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ERISA Update

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"Roadmap"

- Department of Labor Fiduciary Regulation and Related Matters
- State-level Fiduciary Rulemaking Initiatives and Litigation
- Cybersecurity Issues
- ERISA "Stock Drop" Litigation Trends
- Plan Sponsor Fee Litigation Trends

Part: 1

Department of Labor Fiduciary Regulation and Related Matters

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Status of Department of Labor Fiduciary Regulation

- Current Rule and Best Interest Contract Exemption
- Litigation
- Related initiatives

Status of Department of Labor Fiduciary Regulation

- Rule itself became applicable on June 9, 2017

- Best Interest Contract Exemption ("BIC Exemption") also is currently applicable, but until July 1, 2019 only the "impartial conduct standards" component applies

Status of Department of Labor Fiduciary Regulation

- DOL's stated reasons for BIC Exemption "transition period" include
  - Additional review and study of rule
  - Possible proposal of new "streamlined" class exemption (e.g., for "clean shares")
  - Coordination with SEC
  - Avoid waste and investor confusion

DOL Fiduciary Rule Litigation

- There are four ongoing legal challenges to the Rule:
  - Chamber of Commerce of the U.S.A., et al. (Fifth Circuit Court of Appeals)
  - The National Association for Fixed Annuities (D.D.C.)
  - Market Synergy Group Inc. (D. KS)
  - Thrivent Financial for Lutherans (D. Minn.)

DOL Fiduciary Rule Litigation – Substantive Claims

- DOL lacked authority to broaden definition of "fiduciary" to include sales of financial products and services or IRA rollovers
- Congress delegated to states and other organizations primary regulatory authority over broker-dealer and insurance agent activities

DOL Fiduciary Rule Litigation – Substantive Claims

- DOL can't require parties to become subject to state law class actions as a condition of BIC Exemption relief, due to Federal Arbitration Act
- DOL usurped role of SEC and contravened Dodd-Frank Act by imposing fiduciary standard on broker-dealers and wire houses
- Fiduciary Rule violates First and Fourth Amendments

DOL Fiduciary Rule Litigation – Procedural Claims

- DOL failed to consider costs and benefits of its regulatory efforts by not analyzing compliance costs, costs imposed on "independent marketing organizations," lost retirement savings due to reduced access to investment advisers, and reduced contributions to retirement plans
- Insufficient notice and opportunity for comment on DOL amendment to PTE 84-24

DOL Fiduciary Rule Litigation – *Chamber of Commerce* matter

- Consolidated with two Northern District of Texas matters
- DOL prevailed at district court level; Chamber appealed
- Oral arguments held July 31, 2017
- Court may be favorably disposed toward Chamber's arguments
- If Chamber prevails, the fate of the fiduciary regulation is uncertain

DOL Fiduciary Rule Litigation – *NAFA* and *Market Synergy Group Inc.* matters

- *NAFA*: DOL prevailed in district court; on appeal to DC Circuit; briefing complete; oral argument delayed pending resolution of *Chamber*

- *Market Synergy Group Inc.*: DOL prevailed in district court; on appeal to Tenth Circuit; waiting for a decision

DOL Fiduciary Rule Litigation – *Thrivent* matter

- In Minnesota district court
- Court granted preliminary injunction to Thrivent so that while litigation is pending Thrivent will not have to comply with the BIC Exemption's anti-arbitration provision
- Parties agreed to slow down pace of litigation

Status of Department of Labor Fiduciary Regulation – SEC Initiatives

- SEC is working on its own rule
  - May impose a "best interest" standard on broker-dealers
  - Standard may be modeled on DOL's standard in the BIC Exemption
  - May contain a provision governing what broker-dealers can use as a "title"
  - Possible issuance in second quarter 2018, with a comment period to follow

