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CEFEX Analyst Commentary

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Fiduciary Wake-up Call

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A recent ruling has set the stage for heightened liability for corporate failures to adhere to fiduciary standards. Many plan sponsors have no doubt drawn comfort from the sea of dismissed claims and fairly modest settlements that have attended a slew of 401(k) fiduciary breach law suits filed in recent years. Household names such as United Technologies, Unisys, Deere, Lockheed Martin, and IPC saw fiduciary breach claims against them dismissed, while others, such as General Dynamics, Kraft, Bechtel, Caterpillar and Wal-Mart reached settlements rather than risk higher costs and damage awards.

Any resulting sense that the courts are reluctant to find companies responsible for selecting poor or overpriced investment options or for allowing retirement plans to pay too much in administration fees has now suffered a reversal. Yet another prominent company, ABB, the leading power and automation technology group, was sued by its 401(k) plan participants back in 2006 for a variety of fiduciary breaches. The claims survived various motions for dismissal leading to a trial in 2010 and a final \$35.2 million judgment in favor of the plaintiffs in March 2012 (*Tussey v. ABB, Inc.*, No. 2-06-CV-04305, 2010 U.S. Dist. LEXIS 45240 (W.D. Mo. Mar. 31, 2012)).

The Court found that the ABB fiduciaries violated their ERISA fiduciary obligations to the plan when they:

- Failed to monitor recordkeeping costs and negotiate rebates available to the plan;
- Selected more expensive share classes when less expensive share classes were available;
- Failed to abide by selection and monitoring criteria contained in the plan's investment policy

statement when changing fund options in the plan's investment menu;

- Agreed to pay Fidelity higher than market costs for recordkeeping in order to subsidize corporate services provided by Fidelity to ABB.

As part of the judgment, the court also found that Fidelity was a fiduciary to the plan and breached its fiduciary obligations when it failed to distribute for the benefit of the plan "float" income, i.e. interest on monies held pending reinvestment, and when it transferred that income not to the plan but to the investment options.

Some legal commentators downplay the importance of this decision because they say that it does not break new ground. That would be true if it were not for all of the poor legal decisions justifying the dismissals mentioned at the outset, for many of those cases involved similar claims. So, the ABB decision is important because it is one of the few recent decisions involving a 401(k) plan where a full evidentiary record was developed with expert testimony from prudent experts. As a result, we have a well-articulated reinforcement of a fiduciary standard of care that serves as a reminder to investment committees and boards responsible for their oversight that the interests of plan participants come before those of the corporation and its stockholders when dealing with retirement plan assets.

There are some immediate lessons for plan sponsors to take away from the ABB decision:

- Review arrangements with plan service providers to ensure that the corporation is not getting a

benefit from a service provider at the expense of the plan. One example is posed by the subsidy ABB received from Fidelity. A more common abuse might be found in banking relationships, where the plan custodian also provides the corporation with banking services. If a bank offers a corporation favorable banking terms in exchange for becoming custodian of plan assets, even where no subsidy exists, plan assets would not then be used for the exclusive benefit of participants, resulting in fiduciary breach.

- Review the plan's documents, particularly the investment policy statement. This is the roadmap for managing the investment process. It should be current and sufficiently comprehensive for a third party to follow. Above all, the investment committee should comply with its provisions and document their decision making process.
- ERISA permits the payment of reasonable fees and expenses. The law does not require selection of the cheapest provider, but it does require evaluation of expenses so that fiduciaries

can justify what is paid. Plan sponsors should therefore review and evaluate the expenses which a plan and participants bear. New Department of Labor regulation mandates effective August 30, 2012 disclosure to participants of the expenses which are borne by their individual accounts. Plan sponsors should ensure that they are equipped for these disclosures.

Some good news for plan sponsors: the court in the ABB case did not find that large plans should offer only separate account management or commingled funds as investment options, or that "revenue sharing" as a mechanism for paying administrative fees was inherently imprudent, or that such mechanism should be disclosed to participants as a fiduciary obligation. What the court did reinforce is that fiduciaries must act in prudent manner by making reasoned and reasonable decisions and by documenting their process. Accordingly, plan sponsors and their plan fiduciaries would be well advised to evaluate their fiduciary conformity in order to avoid the pitfalls which 401(k) plans pose to the unwary yet well intentioned employers. ☞

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