Plan Governance Protects CFOs and HR Managers from Fiduciary Liability

By Sheldon M. Geller

The role of retirement plan governance has become extremely important as employers face increased scrutiny of the way in which they operate their plans in the current legal and regulatory environment. CFOs and human resource managers administering 401(k) plans have been held responsible for fiduciary breaches. Department of Labor (DOL) enforcement actions and participant lawsuits have resulted in monetary sanctions and damages against these in-house fiduciaries, who are held responsible for plan governance.

Accordingly, employers need to reduce the risk of legal, audit, and investment challenges inherent in signing Form 5500 and making fiduciary decisions on behalf of a 401(k) plan. An effective plan governance framework and documented process substantially reduces risk and enables in-house fiduciaries to make better-informed fiduciary decisions.

Recent Litigation

Three fiduciary breach cases were settled in 2015 for over $220 million, including the payment of $80 million in attorney's fees [Haddock v. Nationwide Life Ins. Co., No. 3:01-cv-01552-SRU, Dist. Court, D. Connecticut; Abbott v. Lockheed Martin Corp., 725 F.3d 803 (2013); and Krueger v. Ameriprise Fin. Inc., No. 11-CV-02781 (SRN/JSM)]. These plaintiff wins have encouraged litigation against other employers.

In addition, a case was filed in 2015 by plaintiffs who alleged that the employer failed to solicit bids before retaining the plan's recordkeeper (Bowers v. BB&T Corp., No. 1:15-cv-00732, M.D.N.C.). There is case law to support the proposition that employers must benchmark fees by procuring actual service and fee proposals based on their plan's specific profile, rather than relying on published averages.

Another case in 2016 found that plaintiffs adequately alleged conflict of interest and improper fiduciary acts and denied a motion to dismiss (Urakchin v. Allianz, C.D. Cal., No. 8:15-cv-01614). Finally, in 2017, a court denied a motion to dismiss as to the allegation that plan fiduciaries breached their duty of prudence with respect to incurring excessive recordkeeping fees, failed to diligently investigate and monitor recordkeeping cost, and were imprudent in the selection of certain investment options (Sacerdote v. N.Y. Univ., 2017 BL 299499, S.D.N.Y., No. 1:16-cv-06284-KBF).

Effective Retirement Plan Governance

Plan governance is the process and the delineation of the roles and responsibilities associated with the management and oversight of a retirement plan. Employers with effective retirement plan governance are better equipped to manage potential retirement plan audit risks, protect against fiduciary liabilities, and improve plan performance.

A recent plan governance survey indicates that employers have focused on the following three concerns:

- Addressing retirement benefit adequacy and the ability to retire in a timely manner
- Engaging third-party advisors to assist with investment decisions
- Managing regulatory risk associated with plan sponsorship

Fifty-eight percent of employers sponsoring a defined contribution plan, including a 401(k) plan, have conducted a review of their plan's operational compliance in the last two years. A large majority of employers engage advisors to assist in investment decisions and increase plan governance. Defined contribution plan sponsors dedicate 74% of their resources to the monitoring of plan fees and 61% of their resources to the monitoring of investment managers.

Thirty-one percent of employers have faced a government audit of their plan, and larger employers report an even higher likelihood of audits. More than 90% of employers use minutes, investment policy guidelines, and written agendas to document their plan governance process ("Unlocking Value From Effective Retirement Plan Governance: The 2016 Willis Tower Watson U.S. Retirement Plan Governance Survey," http://bit.ly/2hjoNxZ).

Service Provider Selection and Supervision

DOL actions and participant lawsuits have accused CFOs and HR managers of failing to properly select and supervise recordkeepers. CFOs and HR managers signing Form 5500, as a plan administrator or as a representative of the employer, have been held responsible for recordkeeper retention, fund selection, fund performance, and fees paid with plan assets.

