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# Understanding the Causes of 401(k) Litigation and How to Avoid a Lawsuit

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# Topics of Discussion

- Litigation Landscape
- The Issues
- How to Stay Out of Court
- Legal/Regulatory Compliance Versus Professional Conduct Standards

# Litigation Landscape – Why Lawsuits Happen

- **Cause of Action:** Participants are alleged to have suffered monetary damage
- **Motivating Factors:** Regulators and litigators are rewarded for recovering money for participants
- **Central Claims:** Fiduciary failures are believed to be to blame
- **Primary Defense:** Fiduciaries must show their policies, procedures, and actions serve participants and beneficiaries' best interests



# Making Decisions for Others Matters

- Participant-directed plans shift most of the risk of loss from the institution to the participant, but not all of it.
- Fiduciaries are accountable for the decisions they make on behalf of participants and beneficiaries.
- “We can’t do everything ourselves.” The fiduciary duties of loyalty and care demand professional ethics and competence from those we depend upon.



# Landmark 401(k) Cases

- *Hecker v. Deere* (2009) – Revenue sharing arrangements do not violate ERISA.
- *Braden v. Walmart* (2009) – Excessive fee case; settlement required fiduciary to replace retail share classes with institutional; consider adding low-cost index funds as options.
- *Leimkuehler v. Am. United Life Ins. Co.* (2013) – One of series of class actions in which fiduciary status for service providers rejected by courts. Led to DOL broadening fiduciary definition in 2016 rule.
- *Tibble v. Edison* (2015) – Supreme Court rejects statute of limitations defense by fiduciaries for selecting imprudent investment options.

# *Prudent Practices* in Court

- ***Tussey v. ABB*** (2010 Bench Trial) – Excessive fees and self-dealing at issue; expert witness citing *Prudent Practices* was found to be credible after 16-day bench trial.
- ***Tibble v. Edison*** (2015) – Supreme Court affirmed continuing duty of fiduciaries to monitor plan assets. *Amicus* brief filed citing *Prudent Practices*.
- ***Kruger v. Novant Health* (2016) and *Gordon v. Mass Mutual* (2016)** – *Prudent Practices* filed to support motions to approve settlements in these cases.

# The New Wave of 403(b) Cases

- 20+ ‘University’ class actions filed in last two years
- These 403(b) cases subject to same fiduciary standard as 401(k) plans
- Common complaints:
  - Excessive fees
  - Too many options
  - Poor investment performance
  - Imprudent investment selections (stable value funds, TDFs, etc.)
  - Multiple recordkeepers



# 'Jury' Still Out on Latest Class Actions

- Financial Services Firms:
  - 3 wins for fiduciaries\*
  - 6 'losses,' i.e. settlements with participants
  - 15+ await pretrial motions or trial
- University Case Score:
  - 3 wins by fiduciaries\*\*
  - 1 'loss,' i.e. settlement with participants
  - 2 others have class certification; three awaiting cert
  - Most judges plan bench trials; two have approved jury trials

\* \*\* All are on appeal or likely to be appealed.

# Focus on Deutsche Bank Settlement

- Suit alleged breaches of fiduciary duties by offering the company's own 401(k) plan proprietary, high-cost investments and failure to adhere to plan documents
- Plan had (as of 2009) \$1.9 billion in assets; offered participants 22 DIAs, of which 10 were proprietary mutual funds of the bank
- \$21.9 million settlement (announced 8/15/2018, awaiting court approval) includes:
  1. Attorneys' fees, contingency reserve to yet-to-be-determined administrative fees, and per participant amount to be determined (estimated at \$632.12 per class member)
  2. Delegate decisions regarding Deutsche Bank proprietary investments to independent fiduciary
  3. Seek written opinion from independent fiduciary whether any fund options -- proprietary and non- -- should be replaced with other investments such as separate accounts or collective trusts
    - Settlement represents more than 50% of estimated damages, involving seven actively managed and three index proprietary funds; approximately 38.5% of settlement derived from non-proprietary funds

# Focus on University of Chicago Settlement

- Suit alleged imprudent investment selections, failure to monitor two annuity options, excessive recordkeeping fees, two recordkeepers
- Court strongly urged mediation; extensive process ensued
- Parties were aware trial in another university lawsuit underway (NYU); could affect outcome here
- \$6.5 million settlement (May 2018)
- Structural changes to plan include
  - No increase in per-head fees for 3 years
  - Continue to try and reduce recordkeeping fees
  - Reduced number of investment options
  - Removal of one annuity option

# Takeaways at This Stage

- Monitor settlements – these provide important clues to how fiduciary defendants are reacting to claims
- Even if courts provide plan sponsors deference on investment selections, many making adjustments to avoid litigation:
  - Reducing number of investment options
  - Reducing investment costs
  - Adding index funds
- Even if class actions abate, regulators have taken notice in exams:
  - Carefully reviewing share class selections
  - Rollover advice remains priority

