Your Best Defense is a Good Offense

Why You Should Focus on ERISA Fiduciary Governance

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Current ERISA Landscape

- The Employee Retirement Income Security Act of 1974 is a federal law that sets minimum standards for private industry retirement and health plans to provide protection for participants in these plans.

- ERISA requires (1) plans to provide participants with plan information including information about plan features and funding; (2) fiduciary responsibilities for those who manage and control plan assets; and (3) plans to establish a grievance and appeals process for participants. ERISA also (4) gives participants the right to sue for benefits and breaches of fiduciary duty.


Nobody understands me.
I have to admit, you're right, ERISA. You're right.

Current ERISA Landscape

- This area of law is not going away and is ever-evolving.
- Many different pieces of legislation interact with ERISA plans and impose additional requirements (Internal Revenue Code, ACA, HIPAA, COBRA, SECURE Act, CARES Act).
- Creating a robust fiduciary governance structure and process can greatly aid in compliance items and managing audit and litigation risks.
- Benefits consultants and lawyers can help you navigate benefits issues with practical and proactive advice.

Agenda

I. Continuing Trend: ERISA Excessive Fee Litigation

II. Review of Recent MDNC Case

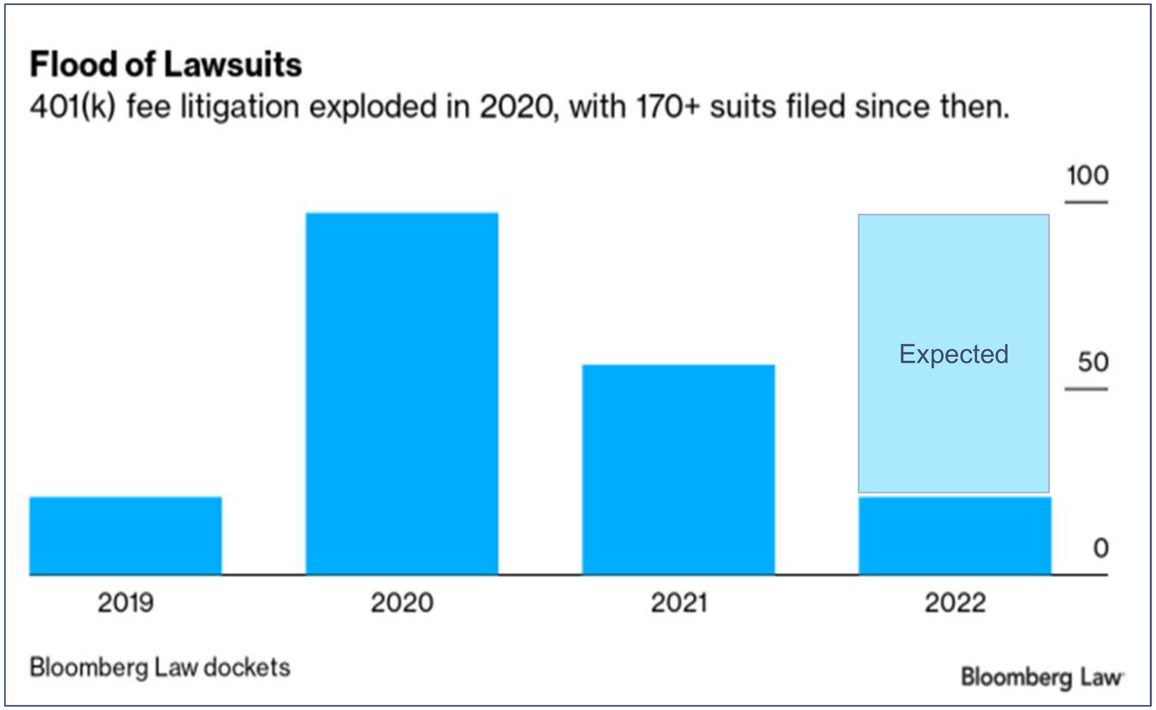
III. Overview of Fiduciary Duties

IV. Best Practices in Fiduciary Governance

V. What We Can Do Now

Trends in ERISA Excessive Fee Litigation

- At least 97 cases in 2020
- Approx. 54 cases in 2021
- Approx. 75-100 cases expected in 2022
- Compare: Fewer than 30 cases in each of 2017, 2018 and 2019



Plaintiffs' Perspective: High Stakes

Assume that you are an employee with 35 years until retirement and a current 401(k) account balance of $25,000. If returns on investments in your account over the next 35 years average 7 percent and fees and expenses reduce your average returns by 0.5 percent, your account balance will grow to $227,000 at retirement, even if there are no further contributions to your account. If fees and expenses are 1.5 percent, however, your account balance will grow to only $163,000. The 1 percent difference in fees and expenses would reduce your account balance at retirement by 28 percent.

