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News & Types: Employment, Labor & Benefits Update

401(k) Service Providers Owe No Fiduciary Duty with Respect to Negotiating Their Fee Compensation

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Practices: Employment, Labor & Benefits

EXECUTIVE SUMMARY

Following the findings expressed in three other Circuits, the United States Court of Appeals for the Ninth Circuit recently held that plan administrators (e.g., Transamerica, Prudential, Fidelity, Principal) are not ERISA fiduciaries when negotiating their own compensation with prospective customers. Instead, because the employer/plan sponsor has the express duty under ERISA to defray reasonable expenses of administering a 401(k) plan, any claims that fully disclosed fee arrangements are unreasonable "lie against the employer, not the service provider."

In the underlying case, plaintiffs who were members of employer-supported 401(k) plans filed a complaint alleging that Transamerica Life Insurance Company violated ERISA by (1) charging fees on the separate accounts in addition to those charged by the managers of the underlying investments; (2) charging an investment management charge; (3) receiving revenue sharing payments from managers of the underlying investments; (4) failing to invest in the lowest priced share class of mutual funds that underlie the separate account investment options which invest in the mutual funds; and (5) negotiating the traditional lower fees that are associated with these investment options but retaining the savings rather than passing them along to the plaintiffs. In denying defendants' motion to dismiss, the district court held that the plan service providers breached their fiduciary duties to plan beneficiaries when they negotiated with employers about providing services to their plans and then later withdrew predetermined fees from plan funds.

On appeal, the Ninth Circuit panel noted that "an employer that forms an ERISA plan is a statutory fiduciary," and that other non-named parties (e.g., Transamerica) can be considered "functional fiduciaries" if they exercise certain discretionary authority or control over certain aspects of the 401(k) plan. Here, the Ninth Circuit stated that "[w]hen it was negotiating with employers, Transamerica did not exercise discretionary control over the plan, possess any authority over its assets, render investment advice, nor have any discretionary authority in the administration of the plan." The Court went on to say, "If service providers were

fiduciaries while negotiating fees, they would have to promise that its fees were no higher than those of any competitor, rather than negotiate at arm's length with an employer."

Action Steps: As plan fiduciaries, employers/plan sponsors are responsible for ensuring that all "direct" and "indirect" fees charged by service providers are reasonable. Although plan fees are regularly disclosed by service providers, they remain a mystery for many employers/plan sponsors and difficult to understand. As a result, we recommend that clients engage the services of an investment advisor to better understand "all of the fees being charged." Although we often hear that a given plan service provider is doing an excellent job administering the 401(k) plan, we urge clients to withhold that determination until a comprehensive review of all fees and funds is completed.