401(K) SUMMIT

Advisors on the Hook: ERISA Panel Says Burden of Proposed Rule Falls Squarely on Plan Advisors

Wagner, Reish and Fleckner break down the proposed alternatives rule, pending Supreme Court review and a class-action curveball out of the Fourth Circuit

A panel of ERISA legal heavyweights told NAPA 401(k) Summit attendees that the retirement plan litigation landscape is shifting beneath their feet, and that the Labor Department's new proposed regulation on alternative investments will reshape how advisors do their jobs, whether or not plans ever add a single alternative asset.

Moderator Nevin Adams, former chief content officer at the National Association of Plan Advisors, opened the session by noting that the word "litigation" appears 107 times in the new proposed regulation on investment alternatives. Panelist Fred Reish, director of ERISA and fiduciary strategy at Prime Capital, quickly topped him. The word "advice" or "advisor," he said, appears 108 times.

"This thing says repeatedly throughout the proposal that if plan sponsors aren't competent to do the evaluations necessary to satisfy the rules, they have to seek qualified investment advice or a 3(38) investment manager," Reish said. "The burden is going to fall mainly on you guys to make it work."

Six Factors, Finalized or Not

Marcia Wagner, founder of The Wagner Law Group, walked the room through the six factors the Labor Department laid out as a procedural safe harbor: performance, fees, liquidity, valuation, meaningful comparator and benchmark, and complexity. She urged advisors to apply all six to every designated investment alternative, not just the alternatives, and to document that analysis in committee minutes.

Wagner cautioned, however, that the so-called safe harbor is likely to face legal challenge. With the Supreme Court having overturned Chevron deference, she noted, regulations now receive only Skidmore deference, which turns on their persuasiveness.

"The age of ERISA litigation is upon us," Wagner said.

She outlined several structural approaches for sponsors weighing alternatives: a sleeve of a target-date fund, a collective investment trust, a cap on the percentage of an account that can flow into alternatives, or a self-directed brokerage window. Each option carries its own complications, she noted, particularly around accredited-investor rules and the requirement that brokerage windows remain available to a nondiscriminatory class of employees.

Reish pushed the practical implications further. If the rule is finalized, investment policy statements will need to reference the six factors, and advisory agreements will need to be modified. He warned that plaintiffs' attorneys will treat the factors as a checklist.

"The first thing I would allege, if I were a plaintiff's attorney, is that the fiduciaries had not gone through each of the six factors the way the Department of Labor says they have," Reish said.

Neither Wagner nor Reish believes plans are required to consider alternatives at all. But Wagner noted that modern portfolio theory, long embraced by defined benefit plans, arguably supports a broader universe of investable assets than the stock, bond, and mutual fund lineup typical of defined contribution plans. That argument, she said, could drive gradual change in what courts consider prudent.

A Fourth Circuit Case That Could Upend Class Actions

James Fleckner, a partner at Goodwin who frequently defends plan sponsors and fiduciaries in ERISA suits, flagged a procedural development in the Fourth Circuit, covering Virginia, Maryland, and the Carolinas, that could reshape defined contribution litigation.

In a case arising from the wave of BlackRock LifePath target-date fund suits, the appellate court refused to rubber-stamp class certification. The court reasoned that a defined contribution plan cannot be treated as a single unified entity for class-action purposes because each participant makes individual investment decisions, including selecting a target-date vintage, each with its own risk-reward profile.

"Individuals participate individually in defined contribution plans," Fleckner said, summarizing the defense argument. "While there may still be abilities to bring classes, it shouldn't be quite a rubber stamp, as a lot of courts have had it be to date."

The ruling applies only in the Fourth Circuit for now. But Fleckner said defense attorneys have pushed this theory since the Supreme Court's 2008 LaRue decision, and if other circuits adopt the approach, it could dramatically alter the economics of plaintiff-driven ERISA class actions against 401(k) and 403(b) plans.

Meaningful Benchmarks Head to the Supreme Court

The Supreme Court in January granted certiorari in Anderson v. Intel, a case Wagner described as "of stellar importance" to anyone in the room.

The question at issue: at the motion-to-dismiss stage, must a plaintiff allege a meaningful comparator to state a breach of fiduciary duty claim, or is an allegation of an imprudent process enough? Cases that survive motions to dismiss typically open the door to discovery and depositions, the expensive phase of litigation where settlements often originate.

Wagner noted that the justices denied cert in the Parker Hannifin case, which involved similar issues. Her theory is that because Intel involves alternative investments and hedge funds, the court may want to make clear that whatever meaningful-comparator doctrine it establishes applies equally to alternatives and to traditional designated investment alternatives.

Reish tied the benchmark question back to the proposed regulation, which would require every investment, including every managed account, to have a meaningful benchmark.

"If you have truly individualized managed accounts, how are you going to establish your meaningful benchmarks?" Reish asked. "That is a headache."

Managed Accounts: The New Target

Managed account litigation is expanding, Reish said, with plaintiffs arguing that participant-managed accounts amount to "just an expensive target-date fund." The question of how individualized a managed account must be to justify its fee remains unsettled.

He pointed to an example in the proposed regulation. A CFO used only participant age to build managed accounts, effectively a target-date fund, and authorized the plan to pay the fees. The Labor Department signaled that it would be hard to justify.

The proposed rule also would require fiduciaries to evaluate a reasonable number of alternatives for each investment, with the regulation's example suggesting five. Reish questioned whether advisors realistically offer five distinct managed account platforms for sponsor evaluation.

Recordkeepers, Due Diligence and Prevailing Standards

Responding to an audience question, Reish said recordkeepers generally are not fiduciaries when they merely implement asset allocation models designed by an advisor and approved by a sponsor. The analysis, he said, comes down to value versus cost.

Fleckner added a caveat. Some plaintiff firms continue to name recordkeepers as defendants, either because they don't fully understand the law or, in at least one firm's case, because they are actively seeking novel theories to hold record keepers accountable.

On the question of whether prevailing-standard defenses will hold up when the prevailing standard is weak due diligence, Fleckner pointed to forfeiture litigation as a parallel. Many companies follow the same forfeiture-offset practice year after year without an active process, he said, and judges may ultimately reject prevailing-standard arguments when the prevailing practice amounts to little more than inertia.

> *"Prevailing standards change over time," Fleckner said. "What a 401(k) plan looks like today is much different than it looked like in 1982, when it was first added to the code."*

Reish closed with advice that the panel agreed Adams could retire on: "Only select investments that go up."

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