Status of Department of Labor Fiduciary Regulation – CFP Board Initiatives

- Certified Financial Planner Board of Standards, Inc. (CFB Board) is working on a private standard applicable to CFP-designated financial advisers
  - May expand scope of fiduciary duties and obligations of financial planners
  - May be issued by end of second quarter 2018

Status of Department of Labor Fiduciary Regulation – NAIC Initiatives

- National Association of Insurance Commissioners (NAIC) has released a comment version of model "best interest" standard language to be adopted by states for insurance products
  - If adopted by NAIC, each state must decide whether to incorporate the model language or ideas into state regulations

Part: 2

State-level Fiduciary Rulemaking Initiatives and Litigation

State-level Fiduciary Rulemaking Initiatives

- Connecticut: Requires administrators of state-run retirement plans to disclose certain investment and advisory fees

- Nevada: Imposes a fiduciary duty on broker-dealers, sales reps and investment advisers who give investment advice
  - State is working on regulations under the statute

State-level Fiduciary Rulemaking Initiatives

- New York: Imposes a "best interest" standard on those selling life insurance and annuity products
  - State is developing regulations

- New Jersey: Requires non-fiduciary investment advisers to disclose to clients that it isn't *mandatory* that such advisers act in their clients' best interest
  - A re-introduction of a bill from last year

State-level Fiduciary Rulemaking Initiatives

- Illinois: A "shelf bill" called "Investment Advisor Disclosure Act"
  - Has no text; text could be developed on the floor
  - Fate of bill may not be clear until May or June 2018

State-level Fiduciary Rulemaking Initiatives

- Maryland:
  - In early February, Democrats in state House and Senate proposed companion financial consumer protection bills that include provisions imposing fiduciary status on broker-dealers, agents, and investment advisers
  - Fiduciary provision was subsequently removed from the House bill
  - Provisions in Senate bill would require these professions to act primarily for the benefit of clients and to disclose commissions received related to advice provided

State-level Fiduciary Rulemaking Initiatives – Possible Preemption Challenges

- ERISA generally prohibits states from passing laws that are similar to or conflict with ERISA
- National Securities Markets Improvement Act preempts (either fully or partially) states from enacting regulations that impose requirements new or different than those under federal securities laws
  - Possible complete preemption with regard to registered investment advisers and possible partial preemption with respect to broker-dealers

State-level Fiduciary Litigation – In the Matter of Scottrade, Inc.

- Administrative complaint filed on February 15, 2018 by Enforcement Section of the Massachusetts Securities Division
- Alleges violations of Massachusetts Uniform Securities Act and regulations issued thereunder
- Contends that Scottrade, a broker-dealer, violated internal DOL fiduciary rule compliance policies by running sales contests involving retirement account clients

State-level Fiduciary Litigation – In the Matter of Scottrade, Inc.

- Complaint alleges only violations of *Massachusetts* law. But the *effect* is to challenge compliance with the DOL Fiduciary Rule and the BIC Exemption.
- Signals that states are stepping in to regulate retirement investment advice market in the absence of current enforcement by DOL or private litigants

State-level Fiduciary Rulemaking Initiatives – In the Matter of Scottrade, Inc.

- If Massachusetts is successful, other states may bring lawsuits to challenge financial institutions' investment advisory activities in light of Rule and BIC Exemption
- Will likely impact DOL's ongoing review of Rule and BIC Exemption
- May spur decision by Fifth Circuit Court of Appeals in *Chamber of Commerce* case

Part: 3

Cybersecurity Issues

Cybersecurity for Retirement Plan Data

- Prevention techniques used to protect integrity of networks, programs and data from attack, damage, or unauthorized access
- Incidents are on the rise; high-profile examples include Equifax; U.S. Office of Personnel Management; and Target
- Risks include: ransomware; phishing; wire transfer e-mail fraud; malware

Cybersecurity for Retirement Plan Data – Types of Data

- Names
- Dates of birth
- Addresses
- Social Security numbers
- Participant compensation
- Financial information

Cybersecurity for Retirement Plan Data – Is Data a Plan Asset?

