

# **RETIREMENT PLAN HOT TOPICS & FIDUCIARY BEST PRACTICES: CUSTOM TDFs**

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**Boston VIP Lunch Discussion**

**Amundi Pioneer, AQR, & Columbia Threadneedle**

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# BACKGROUND & CONTEXT

- [App'x: Fiduciary Duties & Liability]
- New DOL Fiduciary Rule – *Delayed! Effective! TBD??*
- 401(k) / 403(b) Fee Litigation

# **THE NEW DOL FIDUCIARY RULE**

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# 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 impact</li> </ul>
4/7/2017	<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>
8/31/2017	<ul style="list-style-type: none"> <li>DOL proposes <u>further 18-month delay</u> (until 7/1/19) of certain exemptions and requirements, and won't enforce arbitration ban</li> </ul>
<i>11/29/2017</i>	<ul style="list-style-type: none"> <li><i>DOL officially approves the <u>additional 18-month delay</u> (until 7/1/19) 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 broadens definition of covered transactions
  - Buy, sell, hold, transfer, *or rollover*
  - *Asset management*
  - *Provision of investment list*
- Five lawsuits filed challenging DOL regulations

# **401 (K) AND 403(B) FEE AND INVESTMENT LITIGATION**

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## **SELECTED HIGHLIGHTS**

# 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



# RECENT WAVE OF 401(K)/403(B) FEE AND INVESTMENT CASES

- Litigation activity remains high
  - 60+ filed in past year (hard to keep track!)
  - Boilerplate complaints make litigation fast and easy
  - More multi-million dollar settlements announced
  - Settlements include onerous non-monetary sanctions
  - Scrutiny of fee arrangements and additional litigation expected to continue

# 401 (K) / 403(B) FEE COMPLAINTS

Category	Allegations
Record-keeper fees & fee structure	<ul style="list-style-type: none"> <li>• Multiple record keepers – plan forgoes ability to reduce fees</li> <li>• Failure to put out contract for competitive bid regularly</li> <li>• Asset based fees – only flat per participant fee is acceptable</li> <li>• Fees based on revenue sharing – should be capped at flat per participant fee</li> <li>• Financial Engines kickback claims – plan’s fiduciary intrinsically imprudent in allowing deal between record-keeper and FE under which FE pays record-keeper significant percent of FE asset-based fee (up to 45%, depending on record-keeper)</li> </ul>
Unnecessary services/costs	<ul style="list-style-type: none"> <li>• Unnecessary, unreasonable and excessive duplicative mailings to beneficiaries (<i>Lefkowitz v. TIAA</i>)</li> <li>• Superfluous advisors who receive fees to select subadvisors (<i>Aegon</i>)</li> </ul>

# 401 (K) / 403(B) FEE COMPLAINTS

Category	Allegations
High-fee mutual funds	<ul style="list-style-type: none"> <li>Offered retail class funds (as well as institutional class, apparently in same category); failed to offer Vanguard-only line-up which would be cheapest</li> </ul>
Too many funds	<ul style="list-style-type: none"> <li>Deprives plan of bargaining power to reduce fees</li> <li>Too much choice is confusing - “decision paralysis” (citing one study, plaintiffs allege “average” is 15)</li> </ul>
Duplicative funds	<ul style="list-style-type: none"> <li>Duplicative passively managed funds → forgoes bargaining power to reduce fees</li> <li>Multiple actively managed funds with same investment style - offers essential “index fund return” but with higher fees</li> </ul>
Alt. investment vehicles (e.g., CIT, SMA)	<ul style="list-style-type: none"> <li>Failure to provide or investigate collective investment trusts, etc., which for plans with sufficient assets can provide returns identical to mutual funds but at lower cost</li> </ul>

# 401 (K) / 403(B) INVESTMENT COMPLAINTS

Category	Allegations
Inappropriate fund offering — money market funds	<ul style="list-style-type: none"> <li>• Failure to offer stable value fund instead of money market fund as most conservative option (<i>Chevron</i>)</li> </ul>
Inappropriate fund offering — stable value funds	<ul style="list-style-type: none"> <li>• Unduly conservative investment of stable value funds through wrap providers (<i>Ellis v. Fidelity Management Trust</i>)</li> </ul>
Inappropriate fund offering — sector funds	<ul style="list-style-type: none"> <li>• Inappropriate retention of “international specialty funds” in contrast with “dramatically lower cost target date funds” (<i>MIT</i>)</li> <li>• Inappropriate offering of science and technology fund (<i>Boeing</i>)</li> </ul>
Inappropriate fund offering — underperforming funds	<ul style="list-style-type: none"> <li>• Fund underperforms its benchmark</li> </ul>

# 401 (K) / 403(B) INVESTMENT COMPLAINTS

Category	Allegations
Inappropriate fund offering — target date funds (TDFs)	<ul style="list-style-type: none"><li>• Custom TDFs designed by an investment advisor with “no public record.” Target asset allocation resulted in “excessive percentage” of assets in “speculative asset classes.” (<i>Fujitsu</i>)</li><li>• Fiduciary allocated TDFs excessively into hedge funds and alternative investment, relative to TDFs offered by “professional managers,” and also failed to communicate fees in individual funds constituting component of TDF (<i>Intel</i>)</li></ul>
Inappropriate fund offering — badly designed actively managed fund	<ul style="list-style-type: none"><li>• Actively managed funds - 30% of assets were placed in Valeant stock, violating Investment Policy Statement diversification command (<i>Wilson v. Fidelity Mgmt.</i> )</li></ul>

# A REPRESENTATIVE SETTLEMENT

Sponsor	Settlement Terms
Ameriprise	<p>Excessive recordkeeping and management fees alleged</p> <ul style="list-style-type: none"><li>• \$27.5 million settlement</li><li>• Nonmonetary settlement provisions (approved by court):<ul style="list-style-type: none"><li>➤ RFP required for recordkeeping, investment consulting</li><li>➤ Recordkeeping fees must be on flat per-participant basis</li><li>➤ Limitations on expenses charged to plan</li><li>➤ Must consider use of collective trusts or separately managed accounts</li><li>➤ Must hire independent investment consultant</li></ul></li></ul>

# **CUSTOM TARGET DATE FUNDS**

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# TRADITIONAL TDFs - SHORTCOMINGS

- No control over underlying investments
- Lack demographic customizability
- Less aligned with employer benefits philosophy
- Big three market dominance – proprietary issues



# CUSTOM TARGET DATE FUNDS

## Breaking Down a TDF – What can be Customized?

- Asset Classes
- Component Funds
- Glide Path

# ADVANTAGES OF CUSTOM TDFs FOR PLANS/FIDUCIARIES/EMPLOYERS

- Unbundled
- Ability to control or tailor
  - Asset Classes
  - Component Funds
  - Glide Path
- Can incorporate existing plan investment options
- DOL Recommends Consideration of Custom TDFs!

# Q & A





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# **APPENDIX**

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## Fiduciary Duties & Liability

# **FIDUCIARY DUTIES & LIABILITY**

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# WHO IS A FIDUCIARY?

- 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