

Fi360

Latest ERISA Court Actions Offer New Guidance to Fiduciary Practitioners

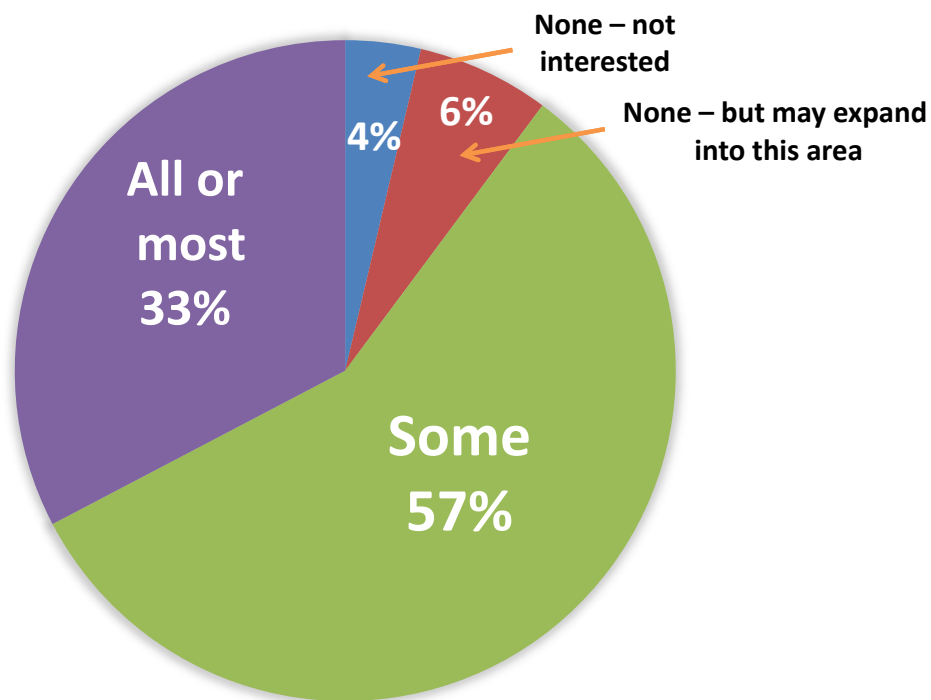
April 24, 2019

Blaine Aikin, AIFA[®], CFP[®], CFA
Fi360 & CEFEX, Executive Chairman

Duane Thompson, AIFA[®]
Fi360, Senior Policy Analyst

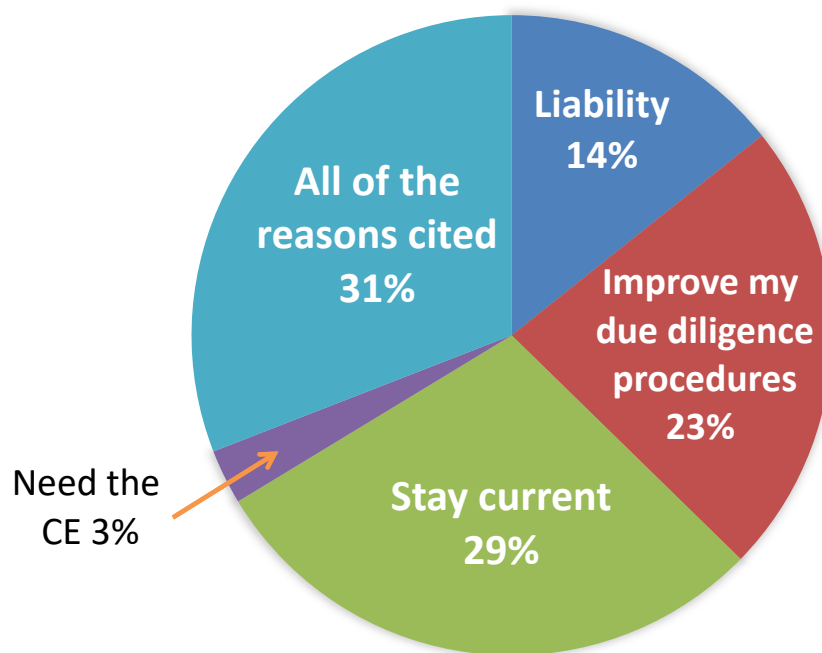
Survey Question #1

How much of your firm's practice involves advice to 401(k) plans?



