VIEWPOINT

SageView Advisory Group Quarterly Newsletter Q3 2017

Recent Trends in Defined Contribution Plan Litigation

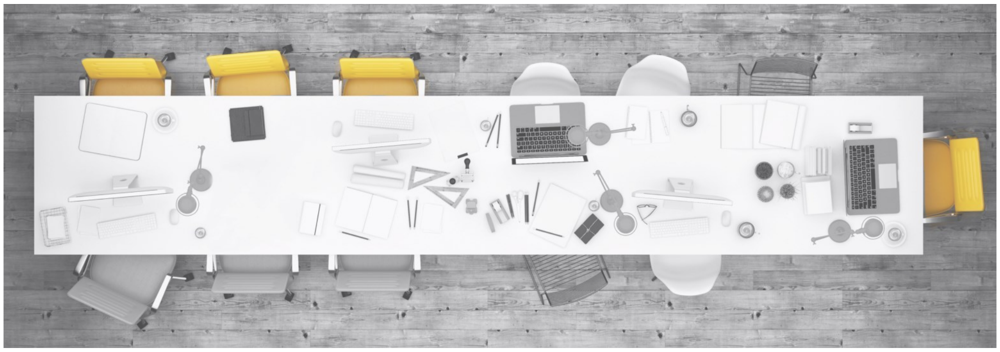
Just over a decade ago, litigation risk in defined contribution plans was generally limited to specific plan categories, or unusual fact patterns that triggered potential liability. Employer stock as a 401(k) investment option was a common litigation target—in Enron, Worldcom, and other similar cases—and litigation arose from time to time around allegations of self-dealing or operational issues, such as plan cutbacks or terminations. But litigation around relatively standard fiduciary issues, such as the duty to manage plan costs, was uncommon.

That all changed in September 2006, when the St. Louis based law firm, Schlichter, Bogard & Denton, and lead attorney Jerry Schlichter filed over a dozen cases against large employers, such as Kraft Foods, Bechtel, General Dynamics, International Paper and Caterpillar. The Schlichter cases worked through the legal system over the ensuing decade. Some cases were dismissed, many were settled, and a few went to trial. Defendants were largely successful in beating back the Schlichter claims, but some court rulings included significant wins for plaintiffs, including a March 2014 court award of $13.4 million to ABB plan participants (this monetary award was later vacated on appeal, and is currently being re-litigated). One case (Tibble v. Edison) went all the way to the US Supreme Court, with Schlichter winning an important decision. In settled cases, Mr. Schlichter obtained approximately $300 million for participants in 401(k) excessive-fee cases, and tens of millions of fees for his firm. Large settlements included $62 million from Lockheed Martin and $57 million from Boeing. Notable defeats include the September 2016 dismissal of class action claims, in a case involving the Chevron 401(k) and its stable value fund.

Following the initial Schlichter barrage, other plaintiff firms entered the 401(k) fee litigation space, using Schlichter's complaints as models for their own filings. Schlichter himself appears to have generally moved on to other targets, filing a dozen lawsuits against university retirement programs in August 2016. However, Schlichter filed a lawsuit against the Oracle 401(k) in January 2016, which was certified as a class action in February 2017. More recently, many cases have been filed against financial services firms offering their own proprietary investment options through their 401(k)s, claiming conflicts of interest. Defendants have included Wells Fargo, Fidelity, BlackRock, American Funds, MFS, Putnam, Franklin, TIAA, Allianz, and New York Life.

As fact patterns for plaintiff claims that survive defendant motions to dismiss have become clearer, and as model complaint filings have become more generally available, the range of plans being sued has expanded. Schlichter only sued plans holding at least $1 billion in assets. Conversely, a June 27, 2017 complaint against Nationwide and the Andrus Wagstaff, PC 401(k) Profit Sharing Plan presented excessive fee claims involving a small plan, with just 27 participants and $1.1 million in assets. And a June 28, 2017 excessive fee complaint was filed against Pioneer Natural Resources and its $500 million 401(k) plan by a plaintiff's firm that specializes in motor vehicle accidents, defective products, and slip-and-fall accidents, according to its website. Pioneer represents the Colorado firm's first ERISA class action case.

