LESSONS LEARNED FROM ABB

An Analysis of Tussey v. ABB, Inc.

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Welcome to Today's Webinar

- On behalf of Raymond James and WithumSmith+Brown, welcome and thanks for spending your lunch time with us.
- Have a question or comment – Please use the chat box. If we don’t get to your question, we will reach out to you at the conclusion of the webinar.
- Today is interactive. Your participation in the polling questions is appreciated.
- We will begin shortly!

Today’s Disclaimer

The information presented in this webinar represent our perspectives, is not necessarily all inclusive, does not constitute legal or any other advice, and should not be relied upon without first consulting with appropriate qualified professionals for your plan’s individual facts and circumstances.

Meet Your Professors

- JOSHUA ANDERSON, AIF
- BERNARD LEONE, CPA, CITP, CGMA
  Partner, WithumSmith+Brown, PC
- DAVID DACEY, CPA
  Partner, Practice Leader, Employee Benefit and Pension Plans Group, WithumSmith+Brown, PC
Today’s Session

ABB CASE BACKGROUND (THE BACKDROP!)
SUMMARY OF RULING
ANALYSIS OF KEY FINDINGS
OVERVIEW OF NEW FEE DISCLOSURE RULES
WHAT DOES THIS MEAN TO YOU?

The Backdrop!

- 2006 – The Year of the Class Action Lawsuit
- Asserting Failure of Sponsors to Negotiate Reasonable Administrative Fees (Violation of Fiduciary Responsibilities)
- Similar Cases:
  - Hecker v Deere - Dismissed
  - Tibble v. Edison - Resulted in Award to Plaintiff for Failure to Evaluate Share Class Alternatives
- ABB Case - Resulted in $37 million to Plaintiffs

Summary of ABB Ruling

- $13.4 Million in Costs to ABB:
  - Failure to Monitor Recordkeeping Costs
  - Failure to Negotiate Rebates in Costs
- $21.8 Million Costs to ABB for Replacing Vanguard (Lower Fees) with Fidelity Freedom Funds (Higher fees)
- $1.7 Million Costs to Fidelity for Failure to Distribute Float Income
- ABB Violated Fiduciary Responsibility under its Investment Policy Statement (IPS) by Using Revenue Sharing to Offset Other Costs vs. a "Per Participant Fee"
- Too Much Reliance on Expense Ratios
ANALYSIS OF KEY FINDINGS
Vanguard vs. Fidelity Freedom Funds

- Vanguard Wellington Fund Replaced By Fidelity Freedom Funds
- Vanguard Fund Compared To Fidelity Freedom Fund
  - Lower Expense Ratio For Vanguard
  - Vanguard Had Superior Performance
- Lack of Prudent Process For Selecting New Fund Violated IPS
- More Revenue Sharing Equaled Less Sponsor Cost Equaled More Participant Cost Equaled Breach of Duty of Prudence

ANALYSIS OF KEY FINDINGS
Revenue Sharing vs. Per Participant Fee

- **Cost Approaches**
  - **Revenue Sharing Approach** – Payment by Mutual Fund of a Fixed Percentage of Revenue – Reduced Earnings to Participants
  - **Per Participant Fee Approach** – Set Specific Dollar Fee Paid By Plan Sponsor
- **Court Finding**
  - ABB Found to Maximize Revenue Sharing at Higher Participant Costs and Lower Sponsor Costs (Fiduciary “Self-Dealing” Breach)

ANALYSIS OF KEY FINDINGS
Issues With ABB Just Reviewing Expense Ratios

- Don’t Show Revenue to Record Keeper
- Don’t Show Competitive Market
- Don’t Take Into Account Size of Plan and Potential Bargaining Power
- Therefore Can’t Gain Requisite Understanding of Underlying Fees
  - Lack of Understanding Precludes Evaluation of Fee Reasonableness
ANALYSIS OF KEY FINDINGS
Fidelity and Playing the Float