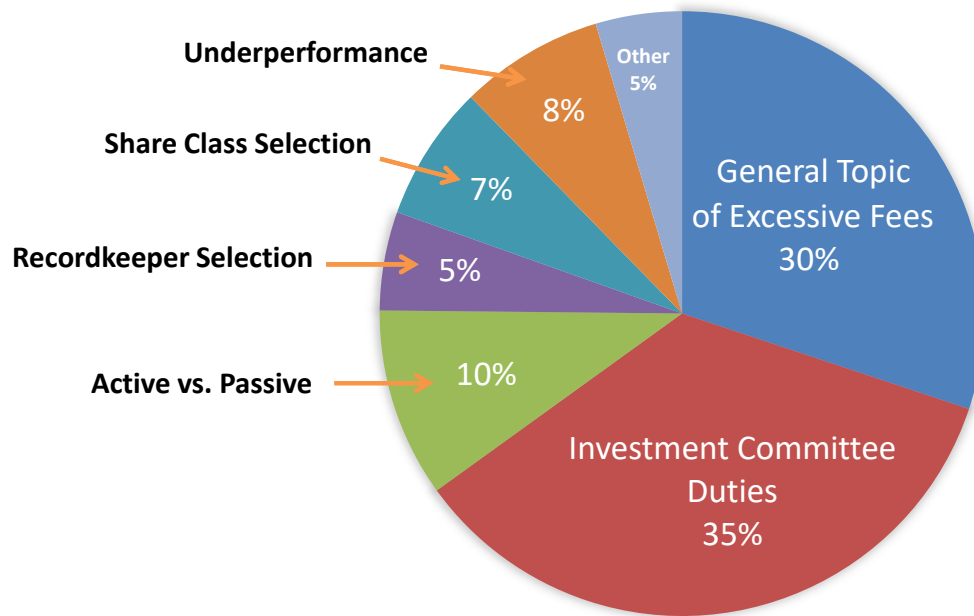
Survey Question #2

I am interested in this session on current ERISA litigation because



Survey Question #3

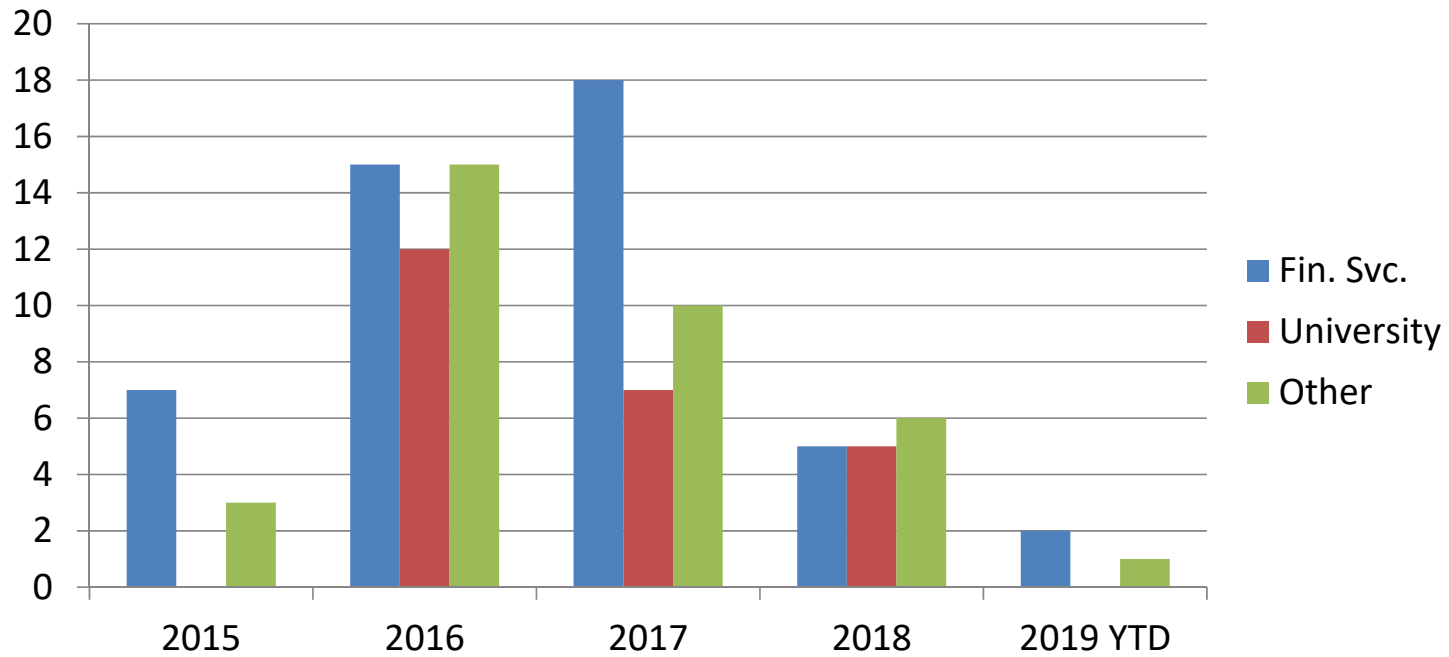
Regarding excessive fee litigation, I am most interested in ERISA breach claims involving



