Litigation and Legislation Highlights

Litigation

1998 The first class action ERISA suit.

By 2005, over 11,000 suits had been filed.

2004 Enron

A court forced former outside directors of Enron to pay damages personally, and no insurance allowed.

2007 The Merrill Lynch Ruling

The "Merrill Lynch" ruling distinguished the liability difference between a broker and an adviser.

Under a 2005 Securities and Exchange Commission (SEC) rule brokers could charge clients fees for "incidental" advice without having to be registered as Registered Investment Advisers (RIA). The Financial Planning Association sued the SEC and every big broker dealer in the industry; ("Merrill Lynch" became the nickname of the case) because under the "incidental advice" rule brokers could charge fees for advice without having to take the personal fiduciary liability that RIAs take for giving advice.

The court ruled in favor of the Financial Planning Association requiring brokers that charge for advice to be also licensed as an RIA. As a result, today brokers who charge for advice must be dual licensed as both a broker and an RIA.

Dual licensing is today a common arrangement but in the context of a retirement plan it creates co-fiduciary situation in which both the plan fiduciary and the broker dealer would be fiduciaries to the participants advised by the broker. Both have liability for each other's activities and decisions as co-fiduciaries.

2007 Kanawi v Bechtel Corp.

In response to this participant class action, Bechtel asked the court to dismiss the suit arguing that the plan was in compliance with ERISA and Department of Labor (DOL) regulations.

- The judge denied the motion ruling that compliance with ERISA and the DOL is not the issue in a participant's suit about breach of fiduciary duty.

2008 LaRue Ruling

The Supreme Court ruled 9-0 that, for the first time, any individual 401(k) participant has as Justice Stevens said, "the green light to sue" the fiduciaries. Included in the new power to sue are the participants' beneficiaries. The statute of limitations is six years.

2009 Johnson v Couturier

Court blocked employer from paying the legal fees of the fiduciary defendants.

2010 Goldman Sachs

Goldman paid a $550 million fine for "inadequate disclosures" and "conflicts of interest".

2009 Tullis

Two plan participants hired outside money managers, separate from those offered by the plan, to manage their 401(k) accounts. The outside money managers reported false balances in the two participants' accounts.

When the two participants discovered the fraud they sued the fiduciaries under the "you should have known and done something" argument.

The fiduciaries responded that it had been the two participants' choice to hire private money managers not approved by the fiduciaries and the participants' responsibility to verify the information.

The court found in favor of the fiduciaries because documentation showed the participants had been provided sufficient information before hiring the money managers. Because the participants had been in control of their money the fiduciaries were not liable.

Legislation

1974 ERISA (Employee Retirement Income Security Act)

Fiduciaries are responsible --personal liability. Any promise to remove fiduciary liability is nullified.

Money managers are exempt from fiduciary liability.

1978 401(k)s

401(k) unique feature: both the plan fiduciary and the plan participant direct the investment of the money.
Fiduciaries are relieved of liability if the participant has control.

2006 Pension Protection Act of 2006

Investment management companies had been looking for a way to charge additional fees from plan participants' accounts for providing investment advice, but charging for advice was a problem on several levels.

Advice creates liability for the adviser. The investment institutions did not want liability for the advice they might give.
Advice is a fiduciary relationship and the investment institutions did not want to become a co-fiduciary with the plan provider /employer/ fiduciary.
The Prohibited Transaction Rule (PTR) prevents the payment of additional fees to a plan's existing service providers.
After a multiyear lobbying effort Congress passed the Pension Protection Act of 2006 which gave the investment industry pretty much everything they wanted.

----The prohibited transaction rule was waived for the provision of advice.
----Liability was waived for the provision of advice.
----Co-fiduciary status was waived.
But there was a catch, the advice would have to be audited.

With all that liability removal for the financial institutions, guess who bears ultimate responsibility and liability for the whole process functioning in the best interests of the participants? If you said, "Fiduciaries!" you are right!

The financial industry expected a windfall after the ’06 Act, but the “Investment Company takes all the fees; the plan sponsor/ employer/ fiduciaries take all the risk” arrangement turned off many employers.