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New Areas for 401(k) Lawsuits Emerge

A new array of developing legal risks awaits unwary retirement plans and their advisers

By Darla Mercado | March 23, 2015 - 11:56 am EST

If litigation in the 401(k) arena isn't keeping retirement plan advisers up at night, it ought to be.

A panel of experts at the National Association of Plan Advisors 401(k) Summit in San Diego discussed on Sunday developing legal risks that await unwary retirement plans and their advisers.

New areas ripe for suits include failure to promptly follow fee disclosure regulations, arrangements where plan service providers have discretion over fund menus and employee stock ownership plans. Even smaller — $20 million to $50 million — plans aren't safe from suits.

The trend is highlighted by a series of multimillion dollar settlements involving unreasonably high fees in retirement plans. Such was the case with Lockheed Martin Corp. and International Paper Co. There's also the employees of financial services firms who have sued their own employers, which happened at MassMutual and Ameriprise Financial Inc.

Those 401(k) fee lawsuits are beginning to trickle down-market, panelist Gregory J. Marsh, director at Bridgehaven Financial Advisors, warned, and advisers are in a prime position to help plan sponsors take a closer look at their arrangements to protect themselves from suits.

“We're in a golden opportunity now from a standpoint of establishing value,” he said. “The talk may start with fee structure, but how was that investment selected? What's the process? Are the revenue sharing agreements practical?”

NEW DISCLOSURE REQUIREMENTS

Bradford P. Campbell, counsel with Drinker Biddle & Reath, noted that the biggest change that's taken place since many of those 401(k) fee suits were filed is the arrival of fee disclosure for plan sponsors and plan participants.

Plan sponsors and fiduciaries hopefully haven't used the DOL's grace period for enforcing those disclosure requirements as an opportunity to slack off. Failure to comply still leaves the door open for a suit alleging fiduciary breach, even if the DOL doesn't punish the offending employer.

“Long term, that can be the basis for asserting that you didn't provide the required disclosures to the employee, and it's a fiduciary breach for failure to do so,” said Mr. Campbell.

Another area of growth for plan litigation is in scenarios where service providers have retained discretion. Mr. Campbell referred to the DOL's 2003 Aetna opinion, which addressed the issue of whether a record keeper that maintains a fund menu is acting as a plan fiduciary based on whether it changes the fund lineup. In this situation, Aetna had indicated that it would not provide advice or act as a fiduciary.

In the advisory opinion, the DOL said that a fiduciary who is apart from the record keeper must decide whether to accept or reject the change, and thus this individual must have time to consider that decision. Mr. Campbell said that the DOL has been taking a closer look at those arrangements.

“In the last few years, the DOL has started to tweak that premise, that if you as a service provider retain discretion to change the fund lineup, but you didn't write that into your contract, then it makes you a fiduciary,” he said.

Indeed, the DOL pursued such an angle when it chimed in on the Santomenno v. John Hancock case in an amicus brief last year, Mr. Campbell said.

Other areas of concern for litigation include employee stock ownership plans, as well as scenarios where the plan's documents and investment policy fail to jibe with what the plan's actual processes.

LOW-HANGING FRUIT

“The last 10 to 15 years have been the first exploratory wave [of 401(k) fee litigation], and it's coming down market,” Mr. Campbell warned.

“If you have everything lined up and ready to go, then the plan isn't as attractive to the attorney who is taking this on speculation,” he added. “They are looking for low-hanging fruit.”

In practice, this means having a clearly defined process behind choosing funds, and being able to demonstrate to plan sponsors the basis behind those decisions, Mr. Marsh noted.

“The end result is to get participant outcomes to where they should be and those who run the plan are taking on a lot of responsibility to get it there,” he said. “We have everything in place from a process standpoint to try as best we can to cover all bases.”