- *Acosta v. Pacific Enterprises* (9th Cir. 1991): Whether the item in question may be used to benefit the fiduciary at the expense of plan participants or beneficiaries
- *Grindstaff v. Green* (6th Cir. 1998): Asset must have some inherent value, be capable of assignment of value, or otherwise be subject to market forces
- DOL: Ordinary property rights

Cybersecurity for Retirement Plan Data – Protection of Plan Assets

- Plan assets must be protected from theft
- ERISA section 404 applies to plan fiduciaries
- Plan service providers should be current and should support fiduciary cybersecurity efforts
- RFPs

Cybersecurity for Retirement Plan Data – Guidance for ERISA Plans

- 2016 Advisory Council on Employee Welfare and Pension Benefit Plans Report: *"Cybersecurity Considerations for Benefit Plans"*
  - Develop a process to identify risks
  - Create a program to protect data
  - Determine how breaches will be detected
  - Establish a response plan to minimize damage

Cybersecurity for Retirement Plan Data – Guidance for ERISA Plans

- SPARK Institute developed standards to help record keepers communicate to plan consultants, clients and prospects the full capabilities of their cybersecurity systems
  - Includes 16 control objectives

Cybersecurity for Retirement Plan Data – Guidance for ERISA Plans

- AICPA's (American Institute of Certified Public Accountants) Systems and Organizations Controls for Cyber Security:
  - An examination engagement performed in accordance with the AICPA's clarified attestation standards on an entity's cybersecurity risk management program

Cybersecurity for Retirement Plan Data – Guidance for ERISA Plans

- State privacy laws, such as Massachusetts Standards for the Protection of Personal Information of Residents of the Commonwealth (201 CMR 17.04)
- Questions regarding preemption

Cybersecurity for Retirement Plan Data – Liability Protection & Insurance

- Inventory and review plan data
- Is all plan data necessary? Is a "data diet" feasible/appropriate?
- Who has access to plan data?

Cybersecurity for Retirement Plan Data – Liability Protection & Insurance

- Greatest risk for plan fiduciaries lies in improper selection and monitoring of service providers
- Do service provider contracts contain notice provisions and outline liability of provider for data breaches?
- Do contracts address cybersecurity readiness? Has the provider adopted the SPARK Institute's best practices, satisfied the GLBA standards, or complied with AICPA standards?

Cybersecurity for Retirement Plan Data – Liability Protection & Insurance

- Fiduciary insurance is triggered when a lawsuit is filed
- Cyberinsurance is triggered by a data breach

Part: 4

ERISA "Stock Drop" Litigation Trends

ERISA "Stock Drop" Litigation Trends

- Until 2014, most courts applied a "presumption of prudence" standard to fiduciaries regarding decisions concerning company stock
- The result was that, in cases where company stock *could* be offered, plaintiffs had to demonstrate an abuse of discretion to succeed in fiduciary breach claims

ERISA "Stock Drop" Litigation Trends

- The Supreme Court's 2014 *Dudenhoeffer* decision rejected the "presumption of prudence" and effectively created two standards for "stock drop" cases:
  - Claims based on public information
  - Claims based on non-public (inside) information

ERISA "Stock Drop" Litigation Trends

- Claims based on **public** information:
  - Plaintiffs must demonstrate "special circumstances" that made market price unreliable;
  - otherwise, allegations that a fiduciary should have recognized from publicly available information that the market was overvaluing or undervaluing stock are generally viewed as implausible

ERISA "Stock Drop" Litigation Trends

- Claims based on **non-public** (inside) information:
  - Plaintiffs must allege:
    (1) an alternative action that the fiduciary could have taken consistent with securities laws; and
    (2) a prudent fiduciary in the same circumstances could not have concluded that the alternative action would do more harm than good to plan participants