Litigation risk for defined contribution plans has clearly escalated over the past decade. Plaintiff success in court, and particularly in settlements, has attracted additional litigants. More recently, litigation has targeted plans of all sizes, not just mega plans. Certain plan categories—such as financial services firms offering their own proprietary investments—face elevated risks, but no sponsors are completely immune. However, litigation risk can be managed. Prudent risk management strategies include strong plan governance, such as ensuring that the Plan Committee is properly appointed, operates under a well-defined mandate, and meets regularly to review plan investments and service providers. Working with qualified advisors also reduces and distributes litigation risk. Properly documenting all plan decisions is a critical defense strategy. Litigation can't be avoided, but following prudent plan management strategies improves the chance of obtaining an early dismissal. Finally, maintaining specific ERISA fiduciary liability coverage, including legal defense costs, reduces the employer's financial risk. Legal defense is often the largest cost of ERISA litigation.



View from Washington

While retirement plans have not been in the headlines nearly as much as health benefit plans have this summer, that does not mean it has been a sleepy time on the Hill for America's number one savings vehicle.

Health Care Reform

Enough ink has been spilled on Congress' efforts to pass reforms to President Obama's signature health care law. One provision seemingly missed in the larger debate over reform concerned Health Savings Accounts (HSAs). Congress had considered increasing the allowable contributions to these accounts to match the annual deductible under high-deductible health plans. For 2018, this could mean an increase from $3,400/$6,710 for individual/family to $6,550/$13,100. Health Savings Accounts have an added tax benefit over qualified retirement plans in that distributions to pay for medical expenses are not taxable. One concern is that increasing the amount available for contributions could lead to a net decrease in Americans covered by, and by extension saving in, a qualified retirement plans as small employers will be dis-incentivized to offer a plan.

While there was a lot of discussion on the potential repeal of the net investment income tax, there are a number of other tax provisions in the Affordable Care Act that could possibly resurface under tax reform. Some of those taxes include: medical device tax, additional Medicare tax, so-called Cadillac tax and individual mandate tax.

Now, the question is whether health care reform is really dead or could it come back either on its own or as a part of tax reform.

Tax Reform

Congress is now making its pivot away from health care to tax reform. The big question now is whether the Senate can garner enough support for any proposal to achieve the requisite 50 votes (with Vice President Pence serving as the tiebreaker). What may have felt straightforward following the election last year is far more uncertain this summer as health care reform has shown. One of the difficulties in getting to 50 votes is that to achieve permanent tax cuts under the budget reconciliation process, any tax proposal would have to be revenue neutral. In other words, any tax cuts for individuals or corporations would require offsetting new revenue elsewhere.

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Employer Contribution Trends

Two recent studies reinforced the value of employer contributions to defined contribution retirement plans and identified key trends on how plan sponsors are applying these contributions to participant accounts.

According to BrightScope and the Investment Company Institute (ICI), 76% of 401(k) plans offer an employer contribution of some sort and 88% of participants are in a plan that provides an employer contribution. Additionally, employer contributions account for one third of contributions to 401(k) plans.*

A report by Deloitte, whose analysis also included 403(b) plans, found that 94% of employers offer matching contributions, profit sharing contributions, or both.**

In recent years, the employer match has become more generous, allowing plan participants to benefit from tax deferral more fully.

Reduced service requirements for eligibility. Deloitte found that 71% of employers who offered matching contributions in 2015 did so immediately upon participation, up from 56% in 2012. An immediate match is more prevalent in plans of larger employers.

Frequency of contributions. Most employer matches are applied frequently - Deloitte found that 89% of employers calculated and deposited the match with each paycheck. Only 7% made contributions annually, and the remaining 4% used a schedule that was less frequent than each pay period.

Contribution formulas. Dollar-for-dollar matches are gaining traction, although 50% matches remain the most common. Deloitte found that 12% of employers matched 100% of the first 6% of employ ee contributions, while 18% matched the first 3% to 5% dollar for dollar. The most common matching formula was 50% of the first 6% of employee contributions, which was offered by 18% of employers participating in the study.

When benchmarking your plan's employer match, it is important to ensure that you are comparing apples to apples. For example, BrightScope and ICI found that the percentage of 401(k) plans with employer contributions varied widely by the size of the plan, ranging from 75% in plans with fewer than 100 participants to 95% in plans with 5,000 to 9,999 participants. Even so, trends noted above are likely to be reflected across the board to varying degrees.

