

## 401(k) Fiduciary Duties Will Be Turned Upside-Down When A Knowledgeable Class Action Lawyer Tells A Good Story

*The difficulty lies not so much in developing new ideas  
as in escaping from old ones.*

—John Maynard Keynes

ERISA litigators are now recognizing that 401(k) excessive fee suits are not going away in spite of the decision in *Hecker v. Deere*. Their reasoning is simple:

- The defendants won primarily due to the ineptness of the plaintiffs' counsel rather than on the merits of their position and the skill of their legal counsel.
- The current and projected high level of unemployment will encourage class action lawyers to seek out angry and financially strapped (unemployed) workers who view the “deep pockets” of their (former) employer or provider as a way out of their financial bind.
- Knowledgeable plaintiffs' attorneys will be able to capitalize on the ambiguities in both ERISA and the regulations regarding the fiduciary duties of loyalty, prudence, and disclosure. To make matters worse, these fiduciary duties are defined by “facts and circumstances”.

Facts and circumstances have changed a lot over the last 36 years thanks to (widely publicized) research on the average American worker's attitudes and abilities regarding investing/retirement planning, his actual behavior in 401(k) plans, and his decision-making processes. In spite of all of these advances, most fiduciaries and essentially all providers use industry standards that were established when 401(k) plans were in their infancy (as evidenced by the quarterly and annual plan utilization reports recordkeepers give fiduciaries).

- Convincing arguments can be made that much, if not all, of the rationale for using actively managed investment options and for relying on so-called “generally accepted investment principles” resides in sales and marketing hype rather than in demonstrable reality.
- Given that both conservative jurist and legal thinker Richard Posner<sup>1</sup> and progressive legal scholar Elizabeth Warren<sup>2</sup> have arrived at essentially the same conclusion—the financial services industry needs regulation to prevent the public from being “taken to the cleaners”—it is foolish for any fiduciary or plan sponsor to think that if they are sued, the “cards will be stacked” in favor of a dismissal.

All 401(k) fiduciaries, but especially those of large and medium-sized plans (1,000 or more participants), must reevaluate their relationships with all their providers, including the value proposition that their participants receive for the fees they pay.

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<sup>1</sup> Richard A. Posner, *The Crisis of Capitalist Democracy*, Harvard UP, Cambridge, Massachusetts, 2010, p.2.

<sup>2</sup> Elizabeth Warren, *The Middle Class on the Precipice: Rising financial risks for American families*, Harvard Magazine, January-February 2006.

401(k) fiduciaries must address:

- the reality that Wall Street (this term encompasses all financial service firms) puts its profit goals ahead of the needs and best interests of its clients;
- the conflicts of interests that plague Wall Street (and your outside ERISA counsel when they also represent recordkeepers and investment advisors);
- the reality that financial innovation is routinely based upon flawed models such as those that led to the implosion of 2010 target-date funds in 2008 and were major contributors (credit derivatives) to the housing bubble;
- the reality that so-called “generally accepted investment principles” may only reflect what occurred in the past (“data mining”) and have little bearing on what may happen in the future since the United States and the rest of the world are undergoing major structural economic realignments;
- the reality that the use of advanced mathematics and statistics cannot convert economics into a “hard” science, like physics and chemistry, with “laws” that can accurately predict future outcomes. Milton Friedman and Alan Greenspan have been “dethroned”, Keynes’s argument for the need for regulation is in-vogue, and Hyman Minsky is being taken seriously (apparent stability breeds instability).

The first step in implementing effective 401(k) risk management is to stop asking: “Is it likely that we will be sued?” and ask: “Will we be able to demonstrate that we ran our plan as a well-informed person would with the goal of helping our employees achieve a financially secure and comfortable retirement?”

For defense counsel to make a convincing argument in the hope of getting the case dismissed, fiduciaries need a paper trail which documents:

- the value proposition that the participants are to receive for the fees they pay;
- that the employees were told the 401(k) plan is only a tool that they must use wisely if they hope to achieve their retirement dreams;
- that participant communications were designed to be easily understood by the average employee and were not framed (“sugar coated”) to mask the required contribution rates and the frailties of the assumptions used to generate these rates;
- their monitoring of the effectiveness of their decisions and the products and services of their providers and the steps taken when past approaches were shown to be ineffective.

Enabling fiduciaries to have an effective paper trail and making them, in the eyes of a class action attorney, a less attractive target than the “guy next door” is Investment Horizons’ value proposition.