ERISA "Stock Drop" Litigation Trends – Public Information Claims

- Many courts (e.g., Second, Sixth, and DC Circuits) are applying the general rule of "implausibility" to claims that a stock's price is artificially inflated and to claims that a stock is excessively risky
- Thus, plaintiffs must generally allege "special circumstances" in order to succeed
- Plaintiffs have been relatively unsuccessful in demonstrating "special circumstances"

ERISA "Stock Drop" Litigation Trends – Public Information Claims

- *Dudenhoeffer* did not say what "special circumstances" means, other than to suggest that such circumstances would be those that call into question the reliability of the publicly-traded price
- Several courts have narrowly construed "special circumstances," making it difficult for plaintiffs to succeed

ERISA "Stock Drop" Litigation Trends – Public Information Claims

- The Eleventh Circuit has suggested that the standard is very high and that only conduct such as fraud, improper accounting, and other illegal acts might meet the standard
- In the *Lehman Brothers* stock drop litigation, the Second Circuit held that even an order issued by the SEC largely prohibiting short selling of Lehman stock during the financial crisis did not constitute a "special circumstance"

ERISA "Stock Drop" Litigation Trends – Public Information Claims

- Importantly, courts have been reluctant to accept that "special circumstances" exist based on a company's financial distress (including the risk of bankruptcy and general risk profile)
- For example, in *RadioShack*, the court found that the company's decline into bankruptcy did not constitute a "special circumstance" that would make the market price unreliable or artificially inflated

ERISA "Stock Drop" Litigation Trends – Non-Public Information Claims

- Plaintiffs are not widely succeeding on claims based on non-public, inside information relating to public company stock held in defined contribution plans
- Many plaintiffs have failed to convince courts that alternative courses of action consistent with federal securities laws exist

ERISA "Stock Drop" Litigation Trends – Non-Public Information Claims

- Courts are generally refusing to accept that halting additional stock purchases or disclosing non-public information to the market would be consistent with the securities laws
- For example, in the *HP* stock drop litigation, the court held that restricting additional investments in HP stock or publicly disclosing inside information about improper accounting practices would be inconsistent with the federal securities laws

ERISA "Stock Drop" Litigation Trends – Non-Public Information Claims

- Moreover, courts are not convinced that prudent fiduciaries in similar situations could not have concluded that such actions would do more harm than good to the plan
- In the *IBM* stock drop litigation, the court agreed that certain public disclosures to correct misinformation could be consistent with the securities laws but was not convinced that a prudent fiduciary could not have concluded that action would cause "more harm than good" to the plan

ERISA "Stock Drop" Litigation Trends – Non-Public Information Claims

- A recent Fifth Circuit decision regarding BP stock has made the standard for succeeding on a non-public claim even more difficult
- Specifically, per the Fifth Circuit, the standard requires demonstrating a course of action that is "so clearly beneficial" that a prudent fiduciary could not conclude that it would be more likely to harm rather than help the plan
- The requirement to demonstrate that an alternative course of action is "beneficial," as opposed to only showing that it is not harmful to the plan, would make the standard significantly more difficult for plaintiffs

Part: 5

Plan Sponsor Fee Litigation Trends

Plan Sponsor Fee Litigation

- Recently, a number of "excessive fee" lawsuits have been brought against defined contribution retirement plan sponsors, alleging:
  - Excessive or hidden fees
  - Improper selection or monitoring of investment options
  - Revenue sharing and other alleged self-dealing transactions

Plan Sponsor Fee Litigation – Types of Lawsuits

- Lawsuits against large corporate plan sponsors challenging fees and expenses associated with employee plans
- Allege breaches of ERISA fiduciary duties based on plan sponsor's selection of investment vehicles and receipt of revenue sharing payments
- Allege that investment options are overly expensive, underperforming, and imprudent, compared to available alternatives

