



Class Action Litigation Against Fiduciaries

How Current Litigation Impacts You and Your Plan

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Agenda

- Introduction
- Class Actions Against Fiduciaries
- Recent Settlement Structures
- Lessons to be Learned: Fiduciary Processes and Documentation
- Best Practices for Fiduciary Liability Insurance and Indemnification Provisions

Presenters

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Class Action Litigation – A Brief History

- 1963 – Studebaker Corp. collapses. Workers receive 15 to 20 cents on the dollar for retirement benefits
- 1974 – Employee Retirement Income Security Act (ERISA) enacted
- 1998 – Federal judge certifies first ERISA class-action where participants of IKON Office Solutions alleged that investment in company stock was imprudent
- 2002 – Stock-drop claims against ENRON and WorldCom related to employer securities in their defined contribution retirement plans
- 2006 – Plaintiffs' firms file challenges to service provider and investment-related fees
- 2014 – Supreme Court issues *Dudenhoeffer* relating to publicly traded stock
- 2016 – Class actions for money market accounts in low interest environment
- 2016 – Twelve universities sued over fees and investment options.

Class Action Litigation – Current Trends

- **401(k)/403(b) Fee/Investment Option Cases**
 - 50-60 (or more) filed in 2016
 - Smaller plans being targeted
 - 403(b) Plans/Universities targeted
 - Plaintiffs are filing boilerplate complaints against plans
- **Company Stock Fund “Stock Drop” Cases**
 - Fewer than 20 filed in 2016
- **Valuation Cases (Reliance on Experts)**
 - Rarer, but principles from these cases affect plaintiffs’ theories in other cases

Class Action Litigation – Current Trends

• 401(k)/403(b) Fee/Investment Option Cases

The Plans Had...	The Plans Should Have Had...
Multiple recordkeepers	One recordkeeper to keep fees lower
Multiple recordkeepers that charged fees for duplicative work	One recordkeeper to keep fees lower
Revenue-sharing arrangement that resulted in excessive fees to service providers	Either no revenue sharing or controlled revenue sharing so service provider paid only a reasonable amount
Fees based on assets, resulting in excessive fees per participant	Flat fees per participant
No open, competitive bidding process for recordkeepers	Competitive bidding every three years or so
An investment advisor/recordkeeper selected because of some relationship with the company or fiduciaries	Independent service provider selected solely in the best interests of participants

Class Action Litigation – Current Trends

• 401(k)/403(b) Fee/Investment Option Cases

The Plans Had...	The Plans Should Have Had...
Fee structure that required 401(k) plan to pay expenses of other plans	Separate fee arrangements among multiple plans
Actively managed funds with higher expenses that had no actual performance benefit	Passively managed funds with lower expenses that performed just as well
Investment options with severe restrictions on liquidity and penalties for early withdrawal	Investment options that allowed participants to move and withdrawal funds without penalty or restriction
Too many core/window investment options that confused participants	Smaller number of options with varied risk/return
Duplicative investment options with different expense ratios (retail v. institutional classes)	One option for a target index with the lowest expense ratio

Class Action Litigation – Current Trends

- **401(k)/403(b) Fee/Investment Option Cases**

The Plans Had...	The Plans Should Have Had...
Particular investment management company funds that were more expensive than competitor fund	The cheapest available with comparable performance
Funds that historically underperformed	New funds introduced when funds underperformed
Mutual funds or brokerage windows, only	Considered collective trusts or separately managed accounts

Class Action Litigation – Current Trends

• Company Stock Fund “Stock Drop” Cases

- Complaints allege that fiduciaries should have sold or limited investment in company stock as price fell
- Some allege that fiduciaries sold stock too early
- Supreme Court in *Dudenhoeffer* held that a participant challenging a fiduciary’s decision with respect to publicly traded company stock must allege:
(1) alternative action the fiduciary could have taken;
(2) that a prudent fiduciary “would” have determined that the alternative action would not have caused more harm than good.
- Question whether *Dudenhoeffer* applies to non-publicly traded stock.

Class Action Litigation – Current Trends

• Valuation Cases

- ESOP cases where participants challenge amount the plan paid to buy company stock from selling shareholders
- Cases involve important issues about when fiduciaries may rely on advice from third-party experts
- Fiduciaries still must show that they acted prudently in hiring and relying on the expert. Factors include:
 - Expert's reputation and experience, extensiveness and thoroughness of expert's investigation, completeness and accuracy of information provided to expert, support for expert's conclusions, appropriateness of expert's approach, inquiry into expert's background and potential conflicts, consideration given to the expert's conclusions.