DOL, "A Look at 401(k) Plan Fees" (2019)

Trends in ERISA Excessive Fee Litigation

- Smaller plans have become targets.
  - About 33% of recent cases were brought against fiduciaries of retirement plans with less than $1 billion in assets.
- After the Supreme Court's decision in *Hughes v. Northwestern* (January 2022), defendants have had less success on motions to dismiss.
  - Between 2015-20, about 33% of motions to dismiss were granted. Since *Hughes*, only about 10-15% of motions to dismiss have been granted.
  - Since about August 2022, however, the Sixth and Seventh Circuits have rejected excessive fee claims for failing to allege necessary detail, creating favorable new precedent for defendants on motions to dismiss.
- According to insurance data, as the number of cases increases, so does the number of settlements. In 2020, approx. $375 million in total settlement dollars was paid to plaintiffs. Recent settlements are between $1.2 million and $4 million.

Common Allegations

- Plaintiffs assert that plan fiduciaries breached their fiduciary duties of loyalty and prudence by:
  - Paying excessive fees to service providers (e.g., recordkeepers, investment managers)
  - Failing to monitor direct and indirect fees paid to services providers
  - Failing to disclose indirect fees paid to service providers
  - Lacking a regular review process to determine market for fees (Request For Proposal or Request for Information)
  - Failing to properly document fiduciary process and decisions

Common Defenses

- Defendants challenge plaintiffs' factual assertions, which are usually taken from public filings and that are conclusory and may be taken out of context.
- Plaintiffs cannot demonstrate that the recordkeeping services are not worth the fees paid.
- Defendants often assert there is an alternative, acceptable explanation for the alleged misconduct.
  - E.g., certain methods of paying fees associated with certain share classes result in lesser costs borne by participants.
- **Most successful defense**: Defendants maintain a prudent fiduciary process.
  - Plan fiduciaries regularly evaluate provider services and fees and document process.

Case Study: *McDonald v. LabCorp*

- On Aug. 18, 2022, a LabCorp employee filed a class action on behalf of participants in LabCorp's 401(k) plan.
  - 55,355 participants
  - $3.9 billion in assets
- Fidelity has managed LabCorp's 401(k) plan since at least 2015.
  - Services include tracking employee eligibility and contributions, verifying participant status, computing and processing data, etc.
- Plaintiffs alleged that LabCorp last conducted an RFP in 2016.
- Fidelity receives compensation from LabCorp in three ways:
  - Direct fees (per participant fees charged regardless of account balance)
  - Interest on funds in clearing account (i.e., funds deposited into or withdrawn from plan, aka "float")
  - "Revenue sharing" fees for admin services (charged to participants based on percentage of account balance)

McDonald Claims

- In total and derived from public filings on the plan, LabCorp paid Fidelity approx. $150 per participant per year in total fees (direct, float and revenue sharing), which is grossly excessive and unreasonable for the services provided by Fidelity.
- LabCorp breached its fiduciary duty of prudence by failing to monitor or control excessive fees, and this resulted in massive loss of assets to participants in plan.
- Plaintiffs state that a prudent fiduciary would have…
  - Tracked expenses by demanding documentation contextualizing Fidelity's fees (e.g., fee analyses and pricing reports);
  - Identified and monitored all fees paid to Fidelity, including float and revenue sharing fees; and
  - Remained informed about overall trends regarding fees in the marketplace by conducting RFPs at least every three to five years.
- To the extent that LabCorp attempted to monitor or control fees, it employed an **ineffective process** to do so.

So What? How Can We Mitigate the Risk of Claims

- Anyone can be sued but setting up a solid fiduciary governance structure and process is KEY risk mitigation.
- The law rewards a prudent “process” – fiduciaries don’t have to get it 100% correct (e.g., don’t have to pick the lowest cost option), but they do need an informed and documented decision-making process.
- In ERISA fiduciary matters, process always wins!
- What loses? No process, no fiduciary structure or training, appropriate and sophisticated fiduciaries, no rigor of review, no supporting process documents or old/outdated documents, no monitoring of your vendors.
- Review major tenants of ERISA fiduciary responsibilities in order to demonstrate potential action steps.

Setting the Stage: Major Elements of a 401(k) Plan

- A written plan that describes the benefit structure and guides day-to-day operations.
- A trust fund to hold the plan assets.
- A recordkeeping system to track the flow of funds into and out of the plan.
- Documents to provide plan information to plan participants and to the government.