Topics of Discussion

- ERISA Class-Action Trajectory – Four Years In
- Excessive Fee Cases and Related Claims
 - Review of Claims That Fail, Claims With Traction
 - Settlement Conditions Offer Clues to What Went Wrong
- Insights into the lessons from litigation
 - How to avoid the biggest litigation risks
 - Moving beyond risk management to marketplace differentiation

Excessive Fee Cases – Class-Action Trajectory*



* Cases filed 2015-2019 ytd. Source: Bloomberg Law.

Has the ‘Wave’ of Class Actions Finally Crashed?

“Ultimately, it may be that 401(k) cases end because [plan] sponsors change their practices. That’s happening now.”

-- Jerry Schlicter

March 2018 podcast interview w/Forbes

- Fiduciaries changing DC plans in response to lawsuits
- Size matters – less than 600 plans (.1%) hold \$1 billion+ in assets
 - Limited number of large plans makes class actions economically less viable
- DOL fiduciary rule vacature means fewer advice-fiduciaries

'Excessive Fee Cases' a Misnomer

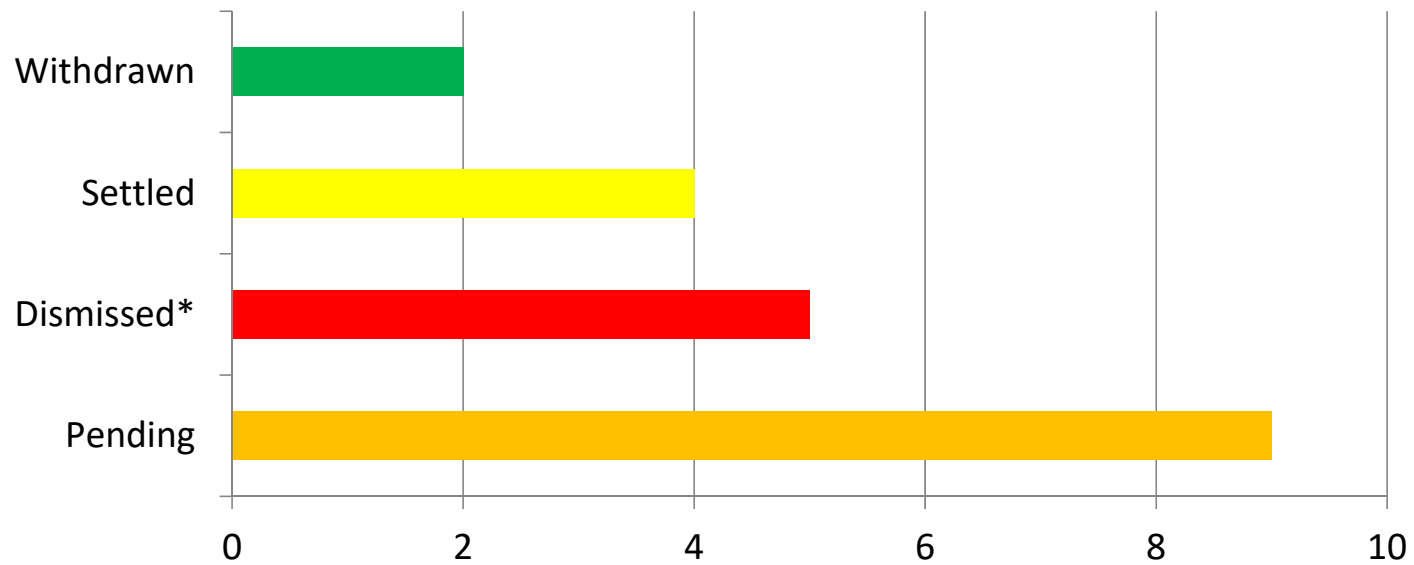
Fee Claims

- Retail vs. institutional share classes
- Passive vs. active options
- Recordkeeping costs
 - Multiple recordkeepers
 - Asset-based fee vs. individual
 - Failure to solicit bids
- Layered fees
- Self-dealing through use of proprietary funds
- Failure to monitor costs

