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WILL THE REAL FIDUCIARY PLEASE STAND UP

In Most Court Cases The Plan Sponsor is Left Standing Alone

Many plan sponsors are aware they need help with the sections of ERISA dealing with fiduciary responsibility. However even with the new DOL Fiduciary Rule, most often they are not aware of the wide disparity in fiduciary services on the market. There are unfortunately many vendors who sell themselves as ERISA fiduciary "experts," when really they are better portrayed as expert fiduciary "marketers". Even among genuine experts, there are many who lack the basic understanding of the true responsibilities and nuances that distinguish the roles. Most plan sponsors would be shocked to see how differently large vendors act in court versus their marketing pitches. In most cases the plan sponsor is left to stand on their own.

> **Most often when plans are sued the mutual fund company or insurance company has claimed not to be a fiduciary, and immediately placed all blame solely on the plan sponsor and their retirement committee.**

The two major duties an ERISA fiduciary must provide are: 1) a duty of loyalty, and 2) a duty to operate at the prudent expert standard of care. In most 401(k) plans the vendor providing the services to the plan will not agree in writing to be loyal or to operate using a prudent expert standard of care.

Vendor sues plan sponsor claiming the plan sponsor was negligent in hiring the vendor

In the Haddock v Nationwide 401(k) case[1], Nationwide even went so far to make the claim in their court documents the plan trustee (Haddock) was negligent in hiring Nationwide in the first place. Nationwide sought to have the trustee pay for Nationwide's fiduciary breaches since in theory the trustees were responsible for managing the plan and hired Nationwide. The judge dismissed this faulty logic because there was no indication that Haddock received any benefit from Nationwide's receipt of hidden revenue sharing payments.

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[1] Haddock v Nationwide Life and Financial Services, Case 3:01-cv-01552-SRU Document 290 Filed 10/12/2007

> **“If Nationwide Life is found to have violated ERISA by arranging for, receiving, or retaining payments from funds…then the Trustees are reckless and also at fault to the extent the Plans suffered any harm…, because the Trustees had the ultimate responsibility for managing the Plan, and investing Plan assets.”**

Likewise in Charters v John Hancock[2], Hancock countersued their client Charters (the plan trustee) for breach of fiduciary duty, monetary contribution and indemnity for being negligent in hiring John Hancock in the first place. John Hancock also claimed to not be a fiduciary.

The court cases show a recurring theme of esoteric legal arguments by large vendors that leave the plan sponsor on their own, fully at risk and without any help. Certainly vendors filing lawsuits against their own customers should greatly concern plan sponsors.

Impact of the New DOL Fiduciary Rule

The DOL took a simple statement “Place the needs of the client first” and came out with a 1,000 pages of rules. In the document[3] there are about 200 pages of how to place the client first, and about 800 pages of exceptions. Most notably, all large vendors (mutual fund companies, insurance companies and many brokerage companies) are exempt from the rule. Thus they are still not required to place the needs of the plan participant first!

Under the regulation, employers will now have a new working relationship with their advisor if that advisor is a broker. This may include additional paperwork, possibly higher costs and a new set of limitations and exemptions. Employers will now have to carefully vet the type of advisor they choose to manage their plan and the compensation structure these advisors utilize. Further scrutiny will be required when the new threshold for “advice” (as opposed to “education”) is met when interacting with employee/participants.

Industry Sues to Block DOL Fiduciary Rule

A coalition of national financial and business trade groups has filed a lawsuit[4] to strike down the DOL’s new regulations that will require most brokers and investment consultants to act as fiduciaries. Thus despite statements to the public about how the rule was “a good idea”, in fact the industry is actively moving to kill the rule. They note the special status of a fiduciary and write : “Under these principles, a fiduciary relationship is established only where a <u>heightened relationship of trust and confidence</u> exists between the parties.”

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[2] Charters v John Hancock Life Insurance Company, Civil Action No. 07-11371-NMG, September 30, 2008
[3] The DOL Fiduciary Rule https://www.dol.gov/ebsa/regs/conflictsofinterest.html
[4] Chamber of Commerce, Financial Services Institute, et al, v Thomas Perez, Civil Action No. 16-cv-1476, June 2016

> **“Congress adopted this definition of “fiduciary” in light of well-established legal principles developed through trust law and codified in the Investment Advisers Act of 1940. Under these principles, a fiduciary relationship is established only where a heightened relationship of trust and confidence exists between the parties as reflected, among other things, through ongoing, personalized contact.”**

Vendor is not a fiduciary…The plan sponsor is the fiduciary with certainty

In almost all cases filed, the mutual fund company or insurance company will vigorously deny any fiduciary status[5]. Similar arguments about non fiduciary status were made by Principal[6]. The vendors instead force the plaintiff to “prove” their fiduciary status exists. In the absence of the legal proof, the liability will fall to the plan sponsor since there can be no doubt the plan sponsor and their committee is a fiduciary under ERISA[7]. In many cases, courts have simply pressed on against the plan sponsor since such an approach involves less work.