Setting the Stage: Major Actors in a 401(k) Plan

- The **plan sponsor** is the employer who establishes and maintains the plan for its employees, who may participate in the plan.
- The **plan administrator** is the person/entity “so designated” in the plan document. If none is designated, the default plan administrator is the plan sponsor.
- The **plan trustee** is named in the plan document or plan trust document and has exclusive authority and discretion to manage and control plan assets.
- An **investment manager** is hired to select and monitor the investments made with plan assets.
- The **recordkeeper** is hired to track contributions, earnings and investments on a participant level.
- The **third-party administrator** (TPA) is hired to manage the plan’s ERISA compliance (e.g., annual reporting, plan document maintenance).

You Have a 401(k) Plan – Now Who is a Plan Fiduciary?

- Fiduciaries may be named or functional.
- A named fiduciary is a person/entity who is designated as a fiduciary in the plan document.
- A functional fiduciary is a person/entity who:
  - Exercises any discretionary authority or responsibility in the administration of the plan;
  - Exercises any authority or control concerning management and disposition of plan assets; or
  - Renders investment advice regarding plan assets for a fee or other compensation.

Named Fiduciaries

- Plan sponsor
- Plan administrator
- Plan trustee

- Appointed by named fiduciary: Investment manager

Functional Fiduciaries

- Anyone with control over plan assets or discretion over plan management
- Determined by person/entity’s function, authority and responsibility

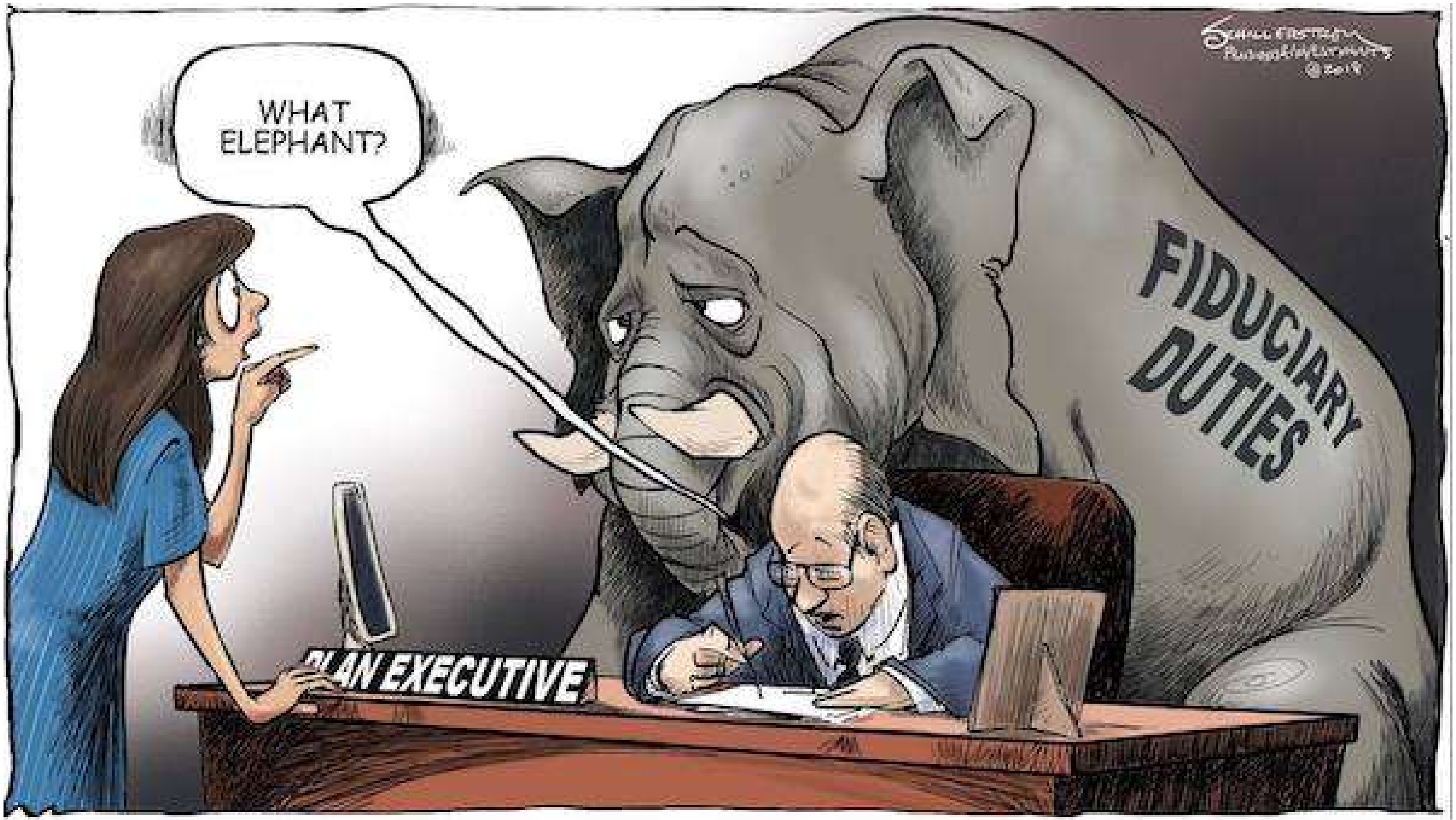
What Must the Plan Fiduciaries Do?