Plan Sponsor Fee Litigation – Types of Lawsuits

- Lawsuits against financial institutions who also are plan sponsors
- Claims are similar to those in general excessive fee cases, but also allege that plan sponsors used affiliated investment products and service providers to increase the financial institution's revenue
- Allege these actions breach ERISA fiduciary duties and constitute ERISA prohibited transactions

Plan Sponsor Fee Litigation – Types of Lawsuits

- Lawsuits involving university-sponsored IRC section 403(b) plans (retirement plans for public school employees, employees of tax-exempt organizations, and ministers)
- Claims are similar to those in general excessive fee cases – that plan fiduciaries breached fiduciary duties by offering large, complex investment lineups with expensive, duplicative, and poorly-performing options

Plan Sponsor Fee Litigation Examples – *White v. Chevron*

- No. 4:16-cv-00793 (N.D. Cal., decided May 31, 2017)
- Plaintiffs alleged that value of 401(k) retirement accounts would have been higher had Chevron acted more prudently and chosen funds with higher returns or lower administrative and management fees
- Plaintiffs alleged that plan fiduciaries breached their fiduciary duties by offering high-fee funds and paying excessive fees to record-keeper

Plan Sponsor Fee Litigation Examples – *White v. Chevron*

- Court found that plaintiffs' complaint needed to plead facts relating to plan sponsor's failure to investigate the appropriateness of the various funds and to plead facts regarding lack of process for choosing funds but that plaintiffs failed to do so
- Emphasis is on fiduciaries' reasoned decision-making process (or lack thereof)

Plan Sponsor Fee Litigation Examples – *Brotherston v. Putnam Invs., LLC*

- No. 1:15-cv-13825 (D. Mass., decided June 19, 2017)
- Plaintiffs alleged breach of fiduciary duties of loyalty and prudence, failure to monitor, and other equitable relief based on ill-gotten proceeds, by stacking investment line-up with all Putnam funds
- Putnam pointed to its actions that cost considerable money and dwarfed revenue received from the plan

Plan Sponsor Fee Litigation Examples – *Brotherston v. Putnam Invs., LLC*

- Court said Putnam's expenditures did not eliminate possibility of fiduciary breach
- However, plaintiffs failed to allege specific circumstances in which Putnam put its own interest ahead of the plan's – pointing to self-dealing alone was not sufficient to demonstrate a breach of duty

Plan Sponsor Fee Litigation Examples – *Brotherston v. Putnam Invs., LLC*

- Plaintiffs also alleged that Putnam breached its duty of prudence by failing to monitor costs and performance of plan investments

- Putnam countered that its Investment Division monitored the performance of all of its funds, including those in which the plan was invested

Plan Sponsor Fee Litigation Examples – *Brotherston v. Putnam Invs., LLC*

- Court said that the fact that Putnam monitored all such investments was not a sufficient process to review plan investments
- But court ultimately decided in favor of Putnam because it found that plaintiffs failed to articulate how Putnam's alleged breaches resulted in losses to the plan
- Emphasis is on prudent process and causation

Plan Sponsor Fee Litigation Examples – *Sweda v. Univ. of Penn.*

- No. 2:16-cv-04329 (E.D. Pa., decided September 21, 2017)
- First school to defeat an "excessive fee" case challenging its plan investment lineup and associated fees
- Court looked to Third Circuit's ruling in *Renfro v. Unisys Corp.*, which held that courts must evaluate the plausibility of claims against a backdrop of the reasonableness of the mix and range of investment options

Plan Sponsor Fee Litigation Examples – *Sweda v. Univ. of Penn.*

- Here, court concluded that plaintiffs' excessive fee argument was invalid because there was a reasonable mix and range of fee options in the plan
- Court held that plan fiduciaries are not required to focus on the singular goal of lower fees
- Court also rejected the notion that a fiduciary can breach its duty by offering *too many* investment options, noting that plaintiffs failed to identify any participants who were confused by the plan's investment lineup
- But court made clear that 403(b) plans will be judged by 401(k) plan standards

Questions?

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