WINIECKI WEALTH MANAGEMENT

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# 401(k) Fiduciary Newsletter

*for Business Owners, Human Resource Directors, CFO's, Plan Fiduciaries and Administrators*

# New 401(k) suits, new lessons

**Numerous financial firms have been sued recently for using their own products in their own 401(k) plans.**

**We don't have to have hundreds of millions in assets to learn lessons from this growing area of litigation.**

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Financial firm Neuberger Berman (NB) has a few thousand employees and an $800 million 401(k) plan. As of last week, NB is also defending a breach of fiduciary duty suit. *Newberger Berman Latest Financial Firm to Be Hit With 401(k) Suit,* Anne Tergesen, August 5, 2016, http://www.wsj.com/articles/neuberger-berman-latest-financial-firm-to-be-hit-with-401-k-suit-1470413580. Citing poor performance and high fund fees, the plaintiffs seek class action status and over $150,000,000 plus attorneys fees.

What are the takeaways?

**The Alleged Breach**

Plaintiffs assert that NB failed in its duties to act solely in the best interests of its employees by using its own Neuberger Berman Value Equity Fund (Value Fund). According to the complaint, that fund returned 4.7% over the last five years, which lagged far behind the S&P 500 benchmark index which returned 12.1%. The plaintiffs also claim that the .80% fee charged on the Value Fund was unreasonable, since one could purchase an index of the S&P 500 for .02% through a different company.

Regardless of the outcome (where even if NB wins, it has already lost by being sued), all plans can learn a lot from the suit as it stands now.

**Red Flag # 1: Underperformance**

Employees are miffed by underperforming funds, and with all the data available, it is one of the first items an attorney investigates. Funds can be evaluated on many different criteria, but perhaps the most important is performance. One can argue about the appropriate comparative benchmark or the period of time over which a fund should be examined, but if a fund scores low in all or nearly all categories regardless of the benchmark or period, any fiduciary can be in trouble.

To comply with ERISA, a fiduciary must have an objective process to select funds. Because a fiduciary' has an ongoing duty to monitor funds, the job continues as long as the plan is in place.

In NB's case, the underperformance of the Value Fund is a problem for NB, although they will certainly argue that a more appropriate benchmark should be some type of actively-managed value funds. Because the particular fund in this case seems to be developed particularly for NB (or for a select group of 401(k) plans), I found little information on the Value Fund.

**Red Flag # 2: Fees**

Available data also allows for relatively easy fee comparisons. For such a big plan, an expense ratio of .80% may seem high for a value fund's expense ratio. However, if .80% is the lowest cost NB offers for that fund, it may be reasonable. Of course, paying a high fee for years of underperformance may not be reasonable. That is a question of fact.

**Red Flag # 3: Conflicts**

Everyone recognizes that in using its own fund, NB benefits immensely. Put into dollars, according to WSJ, the fees generated by the Value Fund allegedly exceed $20,000,000 from 2010 to 2015. While every fund should be used based on its own merit, courts will likely view conflicts of interest that benefit the fiduciary (or the fiduciary's company) as a strike against the defense. In 2014, over $450 million (over half the assets) were in the Value Fund.

In this case, had NB used a fund that did not benefit NB, the underperformance and high fee argument would likely be perceived as significantly weaker. According to the Wall Street Journal article, plaintiff attorney Mark Boyko stated that financial services firms should be aware that "if you are receiving fees from your own employees' retirement savings plans, that's going to create litigation risk."

This risk applies to all plans. Service providers who use their own funds create a conflict of interest that will be scrutinized much more closely than those who are truly independent of the investments offered. The new 401(k) rules that go into effect next year continue to allow service providers to use their own products, but they will have to jump through many hoops to do it. Nevertheless, regardless of how many hoops are cleared, having a conflict of interest when selecting funds will almost certainly increase litigation risk.

**What to Avoid and How**

401(k) plan fiduciaries should seek to avoid underperforming funds, high fees and conflicts of interest. Each of these raises the possibility of disappointed employees and running afoul of ERISA rules.

The Department of Labor emphasizes that plan fiduciaries should select service providers and funds in an objective way, setting up a prudent process to do so. The process should focus on objective criteria and should probably avoid funds with relationships with service providers. A thorough understanding of how your service providers are related to (and possibly paid by) the funds in your plan is paramount to reducing litigation risks.