* BrightScope and the Investment Company Institute, "The BrightScope/ICI Defined Contribution Plan Profile: A Close Look at 401(k) Plans, 2013," December 2015
** Deloitte Consulting, LLP, the International Foundation of Employee Benefit Plans, the International Society of Certified Employee Benefit Specialists, "Annual Defined Contribution Benchmarking Survey, 2015 Edition"

IN THE NEWS

Join SageView at the 2017 Mid-Sized Retirement and Healthcare Conference

Please join us at the upcoming Mid-Sized Retirement and Healthcare Conference in Austin, TX. SageView's Michael Coelho will be presenting "Best Practices for Proactively Managing Retirement Plan Fees" on Tuesday, September19 at 11:00am.

Upcoming Compliance Reminders

SEPTEMBER 15, 2017 - Employer Contributions due for Extended Partnerships, Sole Proprietorships, and LLCs taxed as Partnerships (on Second & Final Extension)

Partnerships, sole proprietorships, and LLCs filing as partnerships, which have filed for a second extension of the federal tax return filing deadline, must make plan contributions no later than September 15, 2017 (i.e., the first business day following the final extension of the 2016 federal income tax return filing deadline).

SEPTEMBER 30, 2017 - Summary Annual Report

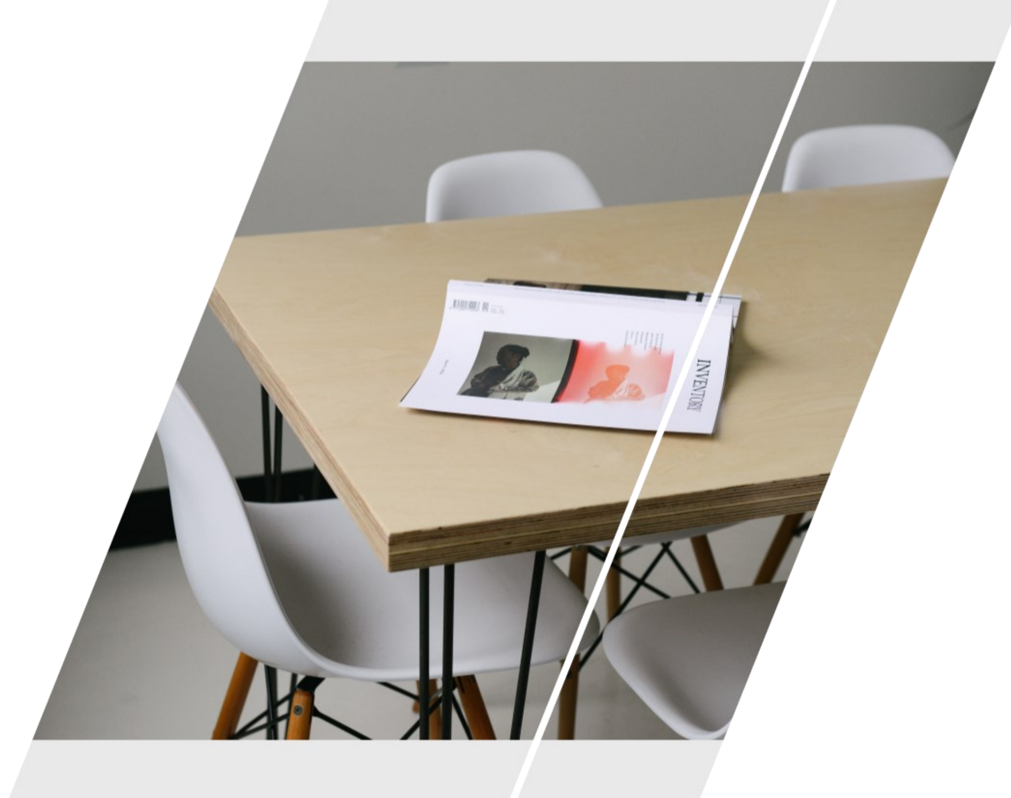
Distribute to plan participants and beneficiaries the summary annual report ("SAR") required by ERISA, on or before September 30, 2017 (i.e., the end of the ninth month after the end of the plan year), unless the filing deadline for Form 5500 and Schedules has been extended.

OCTOBER 16, 2017 - Form 5500 (on Form 5558 Extension)

If an extension of the deadline for filing Form 5500 has been obtained by filing Form 5558, file Form 5500 (Annual Return/Report of Employee Benefit Plan) and all required Schedules with the Department of Labor Employee Benefit Security Administration (EBSA).

