Insights, News & Events

REDUCING YOUR 401(K) LITIGATION RISKS – 10 QUESTIONS EMPLOYERS NEED TO ASK ASAP

Insights
Oct 14, 2022

Here's the scenario:

> Your company has had a 401(k) plan for the past 25 years. Employees appreciate the retirement benefit, and it seems to be operating well with very few questions or concerns from your employees. You're the Human Resources Manager and your CFO asks you if the company should be concerned about the rash of 401(k) lawsuits she's been reading about in her news feeds. She wants to know if your plan is in "good shape?" How do you know what "good shape" even means – and what risks do you run if it's not?

Dozens of lawsuits have been filed over the past 12 months challenging 401(k) plan sponsors for allegedly breaching their fiduciary duty – this after the Supreme Court issued a ruling highlighting the need to monitor plan investment options. The complaints typically allege a breach of fiduciary duty for failing to prudently manage the investment options, allowing excessive fees, and generally failing to carry out their oversight duties with sufficient care, skill, and diligence of a prudent person. If successful, these cases can result in hundreds of millions of dollars in damages and attorneys' fees.

The Standard

The decision to establish a 401(k) plan is a business decision. Companies are free to create a plan using their independent business judgment. However, once the plan is established, decisions regarding the operation of the plan

Related People

Raymond W. Perez
Of Counsel

Ron M. Pierce
Of Counsel
303.218.3626

are governed by the fiduciary obligation to act in the best interests of the plan participants.

ERISA defines the 401(k) fiduciary obligations as:

- acting solely in the interest of the participants and their beneficiaries;
- acting for the exclusive purpose of providing benefits to workers participating in the plan and their beneficiaries, and defraying reasonable expenses of the plan;
- carrying out duties with the care, skill, prudence, and diligence of a prudent person familiar with the matters;
- following the plan documents; and
- diversifying plan investments.

10 Critical Questions

Based on these requirements, here are 10 critical questions you need to ask to confirm compliance with these standards:

1. **Does your company have a 401(k) committee which oversees the plan?**

   Effective governance typically requires an appointed committee with responsibility for overseeing the plan and which is designated as the plan fiduciary. The committee is typically responsible for overseeing the plan investment alternatives, selecting plan administrators, and monitoring investment performance, fees, and expenses.

2. **Does the committee have effective governance documents?**

   Most committees should have a charter which grants it authority to manage the plan and sets forth how members are selected, the length of their terms, and similar matters. In addition, an Investment Policy Statement (IPS) is an essential tool to establish performance criteria for performance options, actions the committee will take when performance fails to meet expectations and processes for ongoing review. Prudent oversight also entails maintaining minutes from committee meetings

Service Focus

Employee Benefits and Tax

Litigation and Trials

documenting decision-making and compliance with the IPS.

3. **Does the committee have signed agreements with financial advisors, third party administrators, and recordkeepers?**

   Signed agreements are crucial to understanding the role of each provider, expected deliverables, the precise fee arrangements, and whether or not the provider is a plan fiduciary.

4. **Have the committee members been trained?**

   Training on basic 401(k) concepts and operational issues helps ensure that the committee members are exercising "care, skill, and prudence" in the performance of their duties. Each committee member should understand that their obligations are to act primarily for the benefit of the plan participants and not the company.

5. **Does the committee conduct regular reviews of the 401(k) providers and consultants?**

   Committees should regularly review the fees and services provided by the plan administrator and recordkeepers – as well as consultants. The assessment should confirm that the quality of the services provided as well as the competitiveness of the fees charged. The committee is not required to select to lowest cost providers. However, the fees must be reasonable. Bidding out services on a periodic basis (once every three to five years) is also an effective method to ensure high quality services at cost competitive fees.

6. **Does the committee review the plan offerings on a continuous basis?**

   It is important to document that the committee is monitoring plan performance on a continuous basis to ensure there are no changes or events which would impact the suitability of the investment alternatives. In addition, ongoing monitoring is necessary to ensure that the plan offers a diversified mix of offerings to meet the plan participants' needs.

7. **Does the committee confirm that it is using the lowest fee options for various investment alternatives?**

It’s not uncommon for investment firms to offer several different classes of identical funds with different fees for the various funds. The committee should have a record that it confirms that there are no lower fees options for the same type of fund offered by the same investment firm. The fees don’t have to be lower than any fees offered by any other competing firm, they must be reasonable.

8. **Does the committee have documented benchmarks for investment options performance?**

   The committee should monitor investment performance relative to established benchmarks. In addition, taking steps to place funds on a “watch list” if performance is unsatisfactory and replacing the fund if performance is unacceptable on a longer-term basis is important to demonstrate prudence in managing the funds. Funds can also change their investment objectives over time. Accordingly, the committee should also monitor the characteristics of the funds to ensure the plan is offering the level of diversification originally intended.

9. **Is the committee providing regular communication and educational opportunities for plan participants?**

   The committee should have a specific plan for providing regular updates to employees. The committee should consider utilizing newsletters and group meetings to explain the operation of the plan and benefits of participating.

10. **Should the analysis of the plan be conducted under the attorney-client privilege?**

    If there are concerns about the governance of the plan, the company may wish to consider conducting the governance assessment under the attorney-client privilege. The privilege does not prevent facts about the operation of the plan from coming to light but does allow the company the opportunity to understand potential legal exposure and address alternatives to address concerns in a confidential setting. The decision to utilize the attorney-client privilege is a case-by-case determination and should be conducted with the advice of counsel.

Conclusion

If you have any questions about how best to effectively administer, and document the administration of, your plans to satisfy fiduciary duties and to limit potential exposure, please contact the authors, your Fisher Phillips attorney, or any member of our Employee Benefits and Tax Practice Group. To ensure you stay up to speed with the latest developments, make sure you are subscribed to Fisher Phillips' Insight System to get the most up-to-date information.