QUALIFIED PLAN
ADVOCATE NEWSLETTER

February: Lessons From Litigation: Trio of Recent Cases Highlights Ongoing Issues

Fiduciaries have had a lot of opportunities to learn more about their responsibilities over the past several years. We're now more than eight years past the settlement in Wal-Mart v. Braden, more than seven years past the effective date of the 408(b)(2) regulations and the initial award of damages in Tussey v. ABB, Inc., and nearly five years removed from the United States Supreme Court's Tibble v. Edison Int'l opinion. Moreover, the last several years of developments occurred against the backdrop of the on-again, off-again Department of Labor fiduciary rule.

Yet a trio of recent 401(k) fee lawsuits reflects that many retirement plans - large ones, in fact - continue to operate under an outdated framework that presents risks to participants and fiduciaries. This month's newsletter recaps the lessons we can learn from those cases.

Harmon v. Shell Oil Co. This lawsuit relates to a mega plan - the kind of plan that we would expect to have moved beyond these age-old issues. The nation's leading 401(k) fee litigation plaintiff's firm alleges in the complaint, however, that the plan sponsor failed to evolve with the marketplace. Here is the recurring argument, in a nutshell, from the complaint:

Multi-billion-dollar-defined contribution plans, like the Plan, have tremendous bargaining power to obtain high-quality, low-cost administrative, managed account, and investment management services. But instead of using the Plan's bargaining power to benefit participants and beneficiaries, Shell Defendants allowed unreasonable expenses to be charged to participants for administration of the Plan and managed account services, failed to even monitor numerous funds in the Plan at all, and retained poorly performing investments that similarly situated fiduciaries removed from their plans.

More specifically, the complaint asserts that, despite the plan's assets exceeding $10.5 billion, the plan fiduciaries:

- retained over 300 designated investment options, most of which were the recordkeeper's proprietary products;
- permitted the recordkeeper to automatically make available those funds, without any initial screening performed by the fiduciaries;
- retained this "haphazard" menu of investment options without conducting ongoing quantitative or qualitative monitoring;
- failed to perform a recordkeeper benchmarking exercise; and
- as a result of those failures, cost the participants millions of dollars.

Marks v. Trader Joe's Co. By comparison, Trader Joe's plan of roughly $1.6 billion in plan assets may seem small. But plaintiffs assert that it features some of the same large issues. Among the highlights of this complaint:

- The fiduciaries permitted the plan's recordkeeper to be paid through a combination of direct payments, revenue sharing payments, and the difference between (i) the higher costs of the share classes used, and (ii) the lower costs of the institutional share classes otherwise available.
- This reliance on revenue sharing and retaining expensive share classes resulted in excessive fees, perhaps as high as $140 per participant per year compared to an alleged market rate closer to $40 per participant.
- The fiduciaries failed to undertake a competitive recordkeeper benchmarking exercise.
- All the while, the fiduciaries failed to "monitor and control" recordkeeping costs.

Glasscock v. Serco, Inc. The third of the three recent lawsuits takes yet another step down in terms of plan size (to around $335 million), but diligently addresses some investment and structural issues that apparently continue to run rampant. In particular, the Serco complaint alleges:

- Of the plan's 30 investment options, 21 offered a cheaper share class from the one selected by the plan, as detailed line-by-line in a two-and-a-half page chart.
- Each of those 21 options delivered superior investment performance than the more expensive version used in the plan, as also detailed in a lengthy chart.
- The plan's recordkeeping expenses were also excessive, arguably greater than over 90% of comparative plans.
- There is no justification for these higher expenses.

What We Learn. The ongoing litigation highlights that not all fiduciaries have stepped into the era of institutional share class investment options, non-proprietary investment selection, and transparent recordkeeping not dependent on revenue sharing. In days gone by, the use of high-cost proprietary funds seemed to make sense, in part because many simply did not - and, due to a lack of transparency, arguably could not - know better. But those times have indeed changed. We will watch with great interest as these three large employers defend themselves against the various allegations, particularly because most of the allegations rest upon the absence of a prudent process. Will they be able to present facts supporting the existence of a prudent process? We shall see.

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March: Retirement Plan Trends: How Choppy Markets Highlight Additional Needs

We're in the midst of a challenging time. The spread of the coronavirus has thrown the markets into a period of choppiness not likely to stop anytime soon (discussed in greater detail below). As we work to help participants and fiduciaries to navigate their investments, we also want to keep our eye on longer term trends that predated the virus concerns and may very well continue throughout 2020 and upcoming years.

Alight Report: 2020 Hot Topics in Retirement and Financial Well-being

Alight produces a helpful annual survey that examines hot topics and emerging trends. Its 2020 report aligns with what many of you are experiencing. In particular, it highlighted two key trends:

(1)The breadth and depth of financial well-being programs are expanding. This is happening at an encouraging rate. Employers that have financial wellness programs are finding that financial wellness has become even more important over the last 24 months. The now-in-the-minority number of employers that do not offer a financial wellness program are working on options for instituting one.

We anticipate that these programs will become even more valuable in the face of economic challenges caused by the coronavirus outbreak. On March 9 your employees started their work weeks with plunging stock markets, oil prices, and interest rates. More than at any time in the last decade, they're going to need a plan to feel financially secure.

(2)Employers are taking steps to help people bridge the gap between working and retiring. This challenging transition gets lost in the process. We've focused so much in recent years on the accumulation phase, but employers - and Congress with the SECURE Act - have identified that employees need more help in how they live in retirement. A large part of this will come in the form of greater awareness of their lifetime income needs. Look for more employers to rely on the SECURE Act safe harbor in providing in-plan investment and distribution options intended to provide guaranteed lifetime income.