Non-Fee Claims

- Underperforming investments
- Failure to prudently select, monitor and replace poorly performing options
- Failure of plan fiduciary to monitor investment committee
- Use of new fund without track record
- Use of money market vs. stable value fund
- Use of alternative investments
- Too many investment options, leading to 'decision paralysis'

University Plans – Case Status



* Dismissed cases are all on appeal

Claims in Court That Fail, Claims With Traction

Little Traction

- Failure to monitor investment costs, recordkeeping fees
- Failure to consider non-proprietary funds in lineup
- Use of proprietary funds for sponsor's own benefit
- Failure to monitor investment committee
- Predominant use of active instead of passive funds
- Money market vs stable value fund

Some Traction

- Failure to consider when to replace an investment option
- Use of retail vs lower-cost institutional shares
- Failure to solicit recordkeeping bids
- Excessive administrative fees (asset-based vs. flat)



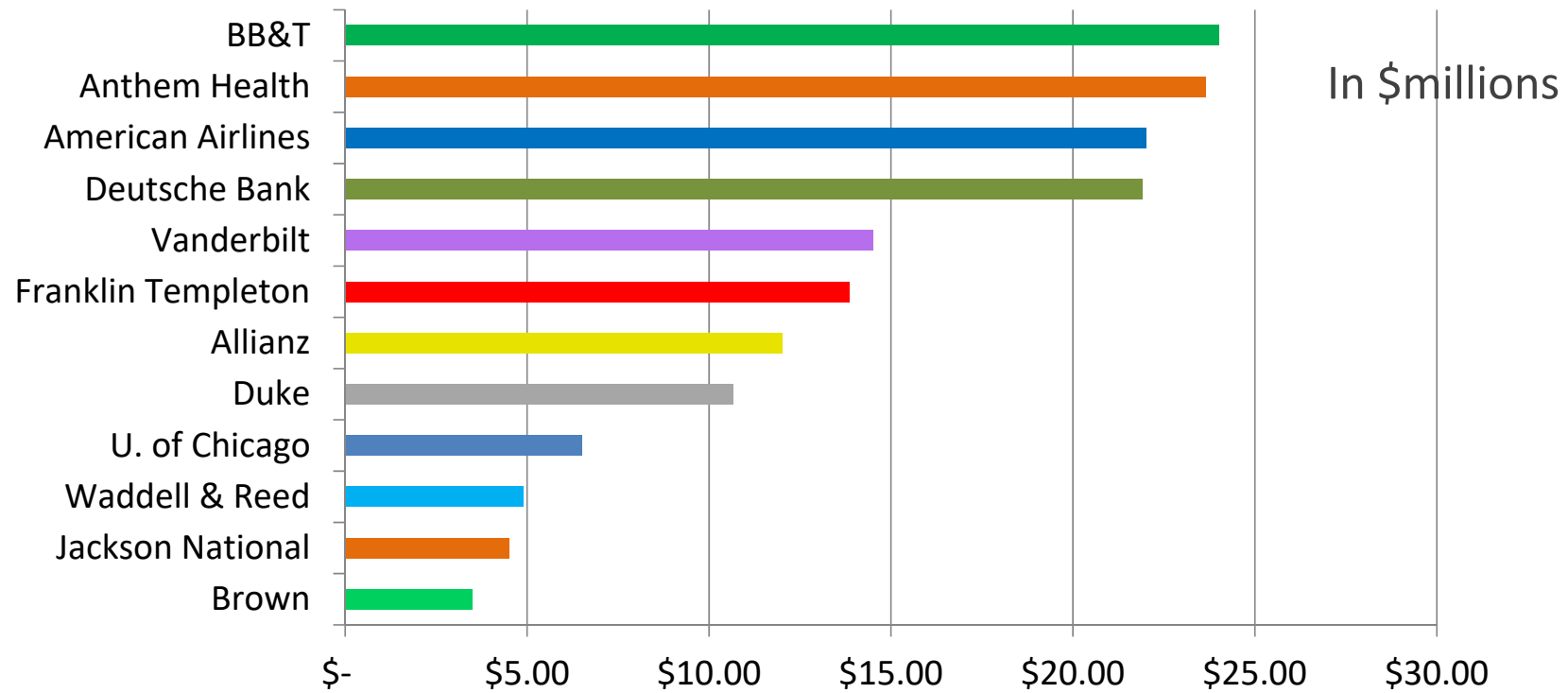
Stable Value vs. MMF Claim

- Plaintiffs do not claim Defendants had a fiduciary duty to offer a stable value fund, just a fiduciary duty to consider offering one. *Bell v. Anthem Health*, 1/30/19.
- ERISA does not require a retirement plan to offer an index fund or a stable value fund, and the failure to include either in the Plan, standing alone, does not violate the duty of prudence. Citing *Hecker v. Deere*, “Nothing in [ERISA] requires plan fiduciaries to include any particular mix of investment vehicles...” *Wildman v. American Century*, 1/23/19.
- Defendants not required to provide a stable value fund. ERISA does not require [it]. It “requires only that the Plan offer some type of low-risk capital preservation option.” *Dorman v. Charles Schwab*, 9/20/18.

A Look at Retail vs. Institutional Share-Classes

- **Retail Imprudent.** Court finds pertinent plaintiff's allegation that defendants "did not. . . select the least expensive share class of the T. Rowe Price 2050 Target Date Fund, which would have no other distinction than being 0.25% cheaper." *Hay v. Gucci America*, 10/2/18.
- **Retail Not Imprudent.** Fiduciaries are required to consider factors beyond price when choosing investment options. [Citing *Loomis v. Exelon Corp.*, 2010] retail funds may have certain advantages over institutional funds, such as higher liquidity. *Patterson v. Capital Group [American Funds]*, 1/23/18.
- **Retail Not Imprudent.** Here...the claim is essentially that including a particular share class is ipso facto imprudent. That claim is not sufficiently supported. Various appellate decisions that have addressed this...indicate a trend supportive of this Court's decision. *Sacerdote v. NYU*, 10/19/17.

Recent Settlements – All Industries*



* Source: Bloomberg Law

Settlement Conditions Offer Clues to Problems



Investments

- Requires plan fiduciary to hire independent consultant to evaluate plan options, provide training sessions for plan fiduciaries
- Selection, retention or removal of proprietary funds delegated to an independent fiduciary
- Independent fiduciary retained for three years to provide annual independent evaluation of plan's lineup and review plan's IPS
- Plan's investment committee minutes to include description of rationale for adding any new options

- Add 10 non-proprietary funds, including 5 with expenses below 15 bps
- Add brokerage window
- Remove one annuity option

Administrative

- Rebate 12b-1, sub-TA fees paid to recordkeeper based on investment options used
- Rebate revenue-sharing from new investments to participants
- Use "commercially reasonable best efforts" to reduce record-keeping fees
- No increase in per-head fees for 3 years

Causes and Consequences*

Boston College study focuses on three main complaints and draws a critical conclusion:

1. Inappropriate investment options
2. Excessive fees
3. Self-dealing

“From the courts’ perspective, fiduciaries’ main responsibility is to follow a prudent process in making plan-related decisions.”

* Source: 401(k) LAWSUITS: WHAT ARE THE CAUSES AND CONSEQUENCES?, Center for Retirement Research at Boston College, By George S. Mellman and Geoffrey T. Sanzenbacher, May 2018