Courts treat the determination of fiduciary status as a mixed question of law and fact. Questioning the fiduciary status of the vendor will be a fact intensive inquiry not to mention a laborious and costly process. There is no such difficultly proving the plan sponsor is a fiduciary. The Tussey v ABB, Inc. case clearly shows this.

In 2012, a federal court in the Western District of Missouri ruled on Tussey v. ABB, Inc. The court determined that the plan sponsor’s retirement committee and chief financial officer were liable for almost all of the $35.2 million in damages to plan participants due to improper Fidelity fund selection and vendor monitoring. In the Tussey v. ABB, Inc. case, Fidelity made the following claim to be dismissed from recommending Fidelity funds in their court filing[8]:

> **“Counts should be dismissed against Fidelity because the Fidelity defendants have no fiduciary status relevant to plaintiffs’ claims.”**

Fidelity Trust argued that they should be dismissed because Fidelity was a “directed trustee” with only a record-keeping function under the plan. The fact that they consistently pushed Fidelity funds was not their problem.

The judge agreed and placed almost all the blame on the plan sponsor, writing: **“By the plain language of the Trust Agreement, Fidelity Trust has no responsibility for reviewing the merits of fund choices made by the Pension Review Committee. Thus, Fidelity Trust had no responsibility to prevent the addition of the Fidelity Freedom Funds to the Plan’s investment line-up. For these reasons, the Court finds that Fidelity Trust cannot be held liable for ABB’s breaches under ERISA Section 405(a)(2).”**

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[5] Wagner, M. “Best Practices Evolving in ERISA Litigation”, April 26, 2010 presentation paper
[6] Ruppert v. Principal Life Ins. Co., No. 4:07-cv-0344-JAJ S.D. Iowa Nov. 5, 2009
[7] ERISA Section 3(21)(A)(i)
[8] Tussey v. ABB, Inc., Case 2:06-CV-04305, 2010 Document 103

Today, almost all plan corporate trustee services offered by both large mutual fund companies and insurance companies do not make decisions but instead are directed by the plan sponsor's retirement committee. The directed trustee is synonymous with passive trustee or custodial trustee. The custodial function is to safeguard or hold plan assets and to do what the plan sponsor instructs, although ensuring that only directions from the plan sponsor that are consistent with ERISA and the plan document are executed. Most, if not all, directed trustees disavow fiduciary status in their contracts. Despite marketing pitches, the contract language is what will be used in court.

Vendor should be immediately dismissed from the case, regardless of whether the case is continued against the plan sponsor

In the Tussey v. ABB case, Fidelity made the following claim in their court filing[9]:

"Defendant ABB Inc. is the plan sponsor. Defendant Employee Benefits Committee of ABB Inc. ("EBC") is a three-member committee appointed by ABB's board of directors to oversee all of ABB's employee benefits programs. It has sole authority to amend or modify the plan. The Pension Review Committee has final authority under the Trust Agreements to direct Fidelity Trust as to which of the investment options are to be provided to Plan participants. Although Fidelity Trust had a limited fiduciary role as a directed trustee, it had no fiduciary responsibility for the conduct challenged by plaintiffs."

If Vendor is a fiduciary, the alleged breach is not covered under the "to the extent" of Vendor's services

One of the greatest misunderstandings among plan sponsors is the "to the extent of" fiduciary language of ERISA[10]. In Beddall v. State Street Bank & Trust[11], the judge ruled "fiduciary status is not an all or nothing proposition." Thus even if a vendor is found to be a fiduciary, it is <u>not</u> for the entire plan operation. It is only "to the extent" of a very, very narrow service, such as selecting an institutional money manager for an insurance company separate account. Typically the breach alleged by the plaintiff will be for a much wider oversight of the plan, such as fund menu selection for the plan, retirement readiness, revenue payments or asset allocation models. Thus the litigation will fall back on plan sponsor.

Vendor "Co-Fiduciary" status amounts to little protective benefit

Although the word "co-fiduciary" is tossed around in many sales presentations, it actually has a very narrow meaning under ERISA. The context is that the secondary party must have had actual knowledge or participated in the fiduciary breach. In court cases the vendor will require that the narrow meaning be strictly enforced. In addition, such vendor liability will typically be excluded under the "to the extent of" carve out as described above.

ERISA makes a plan fiduciary liable for a breach of fiduciary responsibility ("co-fiduciary liability") by another fiduciary for the same plan if: (a) the fiduciary participates knowingly in, or knowingly conceals an act or omission of a co-fiduciary which he knows constitutes a breach; (b) by his failure to comply with the prudence, diversification, or loyalty requirements or failure to follow plan documents in the course of his own fiduciary duties, he enables another fiduciary to commit a breach; or (c) he has knowledge of a breach of the other fiduciary and does not make reasonable efforts under the circumstances to remedy the breach[12].

