February 2011

DC REPORTER
Research & Insights for the DC Professional

AllianceBernstein
Defined Contribution Investments

Catching Up on the DC Industry


Jamie Fleckner

Joe Healy, head of Client Experience at AllianceBernstein Defined Contribution Investments, spoke recently with Jamie Fleckner, a partner in Goodwin Procter's litigation department and head of the firm's ERISA Litigation Practice. Fleckner focuses on complex commercial litigation, primarily in the areas of ERISA and securities law. He explained how sponsors can reduce the risk of ERISA-related lawsuits by making prudent decisions consistent with their investment policy statements—and documenting their decision-making process.

Protecting Plan Sponsors from Litigation

Healy: Several large plan sponsors have been sued by plan participants over fees recently. What are those lawsuits all about?

Fleckner: The lawsuits are challenging under ERISA the fees paid by 401(k) plans and their participants for the administrative and investment-management services provided to the plans.

Those challenges take a lot of different forms. Some challenge the revenue-sharing components specifically. Some challenge the use of certain types of products on the platform, such as retail mutual funds. Others are aimed at the relationships a service provider might have with a plan sponsor.

So far, the results have been mixed. In a number of instances, the cases were dismissed as a matter of law before they went to trial. Some courts have made it clear that a plaintiff can't simply argue that the fees were too high and expect to get a trial against her employer. But not all courts have agreed. In a case against Wal-Mart in Missouri, for example, the appellate court allowed some very broad allegations involving excessive fees and revenue-sharing arrangements to proceed past the dismissal stage.

Healy: What lessons can sponsors learn from this litigation? Are there particular problem areas they should be very careful to avoid?

Fleckner: The key issue being disputed under ERISA is the question of prudence, which has two components: process and substance. The courts generally say that fiduciaries are protected if they're discharging their obligations to the plan prudently—even if the results don't turn out to be perfect in hindsight. The courts recognize that people are human and sponsors are inevitably confronted with different ways of investing. Reasonable people exercising reasonable judgment might make very different investment-selection decisions. So fiduciaries need to make sure that they're engaging in a thoughtful process—that they're taking steps to make informed and thoughtful decisions. That's the process component.

Catching Up on the DC Industry

continued from previous page

The substance component instructs that fiduciaries can't be held liable if the investment results are what one would expect from a prudent process, regardless of what process was actually followed. Fiduciaries can, by and large, protect themselves by making sure that the investments they're choosing fit comfortably within what's being offered in the market today.

One thing that I see in litigating these and other cases is that, as with anyone, fiduciaries' memories fade. Some of these cases challenge decisions going back six or more years. Anybody would be hard-pressed to remember every detail of a decision they made that long ago. To mitigate that risk, it always helps to have a written record of the decision-making processes.

Healy: How should plan sponsors think about investment policy statements in this context?

Fleckner: If fiduciaries have established an investment policy statement, they should be aware that all of the decisions they make subsequently will be scrutinized against that statement. So it's important to make absolutely sure that all the investment decisions are entirely consistent with that statement.

In this context, it is worth noting that the act of sponsoring a plan is not considered a fiduciary act under ERISA. Any company can sponsor and design a plan within various parameters, and the design decisions it makes are not considered ERISA fiduciary decisions. It's only the subsequent management or administration of the plan that gives rise to fiduciary responsibilities, and it's those fiduciary responsibilities that are being challenged in these cases.

Healy: So, making a decision to set up a plan or an automatic contribution program is not a fiduciary activity?

Fleckner: No, but selecting investment options is a fiduciary function. I've seen plan sponsors attempt to make it what we call a "settlor" function—a nonfiduciary function—by building the investment option into the plan document itself. For example, a plan might say: "the following options shall be offered." That's an interesting approach, but I don't know how courts will treat that. Certainly, if the plan is silent as to what investment options will be offered, then the selection and continued monitoring of those investments would be considered fiduciary functions.

The other point I'd make is that if you work at a company sponsoring or administering a retirement plan, you should understand what role you're playing and what you need to do to satisfy your obligations. Are you acting as a plan sponsor in a nonfiduciary capacity, or are you acting in a discretionary fiduciary capacity? If you don't have fiduciary obligations, you don't necessarily have to go through the same steps as a fiduciary.