The establishment by employer boards of committees that maintain plan governance processes and best practices significantly reduces the fiduciary liability associated with the selection, retention, and supervision of recordkeepers and fund managers, as well as the fees paid to these service providers.

Excessive Fees Paid with Plan Assets

A literal definition of an excessive fee is compensation that exceeds the value of services provided to a plan; case law and the DOL, however, have defined an excessive fee as compensation paid in excess of a marketplace benchmark. CFOs, finance executives, and HR managers have mistakenly relied upon self-serving and inflated benchmarks offered by conflicted service providers and limited fiduciary investment advisors. The DOL expects employers to provide evidence that fees paid with plan assets are reasonable based upon actual facts and circumstances, which the DOL refers to as a "market-based fee" determination.

Request for Proposal: A Best Practice

It has become increasingly clear that finance and HR managers held responsible for making recordkeeper and fund selection and retention decisions must procure actual service and fee proposals to support the proposition that their plan pays reasonable fees. Finance and HR managers who negotiate fees by leveraging superior plan profiles and procure marketplace proposals have a defensible strategy. Moreover, retaining an independent fiduciary to conduct a request for proposal is a fail-safe way to protect finance and HR managers from fiduciary breaches and participants from excessive fees.

Retirement Plan Committee: A Best Practice

Best practices include the appointment of a committee to assume responsibility for plan administration and plan investment. Such a committee assumes the fiduciary duties associated with service provider and fund manager selection, retention, and supervision. Committees customarily govern pursuant to a charter and require a quorum vote to carry out fiduciary decisions, rather than having finance and HR managers make individual fiduciary decisions. Moreover, committees are more likely to make informed and reasoned decisions pursuant to a deliberate process, consistent with the DOL's emphasis on the fiduciary decision making process.

Conflicts of Interest and Failure to Supervise

Recordkeepers and investment providers who repeatedly recommend funds without providing adequate data and who recommend high expense share classes without discussing revenue sharing create liability for CFOs and HR managers. Service providers that bundle recordkeeping and investment consulting services, and advocate funds that provide their organization with higher revenue, create liability for employers. It is employers that are then held liable for conflicts that result in plan governance lapses and unreasonable plan fees.

Employers that do not monitor indirect compensation paid to recordkeepers and advisors create unnecessary and avoidable liability. Most compensation arrangements are based upon revenues that flow directly from fund companies to recordkeepers and advisors, a standing direction of payment that does not require periodic employer approval.

Independent Fiduciary: A Best Practice

Principled CFOs and HR managers should consider retaining a qualified independent fiduciary that will enhance and align plan governance with employer objectives and fiduciary guidelines.

Independent fiduciaries with strong capabilities in plan governance, internal controls, and service provider oversight protect in-house plan fiduciaries from excessive fees, poor fund performance, and plan governance lapses.

Employers that lack an understanding of their plan's fee arrangement, tolerate high plan fees, and rely upon conflicted advice create liability for their organizations. Service providers are not fiduciaries with respect to their clients' plans; rather, they are for-profit businesses interested in maximizing compensation.

Effective Plan Governance Results in Operational Excellence

Employers seeking operational excellence should retain an independent fiduciary to manage plan governance. Employers who maintain effective plan governance reduce, if not eliminate, fiduciary breaches and the liability associated therewith. Outsourcing plan governance to an independent fiduciary is akin to purchasing an insurance policy to protect in-house fiduciaries and plan participants from excessive fees and poor performance.

The Need for Employer Action

In accordance with the above best practices, in-house plan fiduciaries need to consider taking the following actions:

- Evaluate the effectiveness of their plan governance process
- Prepare for an IRS and DOL audit
- Retain a third-party fiduciary to manage plan governance and oversee plan operation
- Determine the employer commitment and plan cost structure to meet plan objectives.

Finance executives and HR managers who are parties charged with the governance of their employer's 401(k) plans need to establish a well-structured plan governance process, which is critical for legal compliance, risk mitigation, and benefit accumulation.❑

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