Settlement Structures - Success Breeds Imitation

Defendant	Total Settlement	Attorney Fees/Costs	Other Settlement Terms
Lockheed Martin Corp	\$84.3 M	\$22.3 M	<ul style="list-style-type: none"> Competitive bidding process for recordkeeping services Lowest available expense ratios No more than reasonable compensation for services
Boeing	\$57 M	\$20.8 M	<ul style="list-style-type: none"> Obtain independent opinion and recommendation on how to provide participants access to technology sector strategy as core option
Bechtel	\$26.2 M	\$7.7 M	<ul style="list-style-type: none"> No retail mutual funds as investment option Recordkeeping fees may not be based on percentage of plan assets Competitive bidding process for recordkeeping services
International Paper	\$41.5 M	\$11.5 M	<ul style="list-style-type: none"> RFP for recordkeeping services Continue to permit investment in employer stock One passively managed investment option Fees for recordkeeping cannot be set as a percentage of assets
General Dynamics	\$20.9 M	\$5.7 M	<ul style="list-style-type: none"> Outside consultant will review service provider agreements over \$250,000
Kraft	\$14.2 M	\$4.7 M	<ul style="list-style-type: none"> No retail mutual funds as investment options Limit amount of cash in company stock fund Fees for recordkeeping services will not be based on percentage of assets

Settlement Structures - Success Breeds Imitation

Defendant	Total Settlement	Attorney Fees/Costs	Other Settlement Terms
Novant Health	\$32 M	\$10.8 M	<ul style="list-style-type: none"> Independent consultant shall benchmark and audit existing investment options, recordkeeping fees, and services and review list of existing services providers and their compensation
Ameriprise Financial	\$36.5 M	\$9 M	<ul style="list-style-type: none"> Competitive bidding for recordkeeping and other services Hire independent investment consultant to conduct manager search No compensation for administrative services to plan Investment Committee to have exclusive authority to select, monitor, and retain investment options Flat fees for services Disclosures to participants
Cigna	\$47.8 M	\$12.8 M	<ul style="list-style-type: none"> Independent monitor to determine compliance Independent Consultant with specific expertise re: stable value investments Measures to avoid conflicts of interest Competitive bidding for services from large recordkeepers Plan cannot offer retail funds Unbundled pricing for investment manager and recordkeeper Participant disclosures
Caterpillar	\$22.3 M	\$5.83 M	<ul style="list-style-type: none"> Independent monitor Restore cash in company stock fund as price rises

Settlement Structures - Success Breeds Imitation

Defendant	Total Settlement	Attorney Fees/Costs	Other Settlement Terms
Nationwide	\$190 M	\$50 M	<ul style="list-style-type: none"> • Changes to business practice for minimum of 5 years • Disclosures to participants • Variety of changes to participant options and platforms
Mass Mutual	\$9.8 M	\$315k	<ul style="list-style-type: none"> • addition of insurance company, SIA, Mutual Fund, bank collective trust, etc. to the Product Menu • Defendant to advise current/future plan fiduciaries not to delete, change, or replace any funds on Product Menu without 60 day notice & consent to each fiduciary • Defendant to provide notice to plan sponsors via website re removal of fund from Product Menu • Disclosures on Plan Sponsor website of expense ratios for each Fund, amounts of SIA management fees/direct fees with each Fund, revenue paid to Defendant from a Fund, and Funds that make no Revenue Sharing Payments to Defendant • Advise Plans that Defendant offers various Funds • Defendant to include in proposals explanation of the option for plan customers to pay all fees to Defendant through direct charges • Defendant will note make change in compensation received from plans, including SIA Management Fees without 60 day written notice and chance to terminate Group Contract without penalty"

