

# Pension Plan Fix-It Handbook

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## Follow ERISA Procedures In Plan Administration...or Else!

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Employers and plan administrators fail to follow procedures required under ERISA at their peril. ERISA is a process statute. We have written before about the importance of procedures and the ability to prove that the procedures were followed (see March 2011 newsletter and May 2011 newsletter). A recent decision by the U.S. District Court for the Western District of Missouri serves as the latest reminder to employers and plan administrators that they must follow the rules and fully understand what they are doing in investing and managing funds.

In *Tussey v. ABB, Inc.*, No. 2:06-CV-04305-NKL (W.D. Mo., Mar. 31, 2012), the court found that the plan fiduciaries could not prove that established policies and procedures were followed. The court said the plan fiduciaries breached their fiduciary duties and were jointly and severally liable for: (1) \$13.4 million the plan lost due to failure to monitor recordkeeping fees and negotiate rebates and (2) \$21.8 million the plan lost due to mapping one investment fund to another. The court also held the service provider jointly and severally liable for \$1.7 million for lost float income.

This case has received a lot of press and given the upcoming ERISA Section 408(b)(2) and Section 404(a)(5) disclosure requirements, effective on July 1, 2012 and Aug. 30, 2012, respectively, it is worth a read by plan fiduciaries — especially for plans with revenue sharing arrangements.

### Background

The case involved two retirement plans maintained by ABB, Inc. (the company) — the Personal Retirement Investment and the Savings Management Plan (the non-union plan) and the Savings Management Plan for

Represented Employees of ABB, Inc. (the union plan) collectively referred to as the PRISM Plans or the plans.

The Employee Benefits Committee, a three-member committee the company's board appointed to oversee the plans, is the named plan administrator. The pension review committee, also a named plan fiduciary, is responsible for selecting and monitoring the plan's investment operations.

The Pension & Thrift Management Group of ABB, Inc., which acts as the staff of the Pension Review Committee, is charged with recommending fund lineup changes to that committee.

Fidelity Management Trust is the plans' recordkeeper; Fidelity Research is the investment advisor to the Fidelity mutual funds. Fidelity also provides other services to the company; for example, defined benefit, health and welfare and payroll services.

### The Case

The court chose to focus on the following plaintiff complaints:

- failure to monitor recordkeeping costs and negotiate rebates;
- replacing the Vanguard Wellington Fund with Fidelity Freedom Funds;
- the use of more costly share classes when there were less costly options available;
- subsidizing corporate services with the plans' excessive revenue sharing; and
- the use of float.

See *ERISA Procedures*, p. 2

### Investment Policy Statement (IPS)

Key to the court findings is a detailed IPS. ERISA does not require an IPS; however, most plan sponsors maintain one. DOL Interpretive Bulletin §2509.08-2 provides:

The maintenance by an employee benefit plan of a statement of investment policy designed to further the purposes of the plan and its funding policy is consistent with the fiduciary obligations set forth in ERISA Section 401(a)(1)(A).

The Interpretive Bulletin further provides:

For purposes of this document, the term “statement of investment policy” means a written statement that provides the fiduciaries that are responsible for plan investments with guidelines or general instructions concerning various types or categories of investment management decisions....

The IPS in this case was quite specific about changing the investment fund line requiring that revenue sharing be used to offset or reduce the cost of providing administrative services to plan participants as well as the use of the least expensive share class.

In its deliberations, the court found that the company could not prove to the court’s satisfaction that established procedures were followed.

### Revenue Sharing and Recordkeeping Costs

The court found that ABB, Inc. breached its fiduciary duty because it did not monitor recordkeeping costs and failed to comply with the IPS statement providing that rebates are to be used to offset or reduce the cost of providing administrative services to plan participants.

Recordkeeping fees for the plans were initially based on a per-participant fee. Eventually, the recordkeeper was compensated entirely by revenue sharing for the non-union plan and by revenue sharing and a per participant fee for the union plan. With the exception of one fund that paid revenue sharing amounts to the plans, revenue sharing payments were made to Fidelity Trust, which would bill the plans for the one fund that paid the revenue sharing to the plans.

As assets grew, revenue sharing grew regardless of whether services to the plans increased. If assets declined, Fidelity could request additional hard dollar fees based on the recordkeeping contract. The court found that the company never calculated the cost of recordkeeping fees to establish a baseline. As a result the Company was not in a position to determine if Fidelity was

justified in asking for additional fees if the market value of the assets declined.

The court noted that since the company did not benchmark the recordkeeping services before entering into the revenue sharing agreement, it could not leverage the plans’ size to reduce recordkeeping costs. In addition, the company did not investigate costs even when an outside consulting firm advised the company that it was overpaying for recordkeeping and it appeared that the plans were subsidizing corporate services provided by Fidelity.

Fidelity’s own documents demonstrated that the revenue generated from the plans exceeded revenue earned from other Fidelity plans, which may have been obvious to ABB if they had indeed benchmarked recordkeeping services. In fact, Fidelity suggested to the company that Fidelity viewed its delivery of corporate services and plan services to be interconnected.

