The link between 401(k) litigation and in-plan annuities

By Editorial Staff *Thu, May 3, 2018*

Fear of litigation has made 401(k) plan sponsors leery of innovation, including the adoption of annuities as investment options, these authors suggest.

So-called "401(k) lawsuits" have roiled the retirement industry in recent years. They've disrupted revenue-sharing practices in workplace savings plans, generated a windfall for a handful plaintiffs attorneys, and forced plan sponsors to take their duties as fiduciaries more seriously.

The suits may also have made plan sponsors warier than ever about offering an annuity as an investment option inside their plans. If so, that might disappoint those who hoped to see 401(k) balances serve as a direct source of guaranteed lifetime income.

This assessment is mentioned (though not examined in depth) in a new **Issue Brief** from the Center for Retirement Research (CRR) at Boston College. ERISA lawyers in particular should appreciate this article: The paper's appendix compiles the hundreds of 401(k) lawsuits brought in the past decade..

Here's what George S. Mellman, an institutional investment consultant, and Geoffrey Sanzenbacher, a CRR analyst, wrote about in-plan annuities:

"One open question is whether the fear of litigation prevents the use of creative options that may improve participant outcomes – like investment vehicles designed to provide a lifetime income stream when participants retire.

"So far, these options have not caught on and it is unclear what role litigation has played. After all, offering an annuity option would involve more complexity than passive investments (and thus higher fees) and would require the plan to choose a provider, which itself entails some risk.

"Yet, such options would likely improve retirement security. To the extent the fear of litigation does play a role, retirees may benefit from more government clarification on how plans can offer drawdown products in ways that protect them from any legal consequences."

The balance of the report is dedicated to a review of the complaints that motivated the lawsuits and the impact that the threat of litigation is having on the retirement plan

industry. The report documents a rise in the use of low-cost index funds and a decline in investment and administrative expenses as results of litigation.

In a recent email to *RIJ*, Mellman offered these comments:

“For awhile, I’ve been curious about why there’s been so little implementation of in-plan annuity options,” he wrote.

“In 2014, the Treasury Department, IRS, and DOL issued guidance on how deferred income annuities could be included in target-date funds. Plan sponsors and their consultants know both that older workers worry about post-retirement cash flows and market volatility, and that many near-retirees were totally unprepared during the economic crisis ten years ago when nearly all asset prices collapsed.

“So, despite the needs and potential availability of new in-plan annuity tools, I now wonder about the extent that plan sponsors’ litigation fears have stifled innovation. Especially since the onset of increased litigation, more plan sponsors have expressed fears of being on the ‘bleeding edge’ of investment lineup innovation, and this fear seems to be stronger than for innovation in other areas of plan design and plan operations.

“This is especially true for changes in investment offerings that don’t directly lower plan or participant costs—invariably, avoiding litigation is one of the reasons cited. A formal survey would be an appropriate follow-up activity.”