Pensions&Investments

October 23, 2023 05:00 AM

How retirement security litigation has impacted the defined contribution landscape

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The retirement industry complains about the onslaught of ERISA lawsuits, but DC sponsors have adjusted their practices to reduce litigation risk.

To the late Supreme Court Justice Ruth Bader Ginsburg, ERISA is a "candidate for the most inscrutable legislation Congress ever passed."

To the late Chief Justice William Rehnquist, the court reviews "dreary" ERISA disputes out of "duty, not choice."

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And to some ERISA attorneys, the law's acronym stands for Every Ridiculous Idea Since Adam.

At one year younger than *Pensions & Investments*, the Employee Retirement Income Security Act of 1974 has reshaped and recast retirement policies and practices for most voluntarily established retirement and health plans in private industry.

It has led to greater transparency and greater savings opportunities for participants as defined contribution plans continue to play a more prominent role in employers' retirement programs. Litigation has played a prominent role in ERISA's development and in plan management, but there's no black-or-white verdict on its overall impact on sponsors, record keepers and participants.

"The role of litigation depends on where you stand," said Bradford Campbell, a partner in the law firm of Faegre Drinker Biddle & Reath. "I don't think lawsuits have made improvements."

Instead, ERISA lawsuits have perpetuated a series of "fiduciary myths," said Campbell, who served as assistant secretary for Employee Benefits Security Administration in the Department of Labor from August 2007 to January 2009.

Campbell said those myths include assertions that passive investments reduce litigation risk vs. active investments, that lower fees reduce litigation risk and that short-term performance is a reason for removing an investment from a plan lineup.

For many in the DC industry, litigation is an expensive exercise in defending programs, which siphons funds and sponsors' time that could be used to improve participants' savings by exploring innovative products and expanding services.

ERISA lawyers and DC consultants complain that more firms are filing copycat complaints, hoping a receptive judge will allow their lawsuit to get past the motion-to-dismiss stage leading to an eventual settlement. "That's the problem with the whole tort system," Campbell said.

Even though ERISA lawsuits are "out of control," sponsors and their fiduciaries must sharpen their focus on doing what's best for participants, said Nancy Ross, a partner at Mayer Brown who represents sponsors. "Litigation can't drive how you manage your plan."

Courts are faced with deciding "who has a bona fide issue and who is just trying for a settlement," she said. "A big part is the financial interest of the plaintiffs' bar."

To plaintiffs' lawyers, litigation exposes the gaps in sponsors' plan management and record keepers' strategies that damage participants' savings and hurt their investments.

Litigation can teach a specific defendant as well as industry members about the need for best practices, they said, noting that they operate on a contingent fee basis. If they don't win or secure a settlement, they don't get paid. Otherwise, they can get one-third of the award.

"If you manage the plan and benchmark it correctly, and if you follow a prudent process, then you shouldn't have any trouble," said Charles Field, managing partner of Sanford Heisler Sharp and chair of the firm's financial services practice group.

"It's not just fees," said Jerome Schlichter, founding and managing partner of Schlichter Bogard. Litigation has led to "a heightened level of monitoring and scrutiny, which is most important for sponsors to follow."

Schlichter filed his first ERISA lawsuit in September 2006, igniting a trend of legal challenges to plan management, fees, product performance, record keeping and other services. "We look at a lot of plans where the fiduciaries are asleep at the switch," he said.

Among attorneys who defend sponsors and service providers, there are nuances and shades of gray in how they view the impact of litigation even as they complain about the volume of frivolous lawsuits.

"One of the good things about litigation is that it increases sponsors' awareness and practices to a higher level of attention and care than decades ago," said Andrew Oringer, a partner and general counsel at Wagner Law Group.

The legal environment requires fiduciaries to "keep your eye on the ball," said Oringer, noting that "more care is being taken by plan sponsors on fees. Still, there's too much litigation."

Ross conceded that ERISA lawsuits in general can "make sponsors take notice on (plan) governance," adding that litigation "may prompt a review of process rather than substantive change."