Top 10 Recent ERISA Settlements

Defendant	Settlement	Claim
United Automobile Aerospace And Agricultural Implement Workers of America	\$354.5 M	Breach of collective bargaining agreement
Nationwide Insurance	\$140 M	Excessive fees/investment options
Boeing	\$90 M	Deprived of retirement and health benefits
Meriter Health Services	\$82 M	Lump sum payments from a pension plan
Lockheed Martin Corp.	\$62 M	Excessive fees/investment options
The Boeing Co.	\$67 M	Excessive fees/investment options
AIG	\$40 M	Company Stock
Northern Trust Investments N.A.	\$36 M	Imprudently managing collateral pools in its securities lending program
CIGNA	\$35 M	Excessive fees/investment options
FreightCar America, Inc.	\$33 M	Termination of union workers retiree health and insurance benefits
Novant Health	\$32 M	Excessive fees/investment options

Lessons from Settlement and Litigation

1. The fiduciary obligation requires a prudent ***process***.
2. ERISA does not require the cheapest product, least expensive service provider, or particular level of risk/reward. It does not require fiduciaries to scour the market for alternatives, it does not require that investments beat the indexes.
3. ERISA requires that **decisions be made prudently**, with care, and in the exclusive interests of plan participants.
4. The process **must be well documented**. An objective, uniformed person must be able to look at the documents and see the prudence. Conclusions and decisions must be supported by a prudent process.
5. Participants may have **six years** or **three years** to challenge decisions, including action/inaction taken when monitoring earlier decisions.

Lessons from Settlement and Litigation

6. Have a documented process for evaluating service providers regularly
 - Review of 408(b)2 documentation
 - Benchmarking of fees and services
7. Select independent and competent experts to assist in managing investment and fee monitoring
 - Document the search and selection, including review for potential conflicts
 - Many settlements have required the addition of competent assistance in managing fiduciary aspects of plan operation
8. Document your decisions about share classes, number of options, risk/reward spectrum, particular funds, and the decision to use mutual funds
 - Calculating damages related to fee erosion is easier than many of the alternative breach claims
 - Have agenda, meetings, presentations, and materials documented
 - When there is an issue or potential issue, document the increased consideration and analysis
9. Whether passive or active there are no “safe harbors” for failing to monitor and document decision making
 - Fiduciary duty is about process, but plaintiffs will review outcomes as well

Questions for Consideration

Ask yourself:

- Does the Plan have a committee to carry out the fiduciary responsibilities related to the plan?
- Is the committee representative of a cross-section of the participant population?
- Are there written policies and procedures for fiduciaries?
- Are there written policies and procedures for investment decisions?
- Do committee members understand their fiduciary obligations?
- Are there regular meetings?
- Are there notes taken and minutes prepared with detail so there is evidence of the amount of analysis and consideration given to the issues?
- How are special concerns or potential concerns handled? Are special meetings held? Is there another level of consideration given? Are concerns monitored more closely and discussed?

Questions for Consideration

Ask yourself:

- How are service providers paid for their services?
- Is there a review of the fees paid to service providers and consideration of alternative pricing structures or different providers?
- If there is revenue sharing, how much is ultimately being paid to service providers for their services?
- Has the plan sponsor reviewed the current service agreements with vendors to ensure the fees remain reasonable in light of the service provided?
- Has the plan sponsor evaluated the investment menu and determined there to be an appropriate number of investments given the needs of the plan and its participants?
- Does the plan have a communication strategy to address participant inquiries about fees and other questions related to the plan?

Next Steps and Best Practices

1. Don't Freeze, Evolve
2. Document through charter or plan the fiduciary decision making process
3. Document the monitoring of Covered Service Providers to the plan
4. Be aware of share classes and collectives when selecting an monitoring investment options
5. Develop a process for documenting and answering participant inquiries
6. Review your fee allocation methodology for equity
7. Evaluate the role specific investment options play in the investment menu
 - Money market vs. stable value
 - Target date funds and their glide paths
 - Sector funds
 - Brokerage windows
8. Document your investment selection and monitoring meetings
9. Execute on an effective fiduciary training program for committees

Fiduciary Liability Insurance and Indemnification

- Get a complete copy of the policy each year.
- Work with your broker and insurance-advisory counsel on particular issues:
 - Limits of liability – are they shared among coverage types? Do you have enough?
 - Retentions – how are they handled for the company? For individual fiduciaries?
 - Defense coverage – is it a duty to defend? A duty to pay defense costs? Does it matter?
 - Did you consider competing coverage forms?
- Check the indemnification provisions. **NOT ALL INDEMNIFICATION PROVISIONS ARE VALID UNDER ERISA, even if they are valid under state law.**

Questions & Answers

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