

# **“ASK THE EXPERT” PANEL – RETIREMENT PLANS**

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Retirement Plan Summit  
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Benjamin L. Grosz  
(202) 393-7600  
BGrosz@ipbtax.com

# Q & A



# POTENTIAL AGENDA / TOPICS

- Fiduciary Duties & Liability
- Importance of Fiduciary Training
- DOL Fiduciary Rule – *Delayed! Effective! TBD??*
- 401(k) / 403(b) Fee Litigation
- Retirement Plan Fee Disclosures
- Best Practices

# **FIDUCIARY DUTIES & LIABILITY**

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# WHO IS A FIDUCIARY? YOU?

- Plan sponsor (the company)
- Plan administrator (often a committee)
- Individuals
  - By designation (personal/title)
  - Service on a committee
  - Functional - i.e., you are a fiduciary to the extent you exercise discretion or control with respect to the plan

# WHAT FIDUCIARY RULES DO YOU HAVE TO FOLLOW?

- Internal Revenue Code
  - Tax qualification rules for qualified plans (e.g., 401(k))
  - Exclusive benefit
  - Plan document requirement
- ERISA
  - Fiduciary rules set forth affirmative duties
  - Avoid prohibited transactions and fiduciary breaches
- Plan terms and rules

# ERISA'S BASIC FIDUCIARY RULES

- Fiduciary “Do’s”
  - Exclusive Benefit/Purpose Rule (duty of loyalty)
  - Prudence Rule (duty of care)
  - Diversification/Investment Rule
  - Plan Documents Rule
- Settlor vs. fiduciary functions
- Co-fiduciary liability
- Fiduciary “Don’ts”
  - Prohibited transactions
  - Self-dealing

# **FIDUCIARY TRAINING (INSIGHTS FROM LITIGATION)**

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# HIGH-PROFILE STOCK-DROP SETTLEMENT REQUIRES MORE FIDUCIARY TRAINING

- *Fifth Third Bancorp v. Dudenhoeffer* settles for \$6 million on remand from U.S. Supreme Court
  - After stock drop, participants alleged employer stock plan fiduciary breached duty
  - March 2016 settlement freezes employer stock fund, and
  - Fifth Third's fiduciary committees required to receive more frequent fiduciary education and training
    - Will be increased to at least twice per year

# **DOL FIDUCIARY RULE – DEVELOPMENTS & UPDATE**

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# REVIEW:

## WHAT IS THE FIDUCIARY RULE?

- Broadly, the fiduciary rule refers to the following changes announced in April 2016:
  1. Expand the definition of “fiduciary investment advice”
  2. Require fiduciary investment advisors to:
    - a) act in the best interest of plans and plan participants,
    - b) earn no more than reasonable compensation, and
    - c) meet certain disclosure and other administrative requirements

# THE FIDUCIARY RULE'S BUMPY PATH TO EXISTENCE

Date	Status
4/8/2016	<ul style="list-style-type: none"> <li>Final rule is <u>published</u> (about one year after being first proposed)</li> <li>The rule would become <i>generally</i> applicable 4/10/17 (and <i>fully</i> applicable, including phased-in disclosure and other requirements, on 1/1/18)</li> </ul>
2/3/2017	<ul style="list-style-type: none"> <li>Pres. Trump orders <u>DOL review</u> of the rule and its legal and economic impact</li> </ul>
4/5/2017	<ul style="list-style-type: none"> <li>DOL officially <u>delays</u> the rule's general applicability to 6/9/17</li> </ul>
5/22/2017	<ul style="list-style-type: none"> <li>Sec. Acosta <u>declines to extend</u> the delay, but DOL announces that the rule will <u>not be enforced</u> until 1/1/18</li> </ul>
6/8/2017	<ul style="list-style-type: none"> <li>The House passes the Financial CHOICE Act, which would repeal the rule, but the Act faces longer odds in the Senate</li> </ul>
6/9/2017	<ul style="list-style-type: none"> <li>The rule is <u>generally applicable</u>, but is <u>not enforced</u> (enforcement and full applicability set for 1/1/2018)</li> </ul>
8/30/2017	<ul style="list-style-type: none"> <li><i>DOL proposes <u>further 18-month delay</u> (until 7/1/18) of certain exemptions and requirements, and won't enforce arbitration ban</i></li> </ul>

# CHANGES TO DOL FIDUCIARY RULE

- DOL redefines “fiduciary investment advice” in 2016
  - Investment advice *recommendation*
  - To a plan *or IRA*
  - For a fee *or other compensation*
  - Advice is ~~individualized~~ *based on or directed* to participant
  - Requires an ~~ongoing and mutual relationship~~ *written or verbal understanding*
    - One-time advice is now included
- DOL broadened definition of covered transactions
  - Buy, sell, hold, transfer, *or rollover*
  - *Asset management*
  - *Provision of investment list*
- Five lawsuits filed challenging DOL regulations