DOL Rule's Impartial Conduct Standards

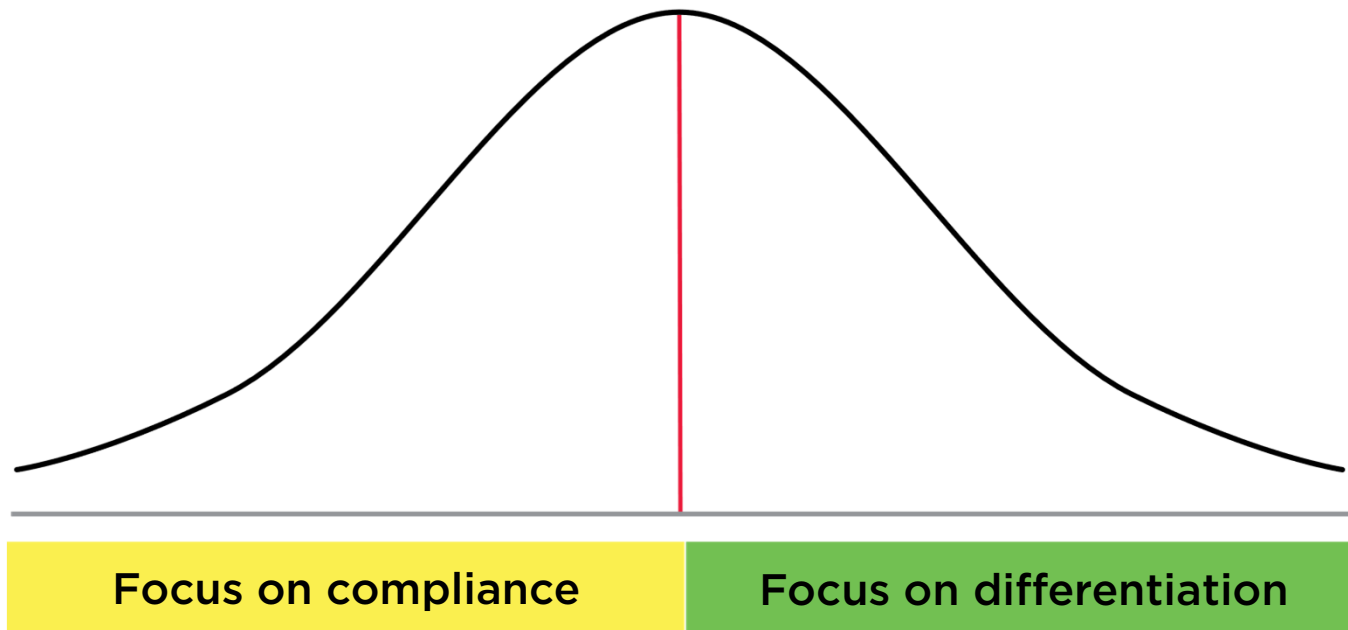
1. Give advice that is in the “best interest” of the retirement investor. This best interest standard has two chief components:
 - Prudence – meet a professional standard of care
 - Loyalty – serve the interests of the customer, rather than the competing financial interest of the adviser or firm;
2. Charge no more than reasonable compensation; and
3. Make no misleading statements about investment transactions, compensation, and conflicts of interest.

Fi360's Prudent Investment Practices

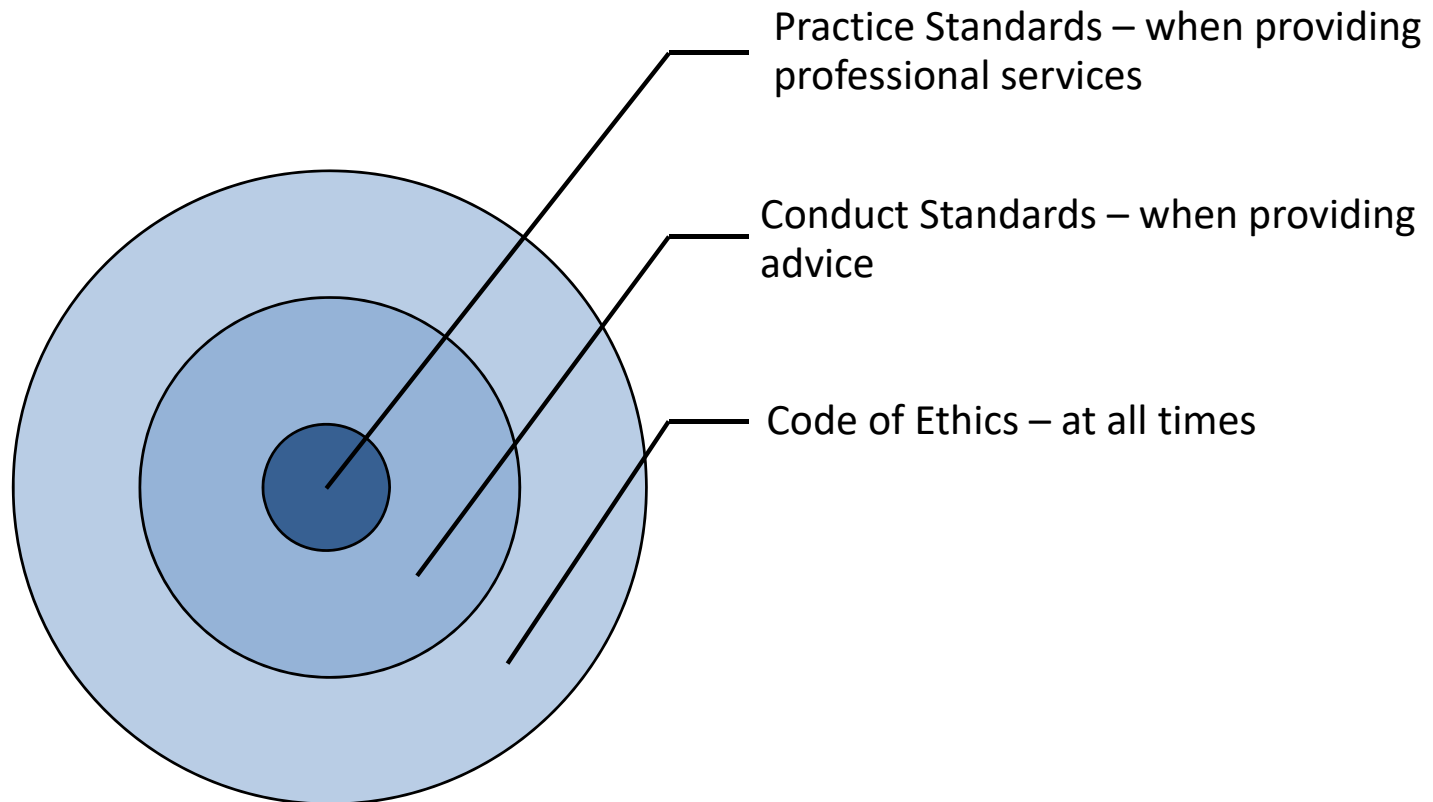
- **Practice 1.1** – The investment steward demonstrates an awareness of fiduciary duties and responsibilities.
- **Practice 1.4** – The investment steward identifies material conflicts of interest and avoids or manages conflicts in a manner consistent with the duty of loyalty.
- **Practice 2.6** – The investment policy statement contains sufficient detail to define, implement, and monitor the portfolio's investment strategy.
- **Practice 3.1** – A prudent due diligence process is followed to select each service provider.
- **Practice 3.2** – Statutory or regulatory investment safe harbors that are elected are implemented in compliance with the applicable provisions.
- **Practice 3.3** – Decisions regarding investment strategies and types of investments are made in accordance with fiduciary obligations and are documented.
- **Practice 4.4** – Periodic reviews are conducted to ensure that investment-related fees, compensation, and expenses are fair and reasonable for the services provided.
- **Practice 4.5** – There is a process to periodically review the steward's effectiveness in meeting its fiduciary responsibilities.