### Changing the Fund Line-up

The fiduciaries removed the Vanguard Wellington Fund and replaced it with Fidelity Freedom Funds. Per the court order, the Pension Review Committee follows the following process before removing funds:

- 1) Examine a three- to five-year period.
- 2) Determine if there are five years of underperformance.
- 3) If there are five years of underperformance, place the fund on a “watch list” and then remove it from the list in six months.

At a May 2000 committee meeting, the director of the Pension & Thrift Management Group recommended that the plan implement an IPS that was unanimously approved by the committee. The IPS required a managed allocation investment option and the director recommended that a lifestyle fund be added to the lineup.

In September 2000, Fidelity met with the director to discuss pricing and presented three different proposals:

- 1) Fidelity would reduce the recordkeeping fees to zero if Wellington assets were mapped and defaulted to the Freedom Funds and Fidelity’s index funds remained in the lineup.
- 2) If Wellington assets were mapped to the Freedom Funds but Fidelity’s index funds were not retained, the recordkeeping fees would go from \$10 to zero for the non-union plan and \$10 to \$8 in the union plan.

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See *ERISA Procedures*, p. 3

- 3) If Fidelity's index funds were not retained or Wellington assets were not mapped to the Freedom Funds, the recordkeeping fees for the non-union Plan would be \$4 and \$27 for the union Plan.

In November 2000, the Pension Review Committee voted to add the Freedom Funds based on the director's statement that the Pension & Thrift Management Group had performed the research. The court found that "the Group's research was scant and the 'review' by the Committee was cursory."

There is another requirement in ABB's process. The human resources department must agree to hard dollar recordkeeping fees but no sign-off is required when recordkeeping fees are paid through revenue sharing.

The court found that the "recommendation to add the Freedom funds to the Plan's investment platform and remove the Wellington fund despite its excellent performance record was motivated in part by his desire to decrease the fees that ABB was paying and to maintain the appearance that the employees were not paying for the administration...."

Later it was discovered that Fidelity charged additional fees for deciding how to allocate additional funds coming into the Freedom Funds; the director was not aware of this until 2005 resulting in additional fees charged from 2001 to September 2005.

The court found that the Pension & Thrift Management Group and the Pension Review Committee violated their duty of prudence when they failed to follow the IPS and failed to engage in a deliberative assessment when selecting investment funds.

### **Float**

When contributions are made to a plan or when distributions are paid from a plan, it is not unusual for the monies to be deposited in a holding account. For example, contribution amounts are posted to participant accounts based on the plan parameters established in the recordkeeping system. Participant accounts are updated when the amount to be posted to participant accounts matches the amount of contributions deposited. The time spent in the holding account generates income typically referred to as float.

The court case provides a detailed description of how plan assets for plan transactions (contributions, distributions and fund transfers) flow through various accounts. Float is often used to reduce administrative expenses. In this case, the excess of float over any expenses was

distributed pro rata among the investment funds, thereby benefitting all shareholders — not just the plan participants. The court noted that Fidelity Operations made the decision regarding the use of float income.

The court stated that float income earned on plan assets are plan assets and that Fidelity exercised discretion in deciding how to allocate float and thus is a plan fiduciary. Since plan assets were not used for the exclusive benefit of plan participants, Fidelity breached its fiduciary responsibilities.

The court did not find any evidence that ABB was or should have been aware of the unlawful distribution of float income and therefore not liable for Fidelity's breaches.

### **Injunctive Relief**

The court ordered that ABB do the following:

- 1) Within 18 months, use a competitive bidding process to select a recordkeeper. Fidelity can be included in the request for proposal process.
- 2) Negotiate for a reasonable, market price for recordkeeping services.
- 3) Monitor recordkeeping costs in accordance with plan documents and its fiduciary responsibilities to the participants.
- 4) Leverage its size to negotiate for rebates in a revenue-sharing arrangement after determining the dollar amount paid for recordkeeping services.
- 5) Not use a plan recordkeeper to provide any corporate services.
- 6) Choose the share class of investments that has the lowest expense ratio.
- 7) Manage the plans for the exclusive benefit of plan participants and beneficiaries.

The court also ordered that Fidelity not transfer any float income to any entity other than the participants or beneficiaries unless specifically provided otherwise in the plan documents.

### **What this Means**

This ruling reminds employers and plan administrators that they should take the following steps.

- Review your IPS; can you prove that you follow it?
- Follow your plan's IPS. Engage in a deliberative process when evaluating the existing fund

See *ERISA Procedures*, p. 4

## **ERISA Procedures** (continued from p. 3)

line up; do your research and document your findings.

- Revenue sharing is not prohibited but if you have it make sure you understand it. You must understand the cost components of any arrangement; if you

have questions, ask and document the answers. The preamble to the Section 408(b)(2) indicates that the Department of Labor expects plan fiduciaries to read and understand the information provided by covered service providers.

- Benchmark plan expenses.
- Document, document, document decisions. 🏠



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