- Fidelity Deemed to be a Fiduciary
  - Discretionary Control Over Plan Assets For Certain Purposes
- Retained Portion of Float Income

ANALYSIS OF KEY FINDINGS
ABB and Following the IPS

- IPS Indicated Revenue Sharing Was to Offset Costs
- Switch to Higher Cost Fund Without Analysis Violated IPS
- No Documentation of Thought Process
- Details in IPS are Similar to a Plan Document

ABB vs. Key Deadlines For New Fee Disclosure Rules

- April 2012 – Tussey v. ABB
- July 1, 2012 – Covered service provider (CSP) Rules under 408(b)(2) (provider to plan).
- August 30, 2012 – Initial and annual reporting to participants under 404(a)(5) (plan to participants).
- November 14, 2012 – Reporting deadline to participants for initial quarter ended September 30, 2012 (plan to participants).
More 408(b)(2) Timing Issues

- Disclosures for current CSPs required by July 1, 2012
- For new contracts, reasonably in advance of entering into the contract
- If information changes, new disclosure required within 60 days of learning of the change
- Disclosure of investment-related changes must only be updated annually

Overview of Fee Disclosure Rules

CSP Disclosure Requirements to the Plan Under 408(b)(2)
- Description of Services to be Provided
- A Statement Whether CSP is Serving as Fiduciary or RIA
- Description of Direct and Indirect Compensation
- Transaction Compensation
- Termination Costs Payable
- Additional Disclosures

Plan Disclosure Requirements to the Participants Under 404(a)(5)
- Initial and Annual
  - Plan Related Information – General Info, Price and Administration Expense and Allocation Method to Participants, Individual Exp
  - Investment Related Information – 10 Yr. Performance Data, Names of Investment
- Quarterly Plan Related Information – All Fees Actually Charged to Participants, Service Description, Explanation that Expenses Paid From Investment Alternatives, Other Fee
- Information

408(b)(2) Consequences Of Failure to Comply

- Compliance is Actually an Exemption From Prohibited Transaction Rules
- Noncompliance Likely a Prohibited Transaction
  - 15% Excise Tax Due Every Year Until Corrected
  - Possible 100% Penalty
- Exemption from Prohibited Transaction Rules if:
  - RPF Did Not Know Disclosures Not Made and Reasonably Believed CSP Provided All Information
- Upon Discovery of Disclosure Failure:
  - RPF Requested Information in Writing
  - If Information not Received in 90 Days, Notify DOL
  - Decide Whether to Terminate Arrangement
SUMMARIZING THE EFFECT OF NON-COMPLIANCE WITH 408(B)(2) TO AUDITORS AND FIDUCIARIES

- No Written Disclosure By July 1, 2012 = Fee Is Not Considered Reasonable
- Fee Is Not Considered Reasonable = Fee Represents A Prohibited Transaction (i.e. Noncompliance with Exemption)
- Prohibited Transactions Under ERISA = Illegal Acts Under GAAS
- GAAS Impacts Both Auditors And Fiduciaries
- Prohibited Transactions Require Disclosure In Annual Report
- Fines and Penalties (or Worse)

What Does this Mean to You?
Lessons Learned and Best Practices

- Awareness of Requirements
- Document a Thorough Decision Making Process on Fees and Investment Decisions (Use Checklists and Tools)
- Follow a Workable Investment Policy Statement (IPS)
- Vigorous Discussions with Service Providers Regarding:
  - Costs Related to Revenue Sharing
  - Best Possible Share Fund Classes

What Does this Mean to You?
Lessons Learned and Best Practices

- Understand “All” Fees and Expenses
- Avoid Self-Dealing and Conflicts of Interest
- Document Consultations and Conclusions
- Maintain Fiduciary Education
- Clarify Reporting Responsibilities in Writing
- More Information:
  - Withum ERISA Knowledge Corner
  - Raymond James Website
  - Google
Thank You for Your Time!
Please contact us with any questions.

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