DECEMBER 1, but no more than 90 days prior to beginning of the plan year - Annual notice to participants for plans with automatic contribution arrangement (ACA), also referred to as "negative election."

Plans with an automatic contribution arrangement (ACA), also referred to as a 'negative election', must provide an annual notice to participants by December 1 but no more than 90 days prior to beginning of the plan year. Plans must comply with DOL-issued default investment rules providing a notice to each participant to whom the arrangement applies within a reasonable period of time prior to the start of the plan year.



View from Washington continued...

Among the ideas floating thus far for achieving this, some in Congress have suggested the Border Allocation Tax (BAT). This idea is heavily opposed by retailers like Walmart and Home Depot, which import the majority of their inventories. The other main new source of revenue would be to limit deductions, the three largest of which are mortgage interest, charitable gifts, and retirement plan contributions. Congress is required to view pre-tax deferrals as tax expenditures for budget and tax purposes because the average distribution for a retirement plan is not taxed until after the 10-year window under by the CBO in preparing its economic analysis.

Most outsiders are giving this Congress long odds of getting permanent tax reform done given these hurdles. However, this Congress is feeling a lot of motivation ahead of the 2018 midterm elections. It will be interesting to watch what levels Congress pulls to move reform ahead.

Fiduciary Rule Postponed, Again

The Trump Administration has been looking for ways to tweak or rescind the fiduciary rule. The process is more complicated than it may appear given the regulation was in April 2016, which precluded Congress from rescinding under the Congressional Review Act and the Senate would likely not have the necessary votes to push it through on a standalone basis. The DOL could go through normal rule making channels, but this opens the process to additional notice and comment periods as well as potential legal challenges seeking to keep the current rule in place.

On August 9, the DOL notified a Minnesota District Court that a further delay had been submitted to the OMB. The delay concerns prohibited transaction exemptions, including the Best Interest Contract until July 2019. There is a belief that additional changes to the rule are likely.

Make benchmarking your plan an annual exercise

Plan benchmarking is an effective way to help plan sponsors stay abreast of changing industry trends, assess participant metrics, and measure their own plan's features against those of comparable companies. It also offers insight into the costs associated with maintaining a plan and whether those costs are in line with industry norms.

PLANSPONSOR recently polled its plan sponsor readers, asking them how often they benchmarked their defined contribution plans and what features they included in the evaluation.* The vast majority (91.7%) said that they benchmarked their plans annually. The remaining 8.3% reported benchmarking their plans every five years.

"Very important" benchmarking metrics

When asked to rank the benchmarking criteria they considered to be "very important" in determining the success of their defined contribution plan, sponsors responded as follows:

- Investment expenses (as compared with peers) — 100%.
- Administrative expenses (as compared with peers) — 91.7%.
- Average employee participation rate — 81.8%.
- Average deferral percentage — 81.8%.
- Percentage of participants getting the full match — 63.6%.
- Percentage of participants properly diversified in investments — 58.3%.
- Percentage of participants on track to replace a certain income level in retirement — 36.4%.
- Participant use of educational materials/ website — 25%.

How does your plan stack up?

To help plan sponsors gain perspective on how well their own retirement plan might stack up along some standard criteria, we have included highlights from the 2015 Annual Defined Contribution Benchmarking Survey.** While the industry segment with the highest representation in this study consists of those organizations with 1,000 to 5,000 employees (31%), this data can provide a general sense of the trends and priorities emerging within the industry at large.

Employee participation rate: 75%, consistent with 77% reported in 2013-2014. Plan sponsors now consider employee participation to be the top measure of plan effectiveness.

Average account balance: $99,011 — up about 4% from $95,227 in 2013-2014.

Deferral percentage: For non highly compensated employees, the median deferral rate was 5.9% (compared to 5.2% in 2013-2014). The median deferral rate for highly compensated employees was 7%, consistent with 2013-2014 data.

Auto enrollment: In 2015, 62% of plans had an auto enrollment feature. Of that group, 40% of plans offered the feature while also satisfying the safe harbor conditions contained in the Pension Protection Act of 2006. The most common default deferral rate reported was 3%, which was employed by 47% of plan sponsors. Lifecycle/target date funds continue to be the most common default investment option with 85% of plan sponsors (up from 72% in 2013-2014). More than three out of four plans (77%) offer a qualified default investment alternative, up from 64% in 2013-2014.