- Select and monitor plan service providers (e.g., recordkeepers, TPAs, consultants)
- Avoid and/or mitigate conflicts of interest
- Operate the plan according to the governing documents, laws and regulations
- Keep documents up-to-date with changes in the law
- Ensure fulfillment of reporting and disclosure requirements
- Oversee plan investments and expenses

How Do They Do It? Overview of Basic ERISA Fiduciary Duties

- **Duty of loyalty.** Fiduciaries must fulfill their responsibilities in a way that solely benefits plan participants and beneficiaries.
- **Duty of prudence.** Fiduciaries must act with the skill, care and diligence under the circumstances that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims.
- **Duty to follow plan documents.** Fiduciaries must follow the terms of the plan unless those terms contradict ERISA rules.
- **Duty of diversification.** Fiduciaries must offer a wide range of investment options to help participants meet their investments needs and diversify their investments to minimize the risk of large losses.

*Fiduciary duties apply to fiduciary actions, but not to non-fiduciary actions (e.g., amending or terminating a plan).


WHAT ELEPHANT?
FIDUCIARY DUTIES
PLAN EXECUTIVE

What Could Happen if They Fail to Do It: Potential Penalties

- Fiduciaries may be held personally liable for violating ERISA's fiduciary duty rules – they are on the hook to make good on any plan losses!
- In addition to suits related to excessive fees, civil suits related to conflicts of interest, participant notices and cybersecurity are on the rise.
- The DOL and IRS may impose civil penalties and excise taxes through its regular audit programs or investigations of participant complaints.
- For willful ERISA violations, criminal penalties may be imposed.

Plan Governance: Golden Rule

- Establish a written governance process.
- Follow the process.
- Document the process.
  - As far as the DOL is concerned, if it was not documented, it did not happen.

Plan Governance: Best Practices

- **Process.** Create a governance policy document that clearly defines the governance process by:
  - Delegating authority and assigning duties to responsible parties.
  - Setting the frequency at which responsible parties must meet and identifying recurring agenda items.
  - Establishing how actions with the respect to the plan are approved and how meetings/actions are documented and archived.
- **Oversight.** Form a plan committee to oversee the administration of the plan.
- **Education.** Educate plan fiduciaries and members of the plan committee on their responsibilities and applicable ERISA rules. Hire experts when needed.

Case Study: *Falberg v. Goldman Sachs*

- On Oct. 25, 2019, a participant in the Goldman Sachs 401(k) plan filed suit against Goldman Sachs and its Retirement Committee.
- Relevant allegation: Defendants breached their fiduciary duty of prudence by failing to develop and follow an Investment Policy Statement (IPS).
- On Sept. 22, 2022, the court granted summary judgment in favor of defendants, emphasizing that ERISA requires plan fiduciaries to follow a prudent fiduciary process, but does not specifically require fiduciaries to maintain an IPS.
- Defendants here followed a prudent fiduciary process by:
  - Maintaining the Retirement Committee to oversee plan investment options.
  - Staffing the Retirement Committee with experienced financial professionals and conducting periodic trainings for committee members.
  - Working closely with an investment adviser for investment advice.
  - Holding quarterly meetings to review performance and documenting meeting discussions.

Where to Start: Threshold Questions to Ask

1. What ERISA plans do we have?
2. Who are your fiduciaries – and are they the “right” people?
3. Where is the fiduciary process set out? What do your plans say about this?
    - Committee charter, investment policy statement, meeting cadence, plan documents, fiduciary training materials
    - Balance between structure and flexibility is key
4. How do fiduciaries act and how evidenced?
    - Meetings vs. consents – meeting minutes and signed resolutions

Make a plan … it's fairly simple and straightforward

- Understand the genesis of your current structure.
- Evaluate your process and any gaps in operation versus documentation.
- Prioritize items to address first. Make a plan – lawyers develop and maintain.
- If you've not had fiduciary training in the last three years, schedule it!
- Evaluate your service providers (services, fees and contracts).
- Enlist assistance when needed.
- Embrace that ERISA is here to stay so stay current on litigation trends.

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