Download new Prudent Practices handbook at www.fi360.com/advisorshandbook

Shifting Focus from Compliance to Differentiation



Differentiation Through Professionalism



THE TRUST EQUATION

$$\text{TRUST} = (\text{CREDIBILITY} + \text{RELIABILITY} + \text{INTIMACY}) / \text{SELF-ORIENTATION}$$

Credibility: Demonstrated or verified competence and quality

Reliability: Demonstrated diligence in the performance of responsibilities and fulfillment of commitments

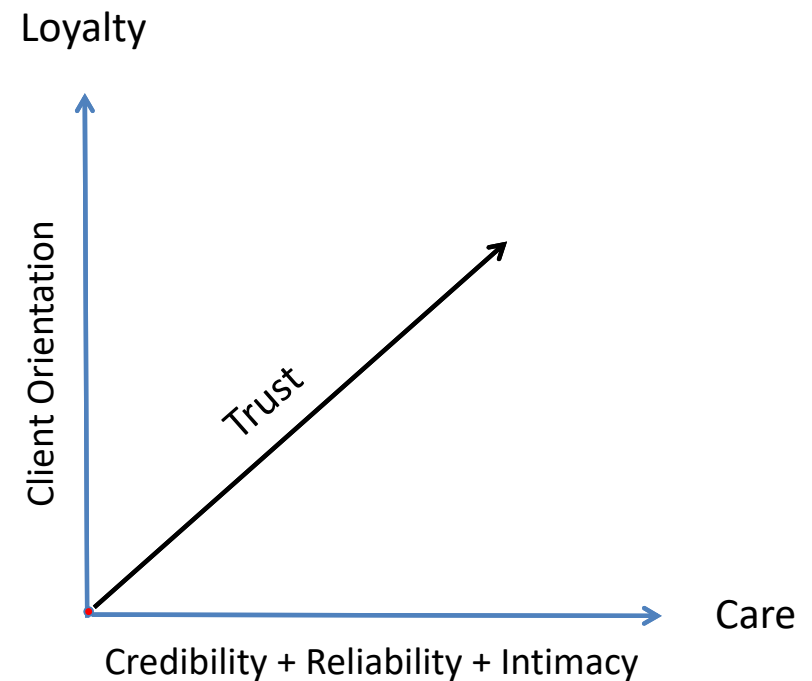
Intimacy: Strength of the relationship; engagement with clients