Eligibility/vesting: Today, 66% of plans allow employees to begin contributing to their retirement accounts immediately. Similarly, with regard to employer matching contributions, 71% of companies begin making contributions when the employee begins participating in the plan — an increase over the 62% of employers who did so in 2013-2014. 43% of plans provide immediate vesting for matching contributions — up from 32% in 2013-2014.

Employer contributions: Virtually all (94%) employers surveyed now offer some type of company matching/profit sharing contribution. (To learn more about the value of matching contributions, see the sidebar article.)

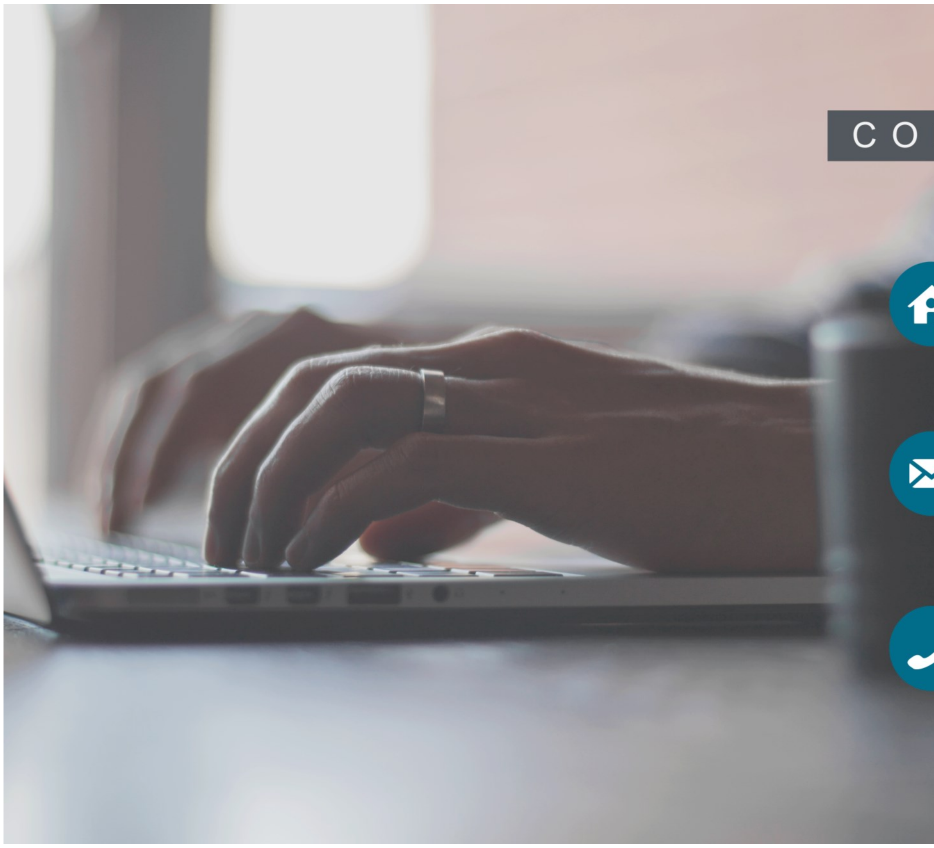
Roth 401(k) option: Roth 401(k)s are now offered by 60% of plan sponsors — a significant increase over the 51% of plans that offered them when the 2013-2014 study was conducted.

Top plan priorities: When asked to rate a number of issues in order of their importance to the company's plan, sponsors sent clear messages. "Providing the right investments to help participants achieve their retirement goals" was the top priority, with 89% of respondents indicating this was a "very" or "quite" important goal. Following closely in second place was "improving participant education" at 86%, and in third place, "retirement readiness," at 83%. These responses were consistent with those in previous surveys.

While this current snapshot of common features and measures of defined contribution plans just scratches the surface, it may provide a general basis of comparison for the state of your own plan. To view the study in its entirety, go to http://www2.deloitte.com/us/en/pages/human-capital/articles/annual-defined-contributionbenchmarking-survey.html.

* PLANSPONSOR, "Plan Benchmarking Measures," February 2015

** Deloitte Consulting, LLP, the International Foundation of Employee Benefit Plans, the International Society of Certified Employee Benefit Specialists, "Annual Defined Contribution Benchmarking Survey, 2015 Edition"



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