



## Economic and Market Insights

June 10, 2015

By Jennifer O'Neill  
Vice President, Institutional Services  
The Commerce Trust Company

### Reaction to increasing litigation directed at 401(k) retirement plan sponsors: A slippery slope for employers

*If litigation in the 401(k) arena isn't keeping retirement plan advisors up at night, it should. The top Employee Retirement Income Security Act (ERISA) class-action settlements exceeded \$1.3 billion in 2014, which was 10 times higher than the previous year; by the close of 2014, there were in excess of 7,000 ERISA lawsuits.<sup>1</sup> No other area of employment workplace law experienced this level of growth in 2014.<sup>1</sup>*

*Jennifer O'Neill, Vice President with The Commerce Trust Company's retirement practice, talks about the developing legal risks found in many retirement plans.*

#### **Q. What are the major issues in these lawsuits?**

A. Common themes that have emerged from industry litigation have been heavily focused on fees -- whether that's excessive fees, lack of fee transparency, improper use of share classes, conflicted advice, or the misuse of proprietary products. 401(k) plan participants will be more likely to demand increasing detail about plan expenses, given the increased attention to these topics in the press. As a result, the fiduciary duty of an employer as the retirement plan sponsor is coming under increased scrutiny.

#### **Q. What should employers be prepared for?**

A. Employers should re-educate themselves and make sure they understand the fees being charged to their participants from third party providers. Revenue sharing arrangements between investment managers and service providers can make this difficult because administrative fees are oftentimes a component of the investment fund's expense ratio. Even if plan sponsors fully understand the *amount* of fees being charged, it can be difficult to know which service providers are receiving *what* fees. Knowing this is important in order to ensure that fees are competitive, current and transparent in each service provider's market space.



**Q. How common are these lawsuits?**

- A. Most attention has been paid to lawsuits involving large companies, such as Lockheed and International Paper. However, the 401(k) fee lawsuits are beginning to trickle down market. But even in the absence of a lawsuit, plan sponsors have the fiduciary responsibility to protect their employees. The plan sponsor is technically the “buyer” of retirement plan services, so employees are subject to the investments, service providers and products offered to them by their employer. It’s no easy task for plan sponsors to take on this responsibility, which is why 84% of plan sponsors use an advisor.<sup>2</sup>

**Q. Why should employers be especially concerned now?**

- A. Both lawsuits and plan audits have dramatically increased in number. Any number of things can trigger an audit which can then lead to inquiries about the potential improper use of share classes or excessive fees. The Obama Administration, Department of Labor, and Securities and Exchange Commission have all spoken out against these abuses in the retirement industry, and have called for a greater emphasis on the fiduciary responsibility of providers that service and influence retirement plans.

**Q. What kinds of changes have occurred as a result of these lawsuits?**

- A. Fee disclosure legislation has attempted to provide greater transparency of fees so that plan sponsors can sort through these issues; however, in many ways fee disclosure has made it more difficult for plan sponsors because a disclosure statement may provide a false sense of security. We regularly review numerous fee disclosure statements from multiple providers and they can be confusing, containing an overload of information and footnotes that lead plan sponsors to simply file them away without fully understanding the information contained within. The law is very clear in placing responsibility squarely on the plan sponsor not only to make sure they receive the disclosure statement, but also to understand it fully. Although this responsibility technically belongs to the plan sponsor, having an advisor can help with this effort.

**Q. Are some 401(k) investments drawing more attention than others?**

- A. Yes. For instance, the prevalent use of guaranteed investment contracts has muddied the waters and compromised the overall transparency of plan fees. These products aren’t regulated like mutual funds and do not have the same reporting requirements. In many cases, no expense is reflected at all for these products because there is no *expense* in the *traditional* sense of the word. The revenue that is generated from these products, which can be significant, is not required to be disclosed. These products can hold a healthy portion of plan assets, so with no expense or revenue reflected, the plan’s total cost can appear artificially low in a fee benchmarking analysis. These products can also carry stringent “out” clauses making it difficult to change service providers or replace these products within a retirement plan.



**Q. What can a company do to protect itself?**

- A. Regular fee benchmarking can certainly help mitigate these issues. Additionally, having a plan committee that regularly reviews the service providers of the plan, investment lineup, fees and services, and other plan attributes is important. Proper documentation around these efforts is also critical in demonstrating intentionality and proper due diligence. Plan sponsors can choose to perform these duties with in-house expertise or they can outsource the lion's share, and even a portion of their fiduciary risk, to an outside advisor.

For more information on this topic or to learn more on how Commerce Trust can assist you with Retirement Plan consulting services, please contact:

Jennifer O'Neill  
[Jennifer.ONeill@CommerceBank.com](mailto:Jennifer.ONeill@CommerceBank.com)  
816-760-1315 (work)  
1-800-892-7100, ext: 21315 (toll free)

<sup>1</sup> *BenefitsPro, January 6, 2015*

<sup>2</sup> *Fidelity 2013 Plan Sponsor Attitudes Survey*

Past performance is no guarantee of future results, and the opinions and other information in this commentary are as of June 10, 2015. This summary is intended to provide general information only and is reflective of the opinions of the Institutional Services Group.

This material is not a recommendation of any particular security, is not based on any particular financial situation or needs, and is not intended to replace the advice of a qualified attorney, tax advisor or investment professional. Diversification does not guarantee a profit or protect against all risk.

Commerce does not provide tax advice or legal advice to customers. Consult a tax specialist regarding tax implications related to any product and specific financial situations.

Data contained herein from third-party providers is obtained from what are considered reliable sources. However, its accuracy, completeness or reliability cannot be guaranteed.

NOT FDIC INSURED

MAY LOSE VALUE

NO BANK GUARANTEE