Litigation has led to changes in plan design such as encouraging open architecture, which features products from multiple providers rather than just those offered by a plan's record keeper, said David Levine, principal and co-chair of Groom Law Group's employers and sponsors group. "Evolution is a good thing," he said.

Lawsuits also have prompted, among other things, increased fiduciary attention to the offering of company stock in 401(k) plans, focusing on services and documenting activities due to ERISA's emphasis on process, he said.

Some lawsuits reflect that fact that "some people are asleep at the switch," said Levine, quickly adding that "a vast majority are not asleep at the switch."

Regardless of fiduciaries' skills, he added, "cookie-cutter litigation drives up costs."

Although DC industry members often speak harshly of ERISA lawsuits, some research shows sponsors are not only paying attention but also acting to reduce litigation risk.

One example is a survey published in July by Pacific Investment Management Co. covering 27 institutional consulting firms with assets of $6.2 trillion for 4,558 clients, primarily large plans.

When they were asked about litigation's impact on sponsors' decisions, many responses were a recitation of best practices and/or elements or non-monetary terms in ERISA settlements.

Among nine choices, the most prominent were: conducting more frequent benchmarking for record keeping and investments (74% of consultants); reviewing investments to make sure they are consistent with plan documents (63%); "primarily considering lowering costs" by offering passively managed investments (41%); and increasing focus on cybersecurity risk and cyber insurance (30%). Only one consultant said litigation thwarted innovation.

The PIMCO survey asked the same question to 10 aggregators that focus on mostly smaller- to midsize DC plans. These are independent DC-focused advisory firms with shared resources who serve 21,467 clients with aggregate DC assets of more than $1.1 trillion.

Among aggregators, benchmarking was the first-ranked answer followed by a three-way tie for plan document review, passively managed investing and cybersecurity/insurance improvements.

Settlements are the most common victories for plaintiffs; favorable verdicts are rare and many complaints are dismissed. Settlements don't provide legal precedents, but they can educate the DC industry especially if the agreements contain non-monetary provisions such as mandates for record-keeping RFPs, requirements for fiduciaries and reviews of investments.

"Settlements are a lesson to everyone else," said Field of Sanford Heisler Sharp. "That's why lawsuits improve the ways plans are managed."

Sponsors' attorneys should tell clients to beware of the legal climate, he said. "Look at the other cases," he said. "If you don't take it seriously, this is what happens."

Many of Schlichter's settlement deals have non-monetary provisions, some of which were in the process of taking effect before courts signed off on the agreements.

Monitoring record keepers and monitoring investments are some examples "that can be worth more (to participants) in the future" than the financial terms, he said.

"Monitoring" has become a common refrain in plaintiffs' ERISA complaints over the years, thanks to a pair of Schlichter lawsuits that the U.S. Supreme Court decided unanimously in favor of participants.

"The duty of prudence involves a continuing duty to monitor investments and remove imprudent ones under trust law," the court ruled in the 2015 case of Tibble et al. vs. Edison International et al. Rejecting lower courts' decisions that sponsors could offer a choice of options even if all weren't monitored, the court in Hughes et al. vs. Northwestern University et al., ruled in 2022 that sponsors have "a duty to monitor all plan investments and remove any imprudent ones."

The DC industry acknowledges non-monetary terms in settlements have an impact on plan management, said Brian Graff, CEO of the American Retirement Association.

"Best practices have changed over the years in response to litigation," said Graff, citing as examples fiduciary training, increased numbers of investment committee meetings, more benchmarking of fees and greater frequency of RFPs.

One litigation byproduct has been the development of specialized fiduciary advisers. As litigation has increased, "the need for advisers has grown with it," Graff said. "Most plans today work with advisers because of their concern with litigation."

In-house fiduciaries "can't stay on top of all of it, so they need help," said Jill Carson, senior director for retirement at Willis Towers Watson.

She agrees that settlements can affect more than just sponsors signing the deals. They "provide a little bit of a road map" for other industry members to better monitor vendors and increase benchmarking, Carson said. "Sponsors need to keep asking questions."

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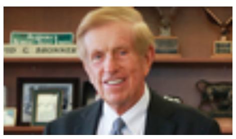

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