Invesco Report: Target-Risk and Target-Date InvestmentOptions

Invesco's "The Forgotten Participant" study and its related commentary comes at an important time in US and global markets. The survey finds that defined contribution plan sponsors and service providers have taken positive steps in the form of plan design and default investments. It also finds a deficiency in plans that include target-date, but not target-risk, funds: participants not wanting a purely age-based solution are left to manage their own portfolios (which they don't do very well).

This research supports the growing conventional wisdom that plan participants are best-suited to have access to both age- and risk-based portfolio investment options. Invesco makes clear that it is not harshly judging target-date funds' net positive impact; it recognizes the manner in which target-date funds have provided better diversification and portfolio management to many participants. Yet at the same time, it recognizes that those thinking more deeply about their individual situations are well-served by having risk-based options.

Closing Thoughts

The studies discussed above were interesting the day they were published. But they've become more interesting with each passing day, as public awareness and fear grow, and as employees continue to demonstrate their need for financial help. Alight's trends - expanding wellness and thinking more about retirement income options - are likely to pick up as a result of the coronavirus concerns. Furthermore, as those defaulted into target-date funds experience potential market drops, they may very well gain more appreciation for the value in assessing their particular risk level and investing accordingly. We welcome any questions about how QPA and Financial Fitness for Life services might help to meet the demand for those solutions.

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April: CARES Act Update: What We Are Learning and What Remains Unanswered

There are times when it's an exaggeration to call something "unprecedented". This is not one of those times. Despite every week feeling like a year, everything else seems to develop and change so quickly. All around the world, people are making decisions without all the answers and doing the best they can with the information they have. The retirement plan provisions of the CARES Act present such a situation.

QPA's CARES Act Summary provides an overview of the four major sections of the Act. This article will provide a practical update regarding the implementation of those provisions. When you review the following commentary, please bear in mind the application of the "qualified individual" requirement for the loan and coronavirus-related provisions (that is, in general terms, those provisions are only available for a participant who can self-certify that he or she has been impacted by COVID-19).

Recordkeeper Approaches

Recordkeepers faced a tough situation here. There is a sense of urgency for those participants who need access to funds. Yet the CARES Act left many questions unanswered. And it's not as if recordkeepers could stop the world from spinning so they could get all plan sponsors to prioritize their decisions around the Act's provisions.

As a result, recordkeepers were all over the map on their approach. Some established a default that required plan sponsors to "opt out" of some or all provisions under a tight deadline. Some applied that urgent "opt out" process to only the coronavirus-related distribution option. Others took an "opt in" approach that requires plan sponsor action. Another group interpreted some provisions as optional and others as mandatory, which created a different set of opt in or opt out iterations.

Recommendation: As a threshold matter, be sure your organization can answer these questions: (1) have we already made an election or been deemed to have made an election? (2) if so, what did we elect? (3) if not, do we have a deadline upcoming? (4) if not, do we want to explore the provisions and take action to implement one or more of the CARES Act features?

Deferral of Payments on Existing Loans

This one presents the greatest mechanical uncertainty. Most recordkeepers/TPAs interpret this as an optional provision that permits the plan sponsor to choose whether to make it available. There is history suggesting the IRS will agree with that approach. A minority of recordkeepers/TPAs viewed this as an option plan sponsors must make available to participants with outstanding loans.

In either case, there are unanswered questions regarding the date on which payments would restart in 2021 and whether participants might find themselves making double payments once the CARES Act relief expires. On the more immediate front, many of you might be waiting for your recordkeeper or TPA to give you the go-ahead to suspend repayments for upcoming payrolls.

Recommendation: Pay close attention to the instructions your recordkeeper or TPA recently provided or will be providing in upcoming days. In doing so, appreciate that the service provider may be in a position to help you initiate this feature (should you desire to do so), but may not yet have all the answers to "what happens next year?" We are hopeful that the IRS provides some interpretive guidance very soon.

Increased Loan Ceiling

This one presents the least mechanical uncertainty. It simply increases the ceiling on new loans for the 180-day period following the March 27 CARES Act effective date.

Recommendation: Take special note of the overlap between the 2020 loan repayment deferral provision (discussed above) and this increase in the loan ceiling: the repayment deferral provision also applies to larger loans taken out under the CARES Act's higher ceiling. In addition, be prepared for questions from participants who have already met the maximum number of loans available under your plan. Those individuals will not have access to the higher loan ceiling if they are not otherwise eligible to take a loan.

$100,000 Distribution Option

Media headlines did not help plan sponsors in regard to this distribution option. They painted a picture of broad availability, leaving many participants to believe that they could certainly withdraw up to $100,000 from their plans. Not only is that an inaccurate picture because of the "qualifying individual" requirements, but it also ignores the threshold question: does an employer want to make this option available?

The answer is unique to your organization. For some, it makes perfect sense. For others, it is not even up for consideration. Somewhere in the middle, many have decided to take a wait-and-see approach.

Recommendation: Feel comfortable in knowing that employers across the country have struggled with the appropriateness of this option. A plan is intended as a "retirement" plan, yet many employees have immediate needs. The conflict between those issues, as well as uncertainty regarding upcoming economic developments and the complexity involved in the tax reporting, led to a lot of different approaches. Choose the one that is best for your company and ignore any discussion point suggesting that "everyone" has made the same decision here.

Closing Thoughts

The CARES Act brought about a timely opportunity for trustees, committee members, or HR representatives to gather for a plan-related discussion. The greatest benefit of that gathering may not have been the CARES Act dialogue; it may have been the opportunity to discuss the bigger picture of what your employees are facing and what they need. This is truly an unprecedented time, and we realize that many of you are working harder than ever before. If we can help to arm you with additional information or resources to help with the circumstances you are facing, please don't hesitate to reach out to any of us at QPA.

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