Published on *The National Law Review* https://natlawreview.com

Best Practices for Plan Sponsors #9

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Best Practices: Lessons Learned from Litigation (#2)—the Vanderbilt Case

I am writing two series of articles that together are called "The Bests." One is about Best Practices for Plan Sponsors, while the other is about the Best Interest Standard of Care for Advisors. Each series is numbered separately to make it easier to identify the articles that are most relevant to you.

This is the ninth of the series about Best Practices for Plan Sponsors.

Plan sponsors should be aware of the latest trends in fiduciary litigation in order to manage the risk of being sued and, if sued, of being liable. In my post, Best Practices for Plan Sponsors #8, I discussed the lessons from the settlement of the Anthem case. The Vanderbilt settlement is another example of the importance of using appropriate share classes and of a good process for selecting investments and monitoring service providers. This article discusses the Vanderbilt lawsuit and the conditions in the settlement agreement.

Vanderbilt sponsored a large 403(b) plan (about $3.4 billion in 2014). The complaint alleged that the plan did not take advantage of its size to use lower cost share classes of mutual funds and to negotiate lower costs for its recordkeeper.

The case settled for $14,500,000. While that is an eye-catching dollar amount, the conditions attached to the settlement offer more helpful lessons to plan fiduciaries.

The participants were represented by the Schlichter, Bogart & Denton law firm. As is typical of that firm, the settlement didn't end with the money. Instead, the agreement imposed a number of conditions on the plan and its fiduciaries. Here are some of the most interesting, together with my comments. Keep in mind that this is for a 403(b) plan.

- The participants must be given a disclosure of the fees and performance of their frozen annuity accounts, and the current investment options, and must be given contact information to facilitate transfers.

Comment: This is an issue unique to 403(b) plans. Where annuity accounts are frozen, they may no longer be supported by the plan, and the plan may have changed its investments from individual annuity contracts to a custodial platform or a group annuity contract, which may have lower

investment and administrative costs. This will provide information and services to help participants transfer money from the frozen accounts to the investments offered on the plan's new platform.

- Vanderbilt must conduct a request for proposal (RFP) for recordkeeping and administrative services that includes at least three qualified providers; the recordkeeping fees must be expressed on a per-participant basis.

Comment: The condition is consistent with the claim that the recordkeeping services were too expensive. The monetary settlement is for losses suffered in the past. This condition is to correct that matter on a forward-looking basis. The law doesn't require RFPs; instead, it requires that fiduciaries spend no more than reasonable amounts for services and investments. RFPs are one method for determining reasonableness; benchmarking is another.

- The agreement with the recordkeeper selected by the RFP process must "contractually prohibit the recordkeeper form using information about Plan participants acquired in the course of providing recordkeeping services to the Plan to market or sell products or services unrelated to the Plan to Plan participants unless a request for such products or services is initiated by a Plan participant."

Comment: The Schlichter law firm did not include this condition in earlier settlements and it may foretell the future. The Schlichter firm takes the position that participant information has value and should not be given to the recordkeeper unless the participants agree. This is a developing area and fiduciaries should discuss the implications with their legal counsel.

- Vanderbilt must provide the Schlichter law firm with "the best and final bid amounts that were submitted in response to the RFP and a copy of the agreed-upon contract for record-keeping services."

Comment: This allows the Schlichter firm to oversee the implementation of the conditions in the settlement agreement.

- Vanderbilt must, when evaluating the plan's investments, consider the cost of different share classes available to the plan.

Comment: This shouldn't be a surprise. The failure to look at the lower cost share classes was a fundamental allegation in the complaint and the settlement imposes this "protection" on a going-forward basis. Every plan committee should consider the costs of investments and should investigate whether lower-cost share classes are available to the plan. As a practical matter, most plan committees will need help with this; as a result, committees should work with advisors to ensure that they are properly identifying and selecting the appropriate share classes.

- Vanderbilt must either continue to use its current independent investment consultant, or engage another investment consultant, to provide investment services and information, and the Vanderbilt committee must consider the information provided by the consultants.

Comment: Plan committees need to engage in an informed and prudent process for vetting their plan investments and service providers, including the fees and costs for those products and services. A certain amount of investment industry knowledge is needed to identify and evaluate the right information. As a result, plan committees should work with knowledgeable and experienced advisors.

Concluding Thoughts

As with the Anthem case, the Vanderbilt settlement teaches fiduciaries that they need to pay attention to the share classes of the mutual funds they include in their plans, including private sector 403(b) plans. A committee should devote at least part of one meeting a year to a report by its investment advisor on the share classes of their plan's investments and the share classes that are available to the plan. This is a high risk area and should be treated accordingly, that is, with close attention and care.

Similarly, plan fiduciaries should be attentive to how much the plan is paying its service providers and regularly benchmark those fees to comparable service providers for peer plans. A best practice, and good risk management, would be to dedicate part of at least one meeting a year to reviewing updated information on fees and benchmarks.

National Law Review, Volume IX, Number 162