# POTENTIAL CONCERNS FOR PLAN SPONSORS

<u>Concern</u>	<u>Explanation</u>
1. “Updated” Service Agreements	Existing vendors may now be fiduciaries. Those vendors may seek to minimize their liability through revised contractual provisions. Check with counsel before signing any new or updated agreements with those vendors.
2. Counterparty Transactions	The DOL has created an exception from the fiduciary rule for arm’s length transactions between investment firms and large plan fiduciaries with financial expertise. This seller’s exception will not apply in all cases. Plan fiduciaries and sponsors will need to note its limitations.
3. New Hidden Fees	Vendors who are now tagged as fiduciaries may seek additional fees to compensate for lost downstream income due to fewer IRA rollovers. Be on guard for fee increases or new hidden fees.

# POTENTIAL CONCERNS FOR PLAN SPONSORS

<u>Concern</u>	<u>Explanation</u>
4. Participant Communications	Plan sponsors and fiduciaries should assess any new participant communications prepared by service providers to screen for unintended fiduciary investment advice. This includes: call center scripts, websites, mobile apps, investment materials, and training materials.
5. Investment Education	Mostly the same as old rule (Interpretive Bulletin 96-1). Plan sponsors and fiduciaries may face heightened exposure for monitoring service provider compliance with specific conditions.
6. Distribution Counseling	Plan sponsors and fiduciaries will want to increase oversight of post-termination messages to participants rather than ceding this space to record keepers and other plan vendors. Expect to see fewer rollovers following termination of employment.

# **401 (K) / 403(B) FEE LITIGATION**

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# SUPREME COURT: ONGOING DUTY TO MONITOR 401 (K) INVESTMENT FUNDS

- *Tibble v. Edison International*: Supreme Court held (unanimously) that ERISA fiduciaries of a 401(k) plan must continue to monitor investment funds on an ongoing basis
  - Edison 401(k) plan had added retail class mutual funds
  - Participants sued: not using institutional class funds → fiduciary breach
  - Edison argued six-year statute of limitations as a defense, based on the theory that the fiduciary duty owed was only on initial fund selection
    - Federal District Court in CA and 9<sup>th</sup> Circuit Agreed (!)
  - Supreme Court reversed, based on a separate “continuing duty to monitor trust investments and remove imprudent ones”
  - Takeaway: Continue regular prudent monitoring of 401(k) plan funds

# 401 (K) FEE LITIGATION – SELECTED SETTLEMENTS

- Settled lawsuits against plan sponsors:

Plan Sponsor	Settlement Amount	Filing Date
Lockheed Martin	\$62 million	Feb. 20, 2015
Boeing	\$57 million	Nov. 5, 2015
Novant Health	\$32 million	Nov. 9, 2015
MassMutual	\$30.9 million	June 15, 2016
Ameriprise	\$27.5 million	Mar. 26, 2015
Fidelity	\$12 million	July 3, 2014
Transamerica	\$3.8 million	June 24, 2016

- Settled lawsuits against service providers:

Service Provider	Settlement Amount	Filing Date
Nationwide	\$140 million	Dec. 12, 2014
MassMutual	\$9.5 million	Oct. 31, 2014

# 401 (K) FEE LITIGATION – NON-MONETARY SETTLEMENT TERMS

- Summary of allegations and settlement terms:

Allegations	Settlement Terms
Excessive Fees	<ul style="list-style-type: none"><li>• RFP for recordkeeping and investment consulting services</li><li>• Limitation on expenses</li><li>• Flat, per-participant recordkeeping fees</li><li>• Share classes with lowest expense ratios</li><li>• Independent review of fund performance</li><li>• Limit and monitor cash equivalents in funds</li></ul>

- Lessons learned on paying reasonable fees to vendors:
  - Use RFP to select record-keepers and investment managers
  - Pay record-keeping fees on per-participant basis
  - Consider passively managed index funds

# 401 (K) FEE LITIGATION – NON-MONETARY SETTLEMENT TERMS

- Summary of allegations and settlement terms:

Allegations	Settlement Terms
Imprudent Investments	<ul style="list-style-type: none"><li>• Collective trusts and separate accounts to be considered</li><li>• Independent review of less traditional offerings (such as technology sector fund)</li></ul>

- Lessons learned on employing prudent investment selection and monitoring process:
  - Judicious use of collective trusts and separate accounts instead of mutual funds
  - Regularly monitor investments for performance, especially less traditional sector funds