# 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

# The Big Three Claims

- Imprudent selection and inadequate monitoring of investments and service providers
- Excessive costs
- Self-dealing



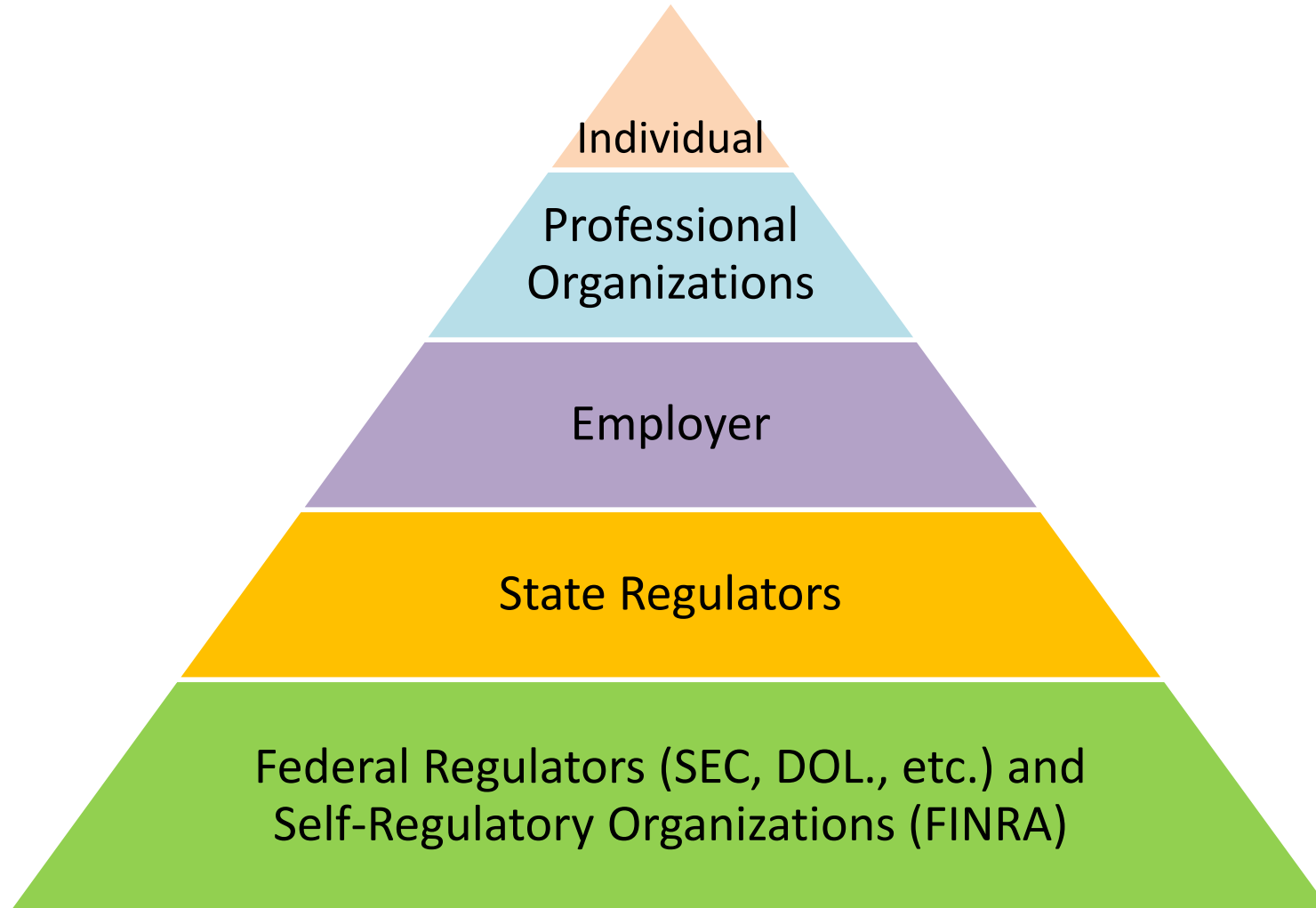
# How to Stay Out of Court

- “From the court’s perspective, fiduciaries’ main responsibility is to follow a prudent process in making plan-related decisions.”\*
- Best practices for ERISA Fiduciaries\*\*
  - Procedural Prudence
  - Monitoring
  - Consult Experts When Appropriate
  - Know What the Job Entails, and Exercise Independent Judgment

\* “401(k) Lawsuits: What Are The Causes And Consequences?”, George S. Mellman and Geoffrey T. Sanzenbacher, Center for Retirement Research at Boston College, May 2018