Healy: You said that an investment policy statement that's not followed can give rise to litigation problems. What if a sponsor has a well-drafted investment policy statement that's followed consistently? Is that helpful in defending a plan sponsor? Or is it neutral?

Catching Up on the DC Industry

continued from previous page

Fleckner: That's a good question. An investment policy statement is probably a net benefit in the defense of a plan sponsor. It demonstrates to the court in a very tangible way that the fiduciaries are being prudent and diligent in exercising their responsibilities. I don't think it's essential in the defense of these cases, but if it's there and it's done properly, it can be a decided advantage.

Healy: And if it's there but not followed?

Fleckner: Yes. I've been involved in litigation where plaintiffs have tried to capitalize on that. In defending these cases, you're trying to demonstrate to the judge that the fiduciaries took their responsibilities seriously and did everything they could do to make good decisions for the plan. Plaintiffs try to show the opposite. If there's no evidence that the investment policy statement has been followed, plaintiffs will try to use that to argue that there wasn't a diligent and thoughtful process.

Healy: What if a plan set up a policy statement and didn't update it for several years? The types of vehicles and revenue-sharing policies have changed dramatically. How does the prevailing-standards requirement play out in the litigation process?

Fleckner: The courts haven't given this question the kind of focus it deserves. How do you judge practices that were entirely consistent with industry norms 10 years ago against today's standards? That's what's critical to present to the judge. The statute itself—the law passed by Congress and signed by the President—says that a fiduciary's conduct is to be judged by the standards prevailing at the time.

One of the economists I work with uses this example: Twenty-five years ago, you'd spend a certain amount of money on typewriters. Today, you might spend the same amount of money on computers. That doesn't mean you were imprudent 25 years ago for spending so much on typewriters. But if you spent the same money on typewriters today, people could really question your decision.

This question of prevailing standards can set these cases in motion. One of the challenges is to get a court to understand that the products and services offered today are much different from those offered a decade ago.

Healy: What kinds of things should plan sponsors document when they make their investment decisions?

Fleckner: Fiduciaries should be able to show analyses demonstrating that they understand the investment issues. Committing the plan to a product, service or fee structure you don't fully understand will lead to a lot of problems down the road. Courts don't expect a fiduciary to be as well versed as all the experts in the field. Fiduciaries can bring in experts to advise them. A number of fiduciaries have done that to their benefit.

Catching Up on the DC Industry

continued from previous page

But bringing in an advisor does not mean a fiduciary abdicates responsibility. A fiduciary typically retains the ultimate decision-making authority. I've seen plaintiffs challenge whether fiduciaries have asked their advisors enough questions to understand the advice that they're given. Fiduciaries must make sure they understand the advice being given.

Healy: How do these issues affect intermediaries such as investment consultants and other service providers?

Fleckner: The issues are similar to the sponsors' issues. As a threshold matter, the court will wonder whether the intermediary is acting as an ERISA fiduciary. In the ordinary course of business, intermediaries don't view themselves as acting in a fiduciary capacity. In fact, many service providers typically structure their business so they don't take on fiduciary obligations. Those providers would need to demonstrate from the outset of any litigation that they're not a fiduciary for the decisions made by the plan to get out of these cases during the earlier stages.

Of course, the best defense in any litigation is not to be sued in the first place. Financial advisors should be attuned to how a plan's decision might impact the potential for future litigation. Everyone benefits if an advisor can educate plan sponsors and help them make better decisions. If a plan is operating in the mainstream and the decisions are consistent with best practices, then the plan is less likely to be involved in a lawsuit. Now, unfortunately, there's a bit of an arbitrary nature to how these suits are being brought; doing these things doesn't guarantee sponsors or intermediaries won't get sued. But it goes a long way to help avoiding the lawsuits in the first place, and being able to successfully defend anyone who is named in the suit, be it a sponsor or an intermediary.

Healy: Any final words of advice?

Fleckner: First, make sure your plan stays current with the marketplace and the developments in the industry, so you're not operating a plan that's out of the mainstream based on today's standards. Second, make sure that you're updating or continually reflecting on the documents governing your plan. You could be doing a great job keeping up with current products and services and your legal obligations—but could lag behind in updating your disclosures to participants. That could cause you some problems.