REGULATION

Supreme Court Says DC Participants Can Sue

BY BRAD BREWER, CPA, CEBS

The U.S. Supreme Court decided the case of LaRue v DeWolff, Boberg & Associates, Inc. on February 20, 2008. The unanimous decision declared that defined contribution participants can bring fiduciary breach lawsuits to recover individual damages.

In summary, LaRue participated in an ERISA regulated 401(k) plan sponsored by his employer and he was allowed to direct the investment of the monies allocated to his account. LaRue's claim centered on the grounds that the investment changes he provided to his employer, DeWolff, in 2001 and 2002 were never carried out. LaRue alleged he lost approximately $150,000 as a result of DeWolff breaching its fiduciary duty to make the investment changes. LaRue lost at the trial level and also lost his appeal to the Fourth Circuit Court of Appeals before appealing the decision to the Supreme Court.

It is helpful to understand the basis of the lower courts previous rulings. The case relied upon by the lower courts was Mass Mutual Life v Russell. Russell filed a disability claim under an ERISA-governed employer sponsored disability plan. Russell claimed that the plan fiduciaries breached their duties in delaying payment of her claim, and as such, she sustained damages. In that case, the Supreme Court held that the provision of ERISA authorizing monetary damages was limited to the recovery of damages to "the plan." After the Russell case, some courts interpreted the decision to mean that money damages were not available to individual participants unless the entire plan was damaged.

The Supreme Court Justices unanimously concluded that the lower court ruling was wrong in the LaRue case. The majority of the Justices based their decision on the fact that the defined contribution plans, not defined benefit plans, are the primary retirement vehicle for today's workforce. As such, a breach of fiduciary should not have to damage the entire plan for an individual who has sustained damages to have a basis for relief.

> "More than 50 million employees have invested nearly $3 trillion in their 401(k) accounts. What are the ramifications to plan sponsors? Time will tell if the LaRue decision increases the amount of ERISA litigation."

Some of the comments expressed by the Supreme Court are worth noting. Stevens' writing recognized the evolution from defined benefit plans to participant-directed individual account plans: "Defined contribution plans dominate the retirement plan scene today." Stevens' comments also suggest the view that focusing only on damages to the plan as a whole in a 401(k) environment is an out-of-date viewpoint.

It is too early to tell whether the LaRue case will significantly increase ERISA litigation. However, if the losses resulting from fiduciary breach are substantial, a hurdle has been removed for attorneys to pursue litigation on behalf of plan participants. Consider one of the fixed income products caught up in the subprime meltdown:

Regions Morgan Keegan Select Intermediate Bond I Fund (RIBIX) is a fixed income fund with a fairly broad set of investment opportunities ranging from regular corporate bonds to manufactured housing loans to aircraft leases. Through June 30, 2007, the fund's five year performance was ahead of 98% of its peers and it was ranked a "five star" fund by Morningstar.

In July of 2007, problems with the fund's investments began to surface. In the month of August of 2007, the fund was down over 15%. It's interesting to note Morningstar dropped the fund's ranking to one star from five within 60 days after the fund was crushed (another article altogether). Problems continued through the remainder of 2007 and the beginning of 2008.

As of February 2008, the 12-month trailing return was negative by more than 60%. Investors fled the product to only compound the problem. In early 2007, the fund had over $1 billion in assets. That number stood at approximately $125 million in early 2008.

The primary driver leading to outperformance through June 30, 2007, was the same driver leading to the fund's prospective implosion: risk. The fund has 60% of its assets in lower-quality fixed income instruments rated BBB. That is approximately three times its peers' average weighting. Risky securities, illiquid credit markets, and investor redemptions created a downward spiral for the fund.

If you place the fund's name in an Internet search engine, the first entries are not the fund family or financial institution. The entries are plaintiff's attorney looking for additional fund holders to join the lawsuit. Litigation is a real risk and plan sponsors should protect themselves. Actions plan sponsors should consider include:

- Review 404(c) compliance, particularly the timely process ing of participant investment changes.
- Educate plan fiduciaries on their responsibilities.
- Ensure the Investment Policy Statement is up to date and that the process for reviewing the plan's investment options are prudent, objective, and documented.
- Engage an objective investment advisor to take co-fiduciary responsibility and monitor the plan's investments; relying on a bundled service provider is not sufficient.
- Review fiduciary insurance policies to ensure coverage is adequate and up-to-date.
- Review all administrative and investment practices and bench mark them to industry best practices.
- Benchmark the plan's investment and administrative fees to ensure the fees are reasonable.

In conclusion, the LaRue case serves as a good reminder that serving as a plan fiduciary carries material responsibility. Plan sponsors should review their existing practices and procedures to ensure they are mitigating their liability. Time will tell if the LaRue decision significantly increases the amount of ERISA litigation over plan investments. What is certain is that plan sponsors who neglect their fiduciary duties have increased risk after the LaRue case. ■

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