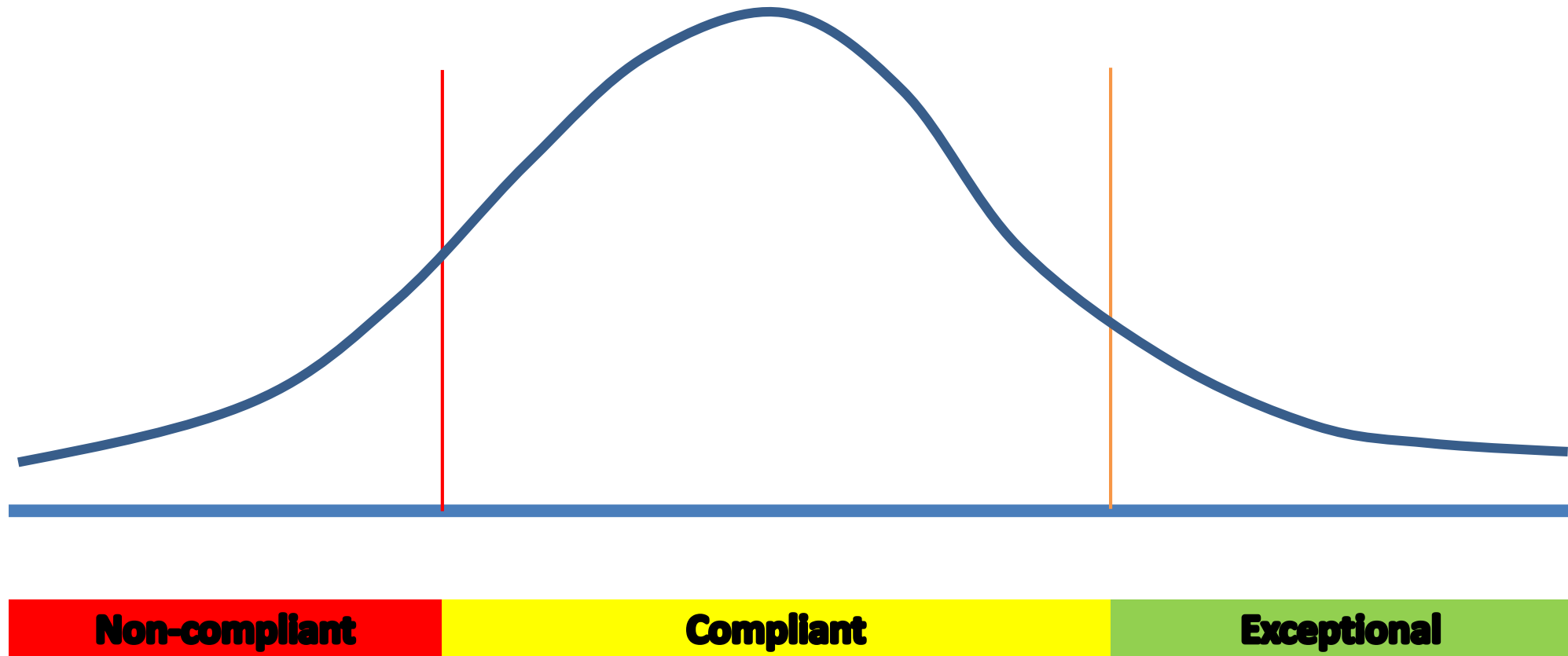
\*\* “The Recent NYU ERISA Decision and Best Practices for ERISA Fiduciaries”, Bond Schoeneck & King Attorneys, News & Insights, August 13, 2018

# Hierarchy of Conduct Standards





# Court is a long way from best in class



# Fi360's Approach to Fiduciary Excellence

## Prudent Investment Practices Handbooks

Fiduciary Practices Substantiated in law and best practices.

“The good book” – follow the definitive guide to investment fiduciary conduct standards.

Provide clients tangible evidence of your commitment to serving their best interests.

## Accredited Investment Fiduciary (AIF)

Mastery of the Prudent Practices.

Reduce compliance and business risk.

Enhance your business practices and your professional reputation.

Distinguish yourself in the marketplace as a truly professional advisor.

## Fiduciary Focus Toolkit

Tools to efficiently and effectively manage the Prudent Practices.

Streamline your fiduciary decision-making process.

Make compliance easier and reliable.

Produce awesome reports and enhance client relationships.

## Accredited investment Fiduciary Analyst (AIFA)

Mastery of the fiduciary audit process based upon Prudent Practices.

Add consulting service to assess and improve fiduciary practices of clients.

Conduct certification engagements through CEFEX.

## Centre for Fiduciary Excellence (CEFEX) Certification

Third-party verification of conformity to Prudent Practices.

Join an elite community of the best in the business.

Showcase the CEFEX Mark, signifying your firm is worthy of trust and confidence.

# Q & A

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Additional questions can also be sent to [support@fi360.com](mailto:support@fi360.com)

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