# 401 (K) FEE LITIGATION – NON-MONETARY SETTLEMENT TERMS

- Summary of allegations and settlement terms:

Allegations	Settlement Terms
Conflict of Interest	<ul style="list-style-type: none"><li>• Removal of brokerage firm that received kickbacks from future involvement in plans</li></ul>

- Lessons learned on avoiding conflict of interest:
  - Unbundle recordkeeping and investment consulting service providers

# 401 (K) FEE LITIGATION – LAWSUIT CLAIMS

- Highlighted summary from recent cases:

Category	Specific Allegations
Excessive Fees	<ul style="list-style-type: none"><li>• Excessive recordkeeping, administrative, and investment consulting fees relative to plans of similar size</li><li>• Improper or misleading disclosure of recordkeeping, administrative, and investment consulting fees</li><li>• Superfluous advisers receiving fees to select subadvisers</li></ul>

- **Lessons learned: Need a prudent process for monitoring and disclosure of fees**
  - Leverage size to obtain lower-cost institutional class shares of investments
  - Coordinate with recordkeeping and investment consulting service providers to comply with fee disclosure rules

# 401 (K) FEE LITIGATION – LAWSUIT CLAIMS

- Highlighted summary from recent cases:

Category	Specific Allegations
Conflict of Interest	<ul style="list-style-type: none"><li>• Self-dealing with respect to plan assets</li></ul>

- Lessons learned:
  - Remain independent from the company
  - Employ an appropriate process for making fiduciary decisions

# 401 (K) FIDUCIARY BREACH CLASS-ACTION LITIGATION TREND REMAINS ACTIVE

- An uptick in the number and variety of suits
  - More plaintiff firms pursuing retirement plan litigation
  - Increase in cookie-cutter complaints
  - Lawsuits against smaller plans
- Plaintiffs targeting new types of defendants and continue testing new types of claims
  - Hot targets include universities and plans offering affiliated funds
  - Some lawsuits involving managed accounts arrangements
  - Many of the novel claims have focused on plan investment options and investment managers



# PLAINTIFFS CONTINUE TO SCRUTINIZE PLANS' INVESTMENT OPTIONS

- Recent lawsuits have asserted numerous theories of fiduciary breach in investment offerings:
  - Too many investment options diluted ability to negotiate lower fees
  - Too many investment options confused participants
  - Failure to replace funds for which there are lower-cost alternatives with similar risk/return characteristics
  - Failure to offer the lowest-cost share class for each investment
  - Failure to negotiate a waiver of minimum investment thresholds based upon the total amount invested in the investment provider's funds

# MANY TYPES OF INVESTMENT OPTIONS ARE BEING SCRUTINIZED

- In some cases, plaintiffs have challenged specific types of investments:
  - Actively managed funds, relying on literature opining that active traders rarely beat the performance of index funds
  - Certain index funds, typically considered low-cost options, on the grounds that even cheaper allegedly comparable investment funds were available
  - Nontraditional investments that did not perform well relative to equity markets
  - Stable value funds, regarded as low-risk options, because they did not perform as well as asserted benchmarks
  - Target date funds that allegedly charged excessive fees or underperformed

# COURTS HAVE RESISTED HINDSIGHT ANALYSIS OF INVESTMENT RESULTS

- The *Disney* case dismissed accusations of breach based solely on investment results
  - Allegations that an investment was observably overpriced are implausible, absent special circumstances indicating market inefficiency.
- The *Chevron* case rejected hindsight-based challenges, too
  - An imprudent process cannot be inferred solely from the inclusion of a money market fund instead of a stable value fund, based on their relative performances.
  - Price is not the only feature that a fiduciary must consider when compiling investment options.
  - Documented practices may indicate a prudent fiduciary process:
    - Plan fiduciaries monitored fund costs and offered diverse mix of investments
    - Fiduciaries monitored recordkeeping fees and renegotiated them as appropriate to specify a per-participant fee structure

Case Citations: *In re Disney ERISA Litigation* (C.D. Cal. Nov. 14, 2016); *White v. Chevron* (N.D. Cal. May 31, 2017).

# CERTAIN QUESTIONS OF FIDUCIARY DUTY REMAIN UNRESOLVED

- Recent decisions against Duke and Emory have allowed most claims to proceed to discovery:
  - Choosing retail-class shares over cheaper available institutional class shares is a plausible fiduciary violation.
  - Hiring multiple recordkeepers where services could have been consolidated with one vendor for cost savings is a plausible fiduciary violation.
  - Cases reached different outcomes on whether offering too many investment choices, on its own, is a plausible fiduciary violation.

