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What the Heck(er) Should Fiduciaries Do Now?

By: Roberta Johnnene

Fiduciaries of qualified retirement plans face many challenges in carrying out their duties. Particularly problematic are challenges from the selection, monitoring and fees associated with investments under the plan. While on the surface a recent 7th Circuit Court of Appeals decision upholding the dismissal of a breach of fiduciary duty in *Hecker v. Deere* appears to ease those challenges, such is not the case. Plan Sponsors must keep proper vigil of their fiduciary responsibilities and take appropriate steps to mitigate exposure to participant claims.

Background: Participants sued John Deere and two Fidelity entities who provided directed trustee, recordkeeper and investment management consulting services for *breach of their fiduciary duties*, alleging "*the fees and expenses paid by the Plans, and thus borne by Plan Participants, were and are unreasonable and excessive; not incurred solely for the benefit of the Plans and the Plans' participants*[1]*; and undisclosed to participants.*" This last allegation concerned the revenue sharing arrangement between the Fidelity entities. The case was dismissed on the pleading in District Court for failure to state a claim against the defendants. That decision was upheld on Plaintiffs initial appeal and again on Plaintiffs secondary appeal for rehearing, for which the Secretary of Labor (DOL) filed an Amicus Curiae[2] brief on behalf of the Plaintiffs. However, as a result of the DOL Amicus Curiae the Appellate Court issued a follow-up Order clarifying some points in its initial decision, most importantly with regard to a Plan Sponsors defenses under §404(c) of ERISA.

Fiduciary Status of Parties: The court held that the Fidelity entities were not fiduciaries as they did not exercise discretionary authority or control over the management of the Plans, the disposition of the Plans' assets, or the administration of the Plans. *"Merely playing a role or furnishing professional advice is not enough to transform a company into a fiduciary."* [3] Plan Sponsors should take note of this finding because while it is good news to plan providers, and we believe it is the correct result, it makes clear that plan sponsors who rely primarily on information provided by their service provider as to the reasonableness of fees, investment options, and services provided must understand they, the Plan Sponsor, are ultimately the **responsible fiduciary** and they are not sharing or delegating that duty with their plan provider. There is a commercial, not a "co-fiduciary" relationship between Plan Sponsors and their service providers. Plan sponsors looking to lower fiduciary risk or enter co-fiduciary arrangements should hire independent experts **willing to acknowledge their fiduciary status** to the plan. ERISA fiduciary standards require nothing less.

[1] *Hecker v. Deere*, 7th Circuit Court of Appeals, Nos. 07-3605 & 08-1224 at page 4.

[2] Amicus Curiae or "Friend of the Court" brief is filed by a person or group, not a party to the lawsuit, but who may be impacted by the outcome or legal points involved in the matter.

[3] *Hecker v. Deere*, *supra* at page 16

Revenue Sharing: In dismissing the complaint against Deere on the issues of non-disclosure and revenue sharing, the court held that neither ERISA nor any regulations at the time[4] required revenue sharing arrangements to be disclosed. The court also found that *"the total fee, not the internal, post-collection distribution of the fee, is the critical figure…and the later distribution of the fees … is not information the participants needed to know to keep from acting to their detriment."* [5]

This conclusion makes sense, at a participant level. But until the DOL publishes additional guidance on what fees need to be disclosed and to whom, Plan Sponsors do, at least at the Plan level have a fiduciary responsibility to know, monitor and benchmark the fees being paid to plan providers, including revenue sharing arrangements.

Excessive Fees: On the issue of excessive fees the court relied on the availability of an affirmative defense by Deere under §404(c) of ERISA. Section 404(c) provides that individual account plans that allow a participant or beneficiary to exercise control over the assets in his account, can not be held liable for losses resulting from such participants' exercise of control.[6] The court outlined the many requirements a Plan Sponsor must meet to satisfy §404(c) including offering a broad range of investment alternatives, notice requirements and fee disclosure information. While normally defenses are not considered in a motion to dismiss, the court determined that plaintiff's pleadings allowed such consideration. What seemed to impress the court the most was that "*the undisputed facts leave no room for doubt that the Deere Plans offered a sufficient mix of investments for their participants ... no rational trier of fact could find, on the basis of the facts… that Deere failed to satisfy that duty.*"[7] To the court, the number and diversity of investments under the plans (23 mutual funds, a stock fund, 2 investment funds managed by Fidelity) and particularly a brokerage window that offered more then 2,500 funds with varying fees, presented ample opportunity for participants to select from a wide range of funds and control the risk of loss from fees. And, "*importantly, all of these funds were also offered to investors in the general public, and so the expense ratios necessarily were set against a backdrop of market competition*".[8]

This ruling would appear to invite Plan Sponsors to offer lots of investments, at retail market prices, and a brokerage window to avoid potential liability for an excessive fee claim. But would such action be prudent? The courts subsequent Memorandum and Order implies no. Since as a strategy "*could result in the inclusion of many investment alternatives that a responsible fiduciary should exclude. It also would place an unreasonable burden on unsophisticated plan participants who do not have the resources to pre-screen investment alternatives.*"[9]

Services Received for Fees Paid: The subsequent Order dated June 2009 raised another point from which Plaintiffs counsel will no doubt learn. The Court commented that "*the complaint is silent about services*

[4] The DOL has promulgated proposed regulations addressing fee disclosures including revenue sharing arrangements. These regulations are currently on hold.
[5] *Hecker v. Deere*, *supra* at page 20-21.
[6] 29 U.S.C. § 1104(c)(1), see *Hecker v. Deere*, *supra* at page 25
[7] *Hecker v. Deere*, *supra* at page 21.
[8] *Id.* at page 22
[9] *Hecker v. Deere*, Nos. 07-3605 & 08-1224, Order dated June 24, 2009.

that Deere participants received from the company-sponsored plans. It would be one thing if they were treated like all other retail market purchasers of Fidelity mutual funds shares; it would be quite another if, for example, they received extra investment advice from someone dedicated to Deere accounts, or if they received extra services. If the Deere participants received more for the same amount of money, then their effective cost of participation may in fact have approached wholesale levels." [10]

In addition, we believe the court missed an important factor; i.e., "*investors in the general public*" do not have the bargaining power that plan sponsors of a retirement plan, with over a billion dollars to invest has, to negotiate for lower price institutional share classes.

Rest assured Plaintiffs counsel will not miss these lessons in the next wave of suits. If there is a case to be made for breach of fiduciary duties resulting from excess fees, it will turn on the value of the Plan Sponsors need to be able to demonstrate they have gone through a suitable analysis and made a reasonable determination that a proper and prudent relationship between cost and value exists.

Conclusion: **It's still all about the process**. As has always been the case, a fiduciary's potential liability lies not in the outcome of the decisions, but in the decision process itself. Plan sponsors must be prepared to defend their own internal decision making, especially on matters involving investments. As such, Plan Sponsors should:

- identify the plan fiduciaries, be they direct or functional;
- clarify the responsibilities of the various fiduciaries, including the responsibility to monitor external fiduciaries;
- carefully execute their duties of care, loyalty, diligence and prudence;
- utilize prudent experts whenever possible to assist with, or take over fiduciary functions which they determine they are not qualified to render;
- avail themselves of affirmative defenses like §404(c) whenever possible;
- exercise diligence and care to leverage their bargaining power to acquire, when able, lower cost institutional share classes for their plan participants; and
- conduct a proper examination and benchmarking of the fees, revenues and services received to determine if a reasonable relationship between cost and value exists.

About the Author:

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[10] *Id*. at page 3.