agency fact-finding proceeding. These actions must allege a wrongful act, such as: a breach of a duty or obligation under ERISA; a negligent act, error or omission in the administration of the plan; a settlor act (such as establishing, designing or terminating a plan); or any other matter claimed against a fiduciary in their capacity of being a fiduciary to a plan.

How much? The policy covers losses, which include defense costs (attorney's fees and expenses), damages, judgments, settlements, pre-judgment interest, post-judgment interest, and certain civil penalties.

What is not covered? The policy excludes items such as benefits due, prior or pending litigation, fraud, breach of contract, or employment related actions.

All these referenced items have to be discussed with your broker and/or carrier to ensure that you have the maximum coverage should you become exposed to an ERISA claim.