Measuring You for an ERISA Suit

By David Lindorff *Wed, Jun 26, 2013*

There are "people out there" who are "running algorithms to spot good targets for excessive fees lawsuits," said Jason Roberts, CEO of Pension Resource Institute in Manhattan Beach, Calif.

Across America, providers of ERISA-regulated retirement are lowering their fees for defensive and proactive reasons. Some want to avoid being sued by participants for not being good fiduciaries of the plan. Some may want participants to accumulate more money at retirement. And, in some cases, they may simply not have realized until recently that they had a problem. "A lot of plan sponsors just never really thought about fees before," said Alicia Munnell, director of the Center for Retirement Research at Boston College.

But they think a lot about them now. Just this week, Cigna Corp. and Prudential, which bought Cigna's retirement business in 2004, reached a $35 million settlement in the case of *Nolte v. Cigna*, filed in 2007. It was alleged that participants were overcharged for proprietary investment options, that plan assets were misused and that Cigna used plan assets and revenue to pump up the value of its retirement business in the sale to Prudential.

Targets on our backs

Plan sponsors, providers and sponsors have been on alert since March 2012, when Missouri Federal District Judge Nanette Laughrey awarded $36.9 million to the plaintiffs in *Tussey v. ABB*. The plaintiff's attorney in that case, like the Cigna case and other similar cases, was the St. Louis law firm of Schlichter, Bogard & Denton.

Judge Laughrey ruled that ABB, a construction firm, and its 401(k) plan provider, Fidelity Management Trust Co., breached fiduciary duty by providing services to management at participants' expense, shifting plan assets from Vanguard Wellington Fund to the proprietary Fidelity Freedom Fund, and, on Fidelity's part, profiting from the "float" on plan contributions and distributions. ABB management and Fidelity have appealed Laughrey's ruling to the Eighth Circuit Court of Appeals.

Courts have made conflicting decisions in such fee cases, which means that one or more of them is bound to wind up before the Supreme Court. Meanwhile, however, the fact that substantial damages are being awarded by some courts has many plan sponsors looking to see what their potential liability could be, and what they can do now to minimize the risk.

"I'm starting to have conversations with plan sponsors who say, 'We look like we have a target on our back. We want to just go to the lowest cost provider for our 401(k) plan,'" said Jason C. Roberts, founder and CEO of the Pension Resource Institute in Manhattan Beach, Calif. "That's dangerous, though, because if you cut fees, you could get stuck with even more liability, because the cheap plans don't do the advisory work you need."

Besides, he adds, if you suddenly cut your fees, your employees might scrutinize what you were charging before. There are “people out there” who are “running algorithms to spot good targets for excessive fees lawsuits,” he told *RIJ*.

Industry-wide risk: large, unknowable

“It’s hard to put a number on the plans that are at risk of lawsuits over excessive fees. But being conservative as we are here, I would say that the number is very high,” James Holland, director of business development at Millennium Investment and Retirement Solutions in Charlotte, NC, told *RIJ*. “Remember, 80% of the cost of most of these plans comes from the investments. And, especially in the smaller space, any time the plans are product-driven, you’ve got a problem. Brokers who sell these plans are driven by commissions, so I’d say the risk in plans is pretty high.”

David Witz, managing director of FRA PlanTools, said, “No one knows the scale of the excessive fee problem. Without knowing the services rendered, we can’t know if the fees charged are excessive. [But] “if you [as a plan sponsor or provider] have a relationship that is five or more years old, you’re vulnerable” simply because the potential damages involved can be so large.

“The perception of the industry is that the plaintiff attorneys in these cases are just ambulance chasers. I think that assessment is off-base,” Witz added. “These attorneys do a lot of research before that will take a case, and won’t bring one unless they think they have a good chance to win. The marketplace doesn’t get this.”

Referring to the recent Cigna settlement, he says, “That is a huge win for the plaintiffs, and the message is that this isn’t going away.” He notes that the first audits of current year plans subject to the new 408(b)(2) rules will be coming out late this year or early next year, and he predicts “a wave of lawsuits over excessive fees next year.” Witz’ firm has a site, ERISA Litigation Index, that tracks the trend.

Marcia Wagner, a partner at the Wagner Law Firm in Boston, says the problem of excessive 401(k) fees is “gradually going to be resolved going forward, because of litigation, and because of new disclosure rules.” But she believes the existing retirement industry is rife with examples of such excessive fees. “I’d say at least half the plans out there have excessive fees,” she said. “Right now you’re seeing these lawsuits against the big guys, but it’s even more of a problem with the smaller plans.”

Excessive fees will also need to be addressed in the 403(b) plans offered in the public education and not-for-profit sector, she added. “I’ve seen plans where the fees are extremely excessive,” she said, but adding that because the DoL’s transparency rules don’t apply to 403(b) plans, high fees are harder for participants in those plans to spot.

Statute of limitations

ERISA’s statute of limitations on 401(k) fees is complex. Participants can sue within up to three years after they first learn of an alleged fiduciary violation by a plan sponsor or provider. But they can also sue within up to six years after the last action that arguably represented a breach in fiduciary behavior, even if it was unknown to participants at the time. Damage awards can therefore reach back a number of years.

One takeaway for plan providers and broker-dealers: You need to be aware of the risk that your own intermediaries, who sell plans to plan sponsors, might be named as co-defendants in an ERISA suit. If an advisor knows that he or she is selling a retirement plan with excessive fees, or knows of any self-dealing between the plan sponsor and the plan provider, "the advisor shouldn't touch it ," cautioned Gretchen Obirst, a plaintiff's attorney at Seattle-based Keller Rohrback. "If the fees are too high, you could be in trouble even if you disclosed them."

If you need a sign that plan sponsors and providers are concerned about recent fee-related court cases and the possibility that participants might sock them with a multi-million dollar federal class action lawsuit, the director of Boston College's Center for Retirement Research, Alicia Munnell, has one.

Less than three weeks ago, she told RIJ, Boston College's 403(b) plan provider, TIAA-CREF, reduced its plan fees by introducing an institutionally priced share class of its CREF Equity Index and closing the retail share class. The retail shares had cost only 42 basis points a year—hardly predatory—but the institutional shares cost a miniscule seven basis points.

Plan providers like TIAA-CREF are lowering their plan fees for defensive and proactive reasons. They want to avoid being sued by participants for not being good fiduciaries of the plan. They want participants to accumulate more money at retirement. And, in many cases, they didn't know until recently that they had a problem. "A lot of plan sponsors just never really thought about fees before," Munnell said.

Editor's note: A TIAA-CREF spokesperson responded to Munnell's comments, saying: "TIAA-CREF works closely with plan sponsors and consultants to determine the most economical mutual fund share class for institutional clients. In line with industry standards, TIAA-CREF offers lower-priced mutual fund share classes when plan economics allow."