Trust, But Verify

How do you test fiduciary conformity?

By Roger Levy

Ed Koch, New York's Mayor in the 70s and early 80s, would walk around the city asking his constituents, "How am I doing?" Employers might ask the same question of their retirement plan participants, particularly those in a 401(k) plan. The answer might give them pause. Writing in the John Marshall Law Review in 2008, attorneys at the law firm of Jenner & Block discussed *Coming Developments in ERISA Litigation*. After examining recent court decisions, they concluded with the following:

> *The new challenges that the retirement of Baby Boomers presents to employers and participants have already given rise to new forms of litigation. The precise path of this new litigation is not entirely clear. However, because these new and eventual retirees are likely to closely scrutinize their benefits and the conduct of those who manage their investments, it is very likely that these new forms of litigation put pressure on fiduciaries to closely monitor how they operate, what investments they select, and how they communicate with participants. (41 J. Marshall L. Rev. 1037 (2008))*

Pension Litigation Data.Com has analyzed more than 2,400 ERISA cases filed between January 1, 2005 and August 31, 2008. In their report, (ERISA Litigation Study, April 15, 2009), they indicated that a claim for breach of fiduciary duty was made in 100 percent of the cases, and that in 69 percent of the cases, a claim was included for failure to observe the Prudent Expert standard, the standard by which fiduciary decisions are measured. The study also showed that plaintiffs were successful in the majority of cases unless there was an appeal, in which case more defendants prevailed. But, however you view these results, one must question whether it makes sense as an employer to wait for a lawsuit to find out the answer to the question, "How am I doing?" Shouldn't there be a better and less costly way to find out if you're performing well as a fiduciary? And wouldn't it be more prudent to have the opportunity to correct things before a lawsuit is filed?

The use of benchmarking to meet these needs is gaining support. For example, Fred Reish, a noted ERISA attorney, argues in favor of benchmarking as part of a prudent process and highlights the need to extend benchmarking from an examination of plan costs to other fiduciary decisions such as the services offered by a plan, including investment education, enrollment meetings, and investment advice and management (*Benchmarking as a Part of a Prudent Process*, Reish & Reicher Adviser Report, October 2009, Vol. 4 No. 1).

Types of Benchmarking Tools

Today, retirement plan fiduciaries, particularly those of 401(k) plans, have all kinds of ways to test how their plans compare to others and to include in their examination the features recommended by Fred Reish. For example, pension consultants and other sources publish on a subscription basis comparative data on plan fees and expenses and on plan features such as contribution levels, the use of self-directed brokerage accounts, auto-enrollment, default investments for participants who fail to make an investment election, loan activity, and participant investment advice services, to name a few. Using this published data as a benchmark, employers can make changes to their own plans when they see anomalies. For example, employers can determine when they find that they are paying higher plan costs than others for comparable services or when they offer too many investment options, which can be confusing to participants. Relying on benchmarking to identify opportunities for making corrections and improvements enables employers to make informed and reasoned decisions which, properly recorded, provides evidence of fiduciary procedural prudence.

Taking advantage of technology, benchmarking is now becoming more sophisticated and plan specific. For example, one service offers a fee-based subscription service that benchmarks the data specific to one plan against data from a comparison group of similar plans. Having submitted its own data, the subscriber receives a number of reports in which plan fees are examined in detail, and an examination is also made of the investment lineup structure, plan complexity, participant behavior, the support provided by service providers in relation to fiduciary oversight, and overall participant satisfaction. Use of these reports demonstrates more specific fiduciary procedural prudence than reliance upon generalized survey data, and disclosure of the results may offer some reassurance to participants concerning the management of their plan.

Another benchmarking tool, available online, uses 401(k) plan data extracted from government filings to analyze six data points: total plan costs, company generosity, investment menu quality, participation rates, participant deferrals, and account balances. The resulting analysis is used to calculate an overall plan rating and to provide a snapshot of the shortfall in anticipated retirement income that a participant may expect based on a comparison of that rating with a top rated plan. Offered as a means to increase the retirement security of the American workforce, this online service primarily targets participants and focuses on opportunities for improving plan features. However, because government filings tend to reflect two-year-old data, employers can now upload their current data to the system and acquire a subscription that permits them to customize the selection of plan data against which to perform comparisons, making this benchmarking tool a benefit to employers, as well as participants.

Assisting employers to fulfill their fiduciary responsibilities, benchmarking is shown to be a valuable due diligence resource. It assists employers in selecting and monitoring service providers and in evaluating plan features. However, by its nature, benchmarking is a comparative tool and relies on pooled experience to represent best practices. The inherent assumption is that pooled experience represents an acceptable prudent standard and courts are likely to give it deference absent compelling reasons.

An alternative approach that is more qualitative is to assess an employer's procedural prudence not against the experience of others but against a standard defined by prudent practices founded in legal statute and court decisions. Such an approach requires a fiduciary audit or assessment but provides on a case-specific basis independent verification of an employer's conformity with best practices, and at least one assessment organization offers certification which the employer can publish. Although relatively new, independent verification of fiduciary conformity is gaining acceptance, and it appears to offer a more certain and reliable answer to the question, "How am I doing?"

Conclusion

The fiduciary duties imposed by ERISA are among the highest recognized by law and, given the prospect of increased ERISA litigation, employers would be well advised to get a fiduciary check up. Relying on a favorite adage of Ronald Regan, "trust, but verify," employers may assume that they are meeting their fiduciary responsibilities, but they had better verify this if they are to avoid the risk of lawsuits. In this article, we have examined some of the opportunities available to employers to test the prudence of their fiduciary process. Many employers already take advantage of these opportunities. The remainder must consider the potential cost of ignoring them.

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