Self-Orientation: Ability and propensity of the advisor to subordinate clients' interests to the advisor's own interests

Source: "The Trusted Advisor", a book by David Maister, Charles Green, and Robert Gaiford, 2001

OBSERVATIONS TO GUIDE SOUND DECISION-MAKING

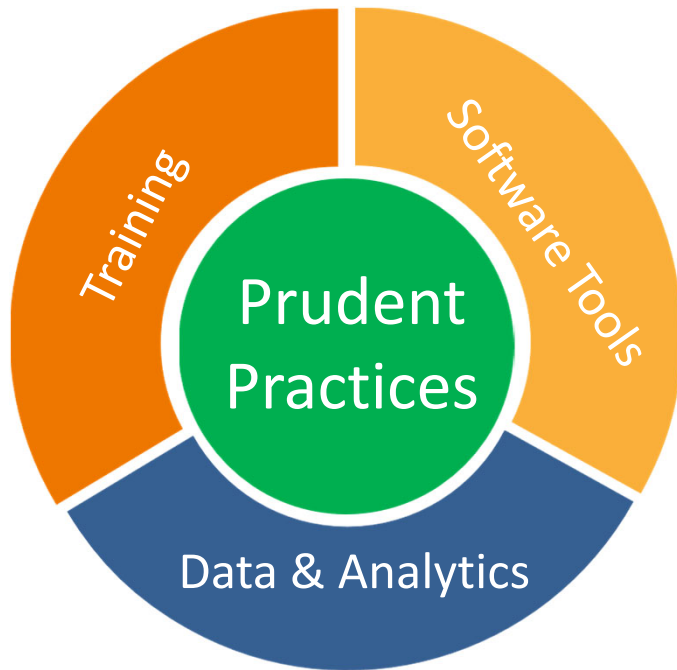
- The regulatory environment will be uncertain for the foreseeable future
- Litigation is increasing
- Given these conditions, the fiduciary high ground is the safest place to be
- Competitively, the one closest to the client always wins



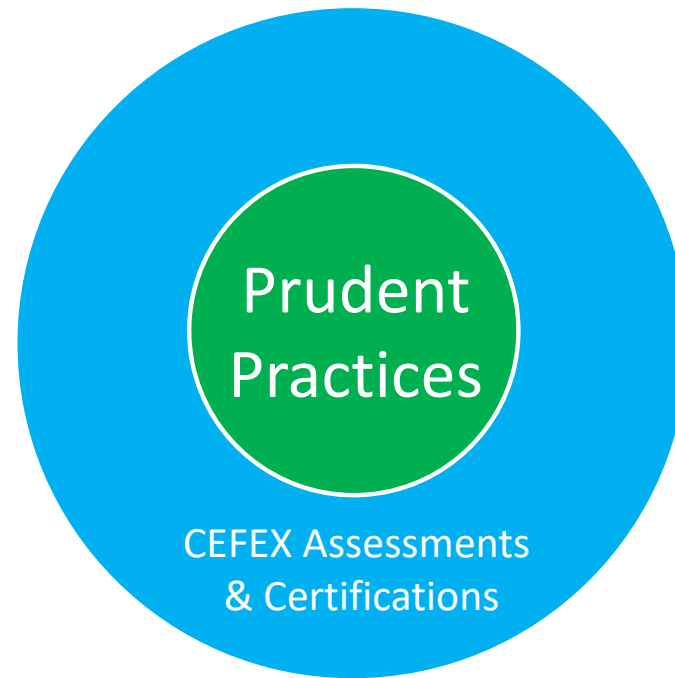
TAKEAWAYS AND ACTION STEPS

- To manage regulatory, litigation and reputation risks, **follow prudent processes:** Impartial Conduct Standards and the Prudent Investment Practices (www.fi360.com/advisorshandbook)
- Concentrate on what you can control, your reputation and the factors in the trust equation:
Trust = (Credibility + Reliability + Intimacy) / Self-orientation
- *Your value proposition as a retirement advisor is your demonstrated commitment to excellence and your ability to have your clients recognized for excellence too.*
- See Fi360's White Paper: "Fiduciary Conduct and Your Reputation - What's trust worth as an investment advisor?" and watch for our upcoming white paper on "Lessons from Litigation" (<https://www.fi360.com/resources/document-downloads/>)

Fi360 Enables
Professional Excellence



CEFEX Promotes and Recognizes
Institutional Excellence



Fi360

Q & A



Please submit any questions using the GoToWebinar interface

Additional questions can also be sent to support@fi360.com

THANK
YOU