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[9] Tussey v. ABB, Inc., Case 2:06-CV-04305, 2010 Document 552
[10] ERISA(3)(21)(A) See Mertens v. Hewitt Assocs., 508 U.S. 248 (1993); and Beddall v. State St. Bank & Trust Co, 137 F.3d 12 (1st Cir. 1998)
[11] Beddall v. State Street Bank & Trust Co., 137 F.3d 12 (1st Cir. 1998)
[12] ERISA Section 405(a)

For example in the Silverman case[13] the insurance company required a three prong test to have any co-fiduciary liability. "In order to prevail, then, plaintiff must prove (1) that Principal is a fiduciary, (2) that Principal breached a fiduciary duty imposed by ERISA Section 405, and (3) losses to the Plan resulting from such breach".

Likewise in ABB, Fidelity rejected any co-fiduciary liability status. "Co-fiduciary liability attaches under ERISA Section 405 only where the defendant fiduciary has actual knowledge that its' co-fiduciary conduct constitutes a breach of fiduciary duty." The actual knowledge standard requires more than proof that the fiduciary "should have known" about the co-fiduciary's breach—the defendant must actually "know that it was a breach." A limited elections or negotiation of Fidelity compensation, they cannot be liable for any breach by ABB of its duties concerning those subjects.[14]

Vendor claims they are not required to be loyal and are allowed to have conflicts of interest.

In the Tussey v. ABB case, Fidelity made the following claim in their court filing[15]:

"Finally, it was not an ERISA violation for Fidelity to market other services to ABB based on the relationship Fidelity developed providing services to the Plan. Because Fidelity did not act as a fiduciary in offering Plan services, it did not violate any fiduciary duty in marketing those services."

The plan sponsor and their representatives are responsible for any liability and dollar award payment

What many plan sponsors and retirement committees do not know is that they, as 'named' fiduciaries in the plan document, can be held 'personally' liable in the event of a fiduciary breach.

In the Tussey v. ABB final decision[16], the judge wrote: "Any person who is a fiduciary with respect to a plan who breaches any of the responsibilities, obligations, or duties imposed upon fiduciaries by this title shall be personally liable to make good to such plan any losses to the plan resulting from each such breach, and to restore to such plan any profits of such fiduciary which have been made through use of assets of the plan by the fiduciary, and shall be subject to such other equitable or remedial relief as the court may deem appropriate, including removal of such fiduciary. All ABB Defendants are held jointly and severally liable for this award."

As mentioned above in the Haddock case, the insurance company stated the plan trustee (Haddock) was negligent in hiring Nationwide in the first place. Any monetary damages from the insurance company's misconduct were claimed to be the responsibility of the plan trustee.

Vendor Fiduciary Warranty provides almost no protection

There are no court cases showing that a vendor's fiduciary warranty protected the plan sponsor. The warranties offered by large insurance companies are sold at no extra cost, and exclude most allegations of misconduct, especially fee-based issues, often the focal point of such lawsuits. Rather, the policies seem exclusively designed to cover overall investment lineups in terms of a very limited 404(c) protection. Certainly the "to the extent of" fiduciary language of ERISA would allow the warranty organization to escape liability in most cases.

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13 Silverman v Mutual Benefit Life. 941 F.Supp. 1327 (1996)
14 Tussey v. ABB, Inc., Case 2:06-cv-04305-NKL Document 552 Filed 02/11/10 Page 52 of 67
15 Tussey v. ABB, Inc., Case 2:06-CV-04305, 2010 Document 552
16 Tussey v. ABB, Inc., Case 2:06-CV-04305, 2012 Document 623

In short, the fiduciary warranty is mostly an empty sales gesture, adding little, if anything, to the safety or security of plan participants. It does nothing to protect the plan sponsor.

The protective role of the Discretionary Trustee

Most of the problems these plan sponsors faced could have been prevented by employing fiduciary best practices and hiring a discretionary trustee such as Unified Trust Company. The discretionary trustee must be loyal and operate at a prudent expert standard of care.

ERISA clearly specifies who has the responsibility to manage plan assets[17]. The primary responsibility falls to the plan sponsor and the plan trustee. ERISA envisioned that the plan sponsor would hire the trustee to make prudent decisions. Since the trustee was empowered to make decisions, they were always a discretionary trustee, and would take over day to day plan management.

> **Under ERISA, the discretionary trustee "shall have exclusive authority and discretion to manage and control the assets of the plan."**

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The plan sponsor and its directors must still prudently hire a discretionary trustee fiduciary to have exclusive authority and discretion to manage and control the assets of the plan. However, when the plan sponsor limits its role to naming the oversight fiduciary, the sponsor and its directors are no longer responsible for selecting, directing and coordinating of the persons who will actually manage and operate the plan.

It is important to restate this important distinction in determining whether an appointing fiduciary has breached its fiduciary duty. If the directors of a plan sponsor's board appoint a named fiduciary committee that in turn appoints the actual discretionary trustee, then the breach is limited to the prudence of the oversight appointment, and does not extend to the prudence of investment management or other plan activity.

A discretionary trustee provides plan sponsors and their participants with the highest level of fiduciary protection.

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[17] ERISA Section 403(a)