ECKERT SEAMANS

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EMPLOYEE BENEFITS ALERT

A PERFECT STORM: FEE DISCLOSURE REGULATIONS AND TUSSEY V. ABB, INC.

A perfect storm of potential liability has hit retirement plan fiduciaries: the new participant fee disclosure regulations and the recent federal district court decision in *Tussey v. ABB Inc.*[1]

The Department of Labor recently finalized a regulation requiring plan administrators of participant directed pension plans to make disclosure of "plan-level" and "investment-level" information (including associated fees and expenses) to participants. Plan administrators will need to make these disclosures starting August 30, 2012.

These regulations come just as the federal district court in *Tussey v. ABB, Inc*. awarded plaintiffs damages of $13.4 million for fiduciary breaches relating to the plans' payment of revenue sharing fees. In recent years, many plaintiffs have filed ERISA fiduciary breach actions relating to fees. Often these cases involve revenue sharing. Revenue sharing, also referred to as "alliance rebates," typically occurs when an investment company, often a mutual fund, pays a percentage of its revenue from plan assets to an entity, like a recordkeeper, that services the plan. Plan sponsors often choose revenue sharing arrangements because they appear to reduce direct costs. However, revenue sharing can result indirectly in higher fees and ERISA plaintiffs' litigation relating to revenue sharing has increased in the past few years.

In *Tussey.*, the federal district court determined that the revenue sharing arrangement resulted in the plans overpaying for record keeping services by as much as $136 per participant per year. The court also found that in order to ensure "revenue neutrality" for the recordkeeper, the plan fiduciaries selected investment options with expenses that were higher than other available investment options. This decision may open to door to further fiduciary liability based upon fees paid by plans and fiduciaries should understand the potential risks relating to fees, including revenue sharing arrangements.

In finding the plan fiduciaries liable for these excessive fees, the court focused on the fiduciaries' failure to evaluate and monitor the revenue sharing arrangements with an eye towards to plans' interests. The court acknowledged that revenue sharing is common, and rejected the notion that ERISA plans cannot prudently use revenue sharing or even arrangements that provide recordkeepers with revenue neutrality. But in the court's view, when using such arrangements, plan fiduciaries must undertake a deliberative process to determine if the arrangement benefits the plan and participants, and complies with plan documents.

This decision underscores the critical role of process to ERISA's fiduciary duties. The particular steps a fiduciary must take in selecting and monitoring revenue sharing (or other fees) will vary based upon the facts and circumstances of the plan and the investment. However, at minimum, it will require a fiduciary to understand the plans' direct and indirect fees, evaluate those fees against the market, consider the benefit of such fees to the plan, and monitor them on an ongoing basis.

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[1] *Tussey v. ABB, Inc.,* (No. 2:06-CV-04305, 2010 U.S. Dist. LEXIS 45240 (W.D. Mo. Mar. 31, 2012).

Based upon the recent court decision, fiduciaries dealing with revenue sharing arrangements should consider taking the following steps to satisfy these duties:

- Determine if your plan is using revenue sharing arrangements and if so, understand the services covered by such an arrangement and the fees generated for each service. Compare those fees to the market rate for similar services to ensure that they are reasonable, competitive and solely benefit the plans' interests. If the service provider is earning fees beyond the market rate or performing non-plan services, consider changing the arrangement or seeking a rebate of the overpayment to plan participants' accounts.

- Monitor fees on an ongoing basis. This duty may not be satisfied by merely monitoring expense ratios, because these ratios do not show how revenue is broken down between services.

- Using any leverage the plan has to reduce costs, including recordkeeping costs. For example, if the plan places certain investment options on an investment platform, and the plan has large assets, it should negotiate lower fees by leveraging its size and the fact that the investment option is receiving preferential treatment on the platform.

- If the fiduciary receives notice, including but not limited to from a consultant or other reputable third party, that the plan may be overpaying for recordkeeping services or improperly subsidizing non-plan expenses, the fiduciary should investigate those claims and remedy them.

- Ensure that the articulated rational for a fee arrangement is actually creating the desired benefit for the plan. A justification that benefits the plan sponsor, such as reducing the fees paid by the plan sponsor or creating the appearance that participant fees are lower so as to make the sponsor more desirable to potential employees, is not a valid justification (and in some circumstances, could constitute a prohibited transaction).

The recent district court decision relied in part on the fact that plan documents, including the investment policy statement, explicitly required fiduciary process and cost reductions. The decision therefore leaves open the question of how stringent fiduciary process must be if the plan documents do not impose similar provisions. Nonetheless fiduciaries should protect themselves from possible liability by adopting the procedural steps outlined above to any revenue sharing arrangement, and perhaps any plan fee arrangements.

The recent district court decision also involved fiduciary selection of managed allocation funds, as the court also found the fiduciaries liable for damages of $21.8 million for improperly selecting less prudent investment options. As with fee arrangements, the court emphasized the importance of process to the selection of investment options, holding that when determining which investment option to choose, plan fiduciaries must engage in a deliberative assessment and ensure all investment options comply with plan documents. In the court's view, ERISA does not require fiduciaries "to make the best choice" but to apply prudent decision making and comply with plan documents. To meet these requirements, fiduciaries selecting or removing an investment option

should consider such procedural steps as:

- Comparison shopping among several investment options. Choosing among two or three funds may not be sufficient, particularly if the fund ultimately selected provides a benefit to fiduciary. Comparison shopping should include some substantive research, review or comparison of like funds, and a fiduciary must be able to support its decision with sufficient findings and legitimate analysis. A justification that solely benefits the plan sponsor is not a valid justification (and in some circumstances, could create a prohibited transaction).

The Employee Benefits Alert is intended to keep readers current on matters affecting employee benefits and is not intended to be legal advice. If you have any questions about this alert or any other issues relating to employee benefits, please contact ***Kathryn English*** *at 412.566.1226,* ***Michael Herzog*** *at 412.566.6130,* ***Malgorzata (Gosia) Kosturek*** *at 412.566.6180,* ***Sandra Mihok*** *at 412.566.1903,* ***Brandon Richards*** *at 412.566.1263,* ***Paul Yenerall*** *at 412.566.1944, or* ***Elizabeth Goldberg*** *at 412.566.6016.*

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