"Class" Actions

Class-action litigation concerning expenses and revenue-sharing

OVER the past few years, there has been a lot of publicity about class-action lawsuits filed against major corporations concerning the expenses and revenue-sharing for 401(k) plans.

More recently, there have been a number of procedural decisions in those cases—primarily concerning whether the lawsuits could go forward and whether they could be certified as class actions. However, there is no uniform pattern to those decisions and so, in many ways, we are still at the beginning.

We do know that the failure to understand and evaluate revenue-sharing can cause fiduciaries to be sued and may result in liability. Even without liability, spending several years in litigation is an unpleasant and expensive proposition.

With that in mind, this article discusses the lessons learned and steps that fiduciaries can take to minimize the risk of being sued—much less being liable. In that regard, plan committees should:

Learn about revenue-sharing paid from the investments (or from any other source) to the plan's service providers—for example, to the recordkeeper. This applies to both bundled and nonbundled arrangements.

In bundled arrangements that involve affiliated mutual funds, consider both revenue-sharing from funds and credits for the use of internal funds. For example, an unaffiliated mutual fund (or its investment manager or an affiliate) may pay subtransfer agent fees to the recordkeeper. For affiliated funds, there may be monetary payments to the recordkeeping division or there may be internal credits. Regardless of whether the arrangement is affiliated or unaffiliated, or involves payments or internal credits, it has the same effect—it becomes part of the analyses for determining the reasonableness of the revenues, both direct and indirect, of the recordkeeper.

The payments and credits should be evaluated (i) relative to the plan and participant services provided by the recordkeeper and (ii) relative to the cost of similar services in the marketplace. For example, if the recordkeeper receives $150,000 of payments and credits, but those services could be purchased for $100,000 in the open marketplace, the plan appears to be overpaying by $50,000 per year. Fiduciaries need to benchmark the compensation of the provider to the cost of comparable services from other providers. This is difficult for most plan sponsors—primarily because they lack the benchmarking information. As a result, plan sponsors should work with consultants who specialize in 401(k) plans and who are familiar with their market segment.

If a plan is overpaying for services, fiduciaries must act to protect the interests of the participants. That can be done in a couple of ways. For one, fiduciaries can change to lower-cost investments. In some cases, it may be appropriate to switch to an even lower-cost collective trust or separate account. Alternatively, fiduciaries can negotiate with the provider to create an expense recapture account for the plan (sometimes called an ERISA budget account). ERISA accounts often are used for the payment of plan expenses during the year and, then, as of the last day of the year, the remaining balance is allocated to participants' accounts in proportion to the account balances.

As a word of warning, if you don't know the mutual fund share classes in your 401(k) or 403(b) plan, you may have serious fiduciary issues. Once you learn the share classes, look at the expense ratios and revenue-sharing of the share class and make sure that it is appropriate for a plan of your size.

While we must wait to see how the court cases ultimately are resolved, fiduciaries can have a high degree of confidence that, if they follow these procedures, they have significantly reduced the likelihood of being sued, and if sued, they have taken meaningful steps to insulate themselves from liability.

Fred Reish is Chair, Financial Services ERISA Practice, at the law firm of Drinker, Biddle & Reath. A nationally recognized expert in employee benefits law, he has written four books and many articles on ERISA, IRS and DoL audits, and pension plan disputes. Fred has been awarded the *Institutional Investor* Lifetime Achievement Award and the *PLANSPONSOR* Lifetime Achievement Award. He is one of the 15 individuals named by *PLANSPONSOR* magazine as "Legends of the Retirement Industry," and also one of five individuals acknowledged as Retirement Plan Adviser Legends by *PLANADVISER* magazine.