COMPENSATION AND BENEFITS ALERT

Recent ERISA Fee Litigation: Key Lessons For Plan Fiduciaries

A recent Federal District Court decision dealing with ERISA plan fees is generating substantial discussion in plan fiduciary circles, not only because of the significant liability imposed on fiduciaries (almost $40 million), but because of its discussion of some key fiduciary issues.

As we discussed in an earlier client alert ("Orrick Client Alert: Final Service Provider Disclosure Regulations"), recently finalized regulations under §408(b)(2) of ERISA require service providers to disclose their fees and compensation to employee benefit plan sponsors. Once the disclosure has been provided, the plan fiduciary must determine whether its arrangements with its service provider are "reasonable."

Tussey v. ABB, Inc [1]., a recent Federal District Court decision, may provide significant guidance to plan fiduciaries in their determination of the "reasonableness" of an arrangement when a service provider engages in revenue sharing.[2] The *Tussey* case also contains some important general lessons for plan fiduciaries.

In *Tussey*, the court found that a 401(k) plan's fiduciaries breached their fiduciary duties by failing to monitor recordkeeping costs, prudently select and retain investment options, and act free of improper influences. The main take-away from *Tussey* for plan fiduciaries is the singular importance of establishing and following meaningful plan processes and prudently managing investments for the exclusive benefit of plan participants and beneficiaries. *Tussey* helps to express these abstract principles in concrete terms that plan fiduciaries can benefit from.

Key Lessons from *Tussey*.

Key lessons from *Tussey* include:

1. **Fiduciaries must meaningfully comply with governing plan documents, including investment policy statements**.

APRIL 26, 2012

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The plan's investment policy statement ("IPS") required that revenue sharing "be used to offset or reduce the cost of providing administrative services to plan participants." However the plan fiduciaries never calculated the actual dollar amount of the recordkeeping fees paid to Fidelity Trust through the revenue sharing arrangement (they merely monitored the overall expense ratio of the plan's investment options) and had no way of knowing if revenue sharing was offsetting or reducing the cost. The court noted that an IPS is, under ERISA, a governing plan document and that the plan fiduciaries' failure to comply with its terms was a breach of fiduciary duty.

2. **Fiduciaries must monitor service providers in a meaningful way.**

The court found that the plan fiduciaries failed to monitor the reasonableness of expenses paid to Fidelity Trust for recordkeeping, mainly through revenue sharing. According to the court, ERISA and the plan's IPS required that the fiduciaries engage in a "deliberative" process to determine whether the revenue sharing arrangement with Fidelity Trust was in the plan participants' best interest. Reviewing expense ratios of the investment funds was not sufficient. The court also noted that the plan fiduciaries essentially ignored a report from a reputable advisor that the plan was overpaying fees. Given the circumstances and ERISA's requirements, the plan fiduciaries are expected to know the exact amount of revenue sharing expenses and whether the amount is competitive with recordkeeping fees for other plans.

3. **Fiduciaries must be free of improper influences when negotiating a fee arrangement and when selecting and de-selecting investment options.**

The court found that decisions by plan fiduciaries to (i) pay Fidelity an above-market fee for plan services in order to subsidize corporate services, (ii) map participants from a Vanguard fund to a Fidelity fund and (iii) choose share classes with higher expenses when less expensive classes were available were in violation of fiduciary duties and not free of conflicts of interest. The court found that plan fiduciaries negotiated above-market fees for Fidelity with respect to the plan sponsor's 401(k) plan in order for the plan sponsor to receive lower priced or free services for its welfare and nonqualified plans. Further, the court found that participants were mapped to Fidelity funds from Vanguard funds so that the plan sponsor could reduce its out-of-pocket costs for recordkeeping fees. The court also found that plan fiduciaries failed to choose less expensive share classes because of the favorable impact the costlier share classes had on the plan sponsor's revenue sharing arrangement with Fidelity (the choice of more expensive share classes indirectly reduced the plan sponsor's out-of-pocket costs). The court found that in all these decisions, the plan fiduciaries failed to act solely in the interest of plan participants and beneficiaries.

It is important to note that the court did not rule that the practice of revenue sharing itself was imprudent. However, plan fiduciaries who engage in revenue sharing should be certain to ensure that their participation in the practice does not violate the terms of plan governing documents or their responsibilities under ERISA, especially in light of the requirements under the §408(b)(2) regulations that arrangements with service providers be "reasonable."

Next Steps.

Fiduciaries should revisit their processes for evaluating service provider arrangements and investment options to make sure they are engaging in a meaningful "deliberative process" that complies with

ERISA and plan documents (including investment policy statements). The *Tussey* case contains important lessons that will endure whatever the eventual outcome of the case.

In light of the current climate of increased plaintiff class action litigation (which may be encouraged by the *Tussey* decision), plan sponsors may wish to revisit their fiduciary liability insurance policies. As we have previously discussed here, under ERISA, plan fiduciaries are personally liable for breaching their fiduciary duties, which can arguably put their personal assets at risk. However, ERISA also provides that insurance may be purchased to cover fiduciaries who risk personal liability exposure. As a result, plan sponsors typically purchase fiduciary liability insurance to protect the employees who serve as fiduciaries of their retirement plans. Orrick's Compensation and Benefits Group and Insurance Practice Group can provide assistance with reviewing plan sponsor clients' fiduciary liability insurance. Our review provides plan sponsors with a useful, practical resource that better informs plan sponsors and equips them to better negotiate and plan with insurers and brokers. Our review, generally offered for a nominal fixed fee, provides detailed recommendations to help plan sponsors ensure that the insurance policy provides adequate coverage to the intended persons.

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[1] *Tussey v. ABB, Inc., 2*012 WL 1113291 (W.D. Mo., March 31, 2012)

[2] In *Tussey,* the parties engaged in both "external" and "internal" revenue sharing. Fidelity Trust, the plans' recordkeeper, was primarily paid through an arrangement by which it was paid a percentage of the plans' assets from participants' accounts in a particular fund. The investment companies whose funds were selected by the plan fiduciaries paid Fidelity a percentage of the income they received from plan participants who selected their company's investment fund. This practice is external revenue sharing. Further, when a Fidelity fund was offered as an investment option in the plans, a percentage amount was transferred from Fidelity Research to Fidelity Trust. This practice is internal revenue sharing.