Case Citations: *Clark v. Duke Univ.* (M.D.N.C. May 11, 2017); *Henderson v. Emory Univ.* (N.D. Ga. May 10, 2017).

# **401 (K) FEE LITIGATION**

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## **APPENDIX**

# SETTLEMENTS IN SUITS AGAINST SERVICE PROVIDERS

- Class actions against service providers
  - *Nationwide* case settles for \$140 million (24,000 ERISA plans)
  - *MassMutual* also agreed to settle a class action for \$9.5 million
  - Also requires enhanced future disclosures of fees and expenses
  - Revenue sharing “kickbacks” among other issues

# 401 (K) FEE LITIGATION – RECENT SETTLEMENT DETAILS

- *Boeing* case settles for \$57 million
  - Excessive investment fees and imprudent investment offerings alleged
  - Non-monetary settlement provisions (pending final court approval):
    - Replace mutual funds with lower-cost separate accounts
    - Independent review of any technology sector fund to be offered
  
- *Novant Health* case settles for \$32 million
  - Excessive recordkeeping and management fees and kickbacks alleged
  - Non-monetary settlement provisions (pending final court approval):
    - RFP required for recordkeeping and investment consulting
    - Recordkeeping fees must be flat, per-participant basis
    - Independent consultant review of investment offerings
    - Prior brokerage firm must be removed from future involvement in plans and real estate relationships

# 401 (K) FEE LITIGATION – RECENT SETTLEMENT DETAILS

- *Lockheed* case settles for \$62 million
  - Excessive investment fees and concealment alleged
  - Non-monetary settlement provisions (approved by Court):
    - Limit and monitor cash equivalents in the funds
    - Independent review of performance of funds
    - RFP for recordkeeping with at least 3 bids
    - Offer share class of investments with lowest expense ratio
  
- *Ameriprise* case settles for \$27.5 million
  - Excessive recordkeeping and management fees alleged
  - Non-monetary settlement provisions (approved by Court):
    - RFP required for recordkeeping and investment consulting
    - Recordkeeping fees must be flat, per-participant basis
    - Limitations on expenses charged to (or reimbursed from) plan
    - Must consider use of collective trusts or separately-managed accounts



# **RETIREMENT PLAN FEE DISCLOSURES, W. 408(B)(2)**

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# REVIEW OF DOL FEE DISCLOSURE REQUIREMENTS FOR RETIREMENT PLANS

## Plan Administrator to Department of Labor: Form 5500 Schedule C

- Annual reporting of fees paid to service providers from plan assets
- Includes both direct compensation as well as certain indirect compensation (e.g., float income, investment fund revenue sharing)

## Service Providers to Plan Administrator: ERISA Section 408(b)(2)

- “Covered Service Providers” (CSPs) must provide a written statement on fees and services to plan administrator
- CSPs include plan fiduciaries, registered investment advisors, 401(k) recordkeepers, and service providers who receive indirect compensation

## Plan Administrator to Participants: DOL Regulation 404a-5

- Applicable to 401(k) plans only
- Annual and quarterly disclosures
- Annual disclosure includes chart of investment options, including fee and performance information

# **(SOME) BEST PRACTICES**

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# BEST PRACTICE: PRUDENT PROCESS

- Prudent Process – maintain and document
  - Have a three-person Committee (at least)
  - Meet on a regular basis and document the decision-making process
  - Consider establishing an investment policy
  - Choose vendors by getting bids and evaluating services/fees
  - Evaluate vendors on a regular basis
  - Ensure that plan provisions and procedures are properly followed



# BEST PRACTICES: FEES & DISCLOSURE

- Focus on fees paid from the plan and 401(k) investment fees
- Compliance with disclosure regulations:
  - 404(c) information to 401(k) plan participants
  - 408(b)(2) service provider information to fiduciaries: Initial disclosures and any updates
  - Annual fee disclosure to 401(k) plan participants
  - Annual QDIA notice



# **BEST PRACTICE: “AN OUNCE OF PREVENTION IS WORTH A POUND OF CURE”**

- Know and follow myriad rules and obligations
- Good fiduciary process
- Documentation
- Vendor selection, contracts, and oversight
  - Indemnification
- Periodic Self-Audits

# BEST PRACTICE: CORRECT ERRORS

- Plan Qualification – IRS’s EPCRS (Rev. Proc. 2013-12, as modified by Rev. Proc. 2015-27)
- DOL Correction Programs
  - Voluntary Fiduciary Correction Program
  - Delinquent Filer Voluntary Compliance Program
- 409A Corrections under IRS Notices 2008-113, 2010-6, and 2010-80
- COBRA & HIPAA Corrections



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