

THE SODERQUIST CENTER

Employers Change 401(k) Management Patterns

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The Employment Retirement Security Act (ERISA) encourages employers to create 401(k) defined contribution pension plans for employees. Defined contribution pension plans allow employees to choose from many investment choices, such as company stock, mutual funds, bonds and money market funds.

401(k) investment plans became available to employees in the early 1980s. In the past 25 years, rapid growth of 401(k) plans increased the nation's investor class and boosted individual savings. 401(k) plans enrich many Americans, including middle-class and lower-income people. More than 50 percent of U.S. workers- roughly 50 million people-invest more than \$2.7 trillion in 401(k) plans. According to the Investment Company Institute, 401(k) plans grow by an average of 13 percent per year. Increasingly, U.S. workers depend on their 401(k) savings for their retirements.

Managing 401(k)s

How much money an employee receives in retirement income from their 401(k) account depends on how much and how wisely the employee invests. Although employees are responsible for their investment decisions, an employer manages a 401(k) plan through an executive committee and serves as the plan's fiduciary. Unfortunately, employers sometimes fail in their fiduciary duties to employees.

Employer 401(k) committees delegate much of their management responsibilities to their attorneys, investment advisers and record keepers. Committee members often have little knowledge of how the plan participants' money is invested or what value participants receive for their investments. For example, in the 1990s, plan participants invested too heavily in their company's stock. Companies did nothing to discourage such investing or warn employees about the need for diversification. Enron's implosion and the huge financial losses of other companies destroyed the savings and retirement dreams of employees heavily invested in their company's stock. Today, employees still invest more than 20 percent of the 401(k) accounts in their

company's stock, although most financial experts recommend an investment of only 10 percent in company stock.

Employers, however, are facing litigation demanding they take more seriously their fiduciary duties in managing employee 401(k) plans. A series of class action lawsuits filed by a St. Louis law firm seeks to force employers to understand how their employees use, misuse, or fail to use 401(k) plans, and address those issues with plan participants. They want employers to provide employees with better investment advice and control plan management costs.

Supreme Court ruling

Until recently, an employer incurred no financial liability if it failed to follow an employee's investment instructions and, as a result, the employee suffered a financial loss.

A series of federal court decisions held that an employee could not sue the company for losses suffered from mismanagement of an employee's individual 401(k) account. Plan participants could sue a plan's manager only if the manager's conduct damaged the entire 401(k) plan and all the plan's investors.

On February 20th, 2008, the U.S. Supreme Court's ruling in *LaRue v. DeWolff, Boberg & Associates* increased the responsibility and liability exposure of employers managing 401(k) plans.

James LaRue took part in the 401(k) plan managed by his employer, DeWolff, Boberg & Associates. LaRue directed DeWolff to change investments in his 401(k) account. DeWolff failed to act as told and DeWolff's failure cost LaRue \$150,000. LaRue claimed that DeWolff breached its fiduciary duty to manage the plan properly and he sought a court order requiring DeWolff to restore \$150,000 to his 401(k) account. DeWolff argued that ERISA did not provide a recovery for a fiduciary breach that damaged the value of only one employee's 401(k) account.

In a surprising decision the U.S. Supreme Court's judges ruled 5 to 4 in LaRue's favor. The Court ruled that under ERISA a 401(k) manager's fiduciary duty includes properly managing individual 401(k) accounts. A plan's manager must timely follow the investment instructions of each plan's participant. DeWolff failed to follow LaRue's instructions and DeWolff's breach obligated it to restore \$150,000 to LaRue's account.

The Court held that it did not matter whether DeWolff's failure to act cost LaRue's account \$150,000 or kept LaRue from taking advantage of a \$150,000 investment opportunity. The Court further held it did not matter whether LaRue's account represented 1% or 99% of the plan's total assets; the principle was the same. DeWolff failed in its fiduciary duty.

The Supreme Court's ruling places greater ethical and legal responsibilities on employers to manage their employees' 401(k) accounts carefully.