DC Plan Litigation: When Stable Value Becomes a Target

By Randy Myers

For three decades following passage of the Employee Retirement Income Security Act in 1974, defined contribution plans largely escaped the eye of class-action plaintiffs' attorneys. That all changed in 2006, when an Illinois-based law firm began filing lawsuits against plan service providers, typically alleging some violation of ERISA based on the fees being charged to plans. Later lawsuits targeted service providers and plan sponsors, arguing that one or more investment options offered to plan participants—usually in the form of mutual funds—was in some way imprudent. Now, say defense attorneys Eric Mattson and Mark Blocker, partners with the law firm of Sidley Austin LLP, the plaintiffs' bar is increasingly assessing whether it might bring claims against service providers or plan sponsors over the choice of stable value funds offered in defined contribution plans.

To gauge how successful such lawsuits might be, it makes sense to consider how defendants have fared in the lawsuits brought thus far. According to Mattson and Blocker, who spoke at the 2014 SVIA Fall Forum, service providers have generally fared well in the fee-centered cases, often because plaintiffs' attorneys have not been able to make the case that the providers were acting as fiduciaries when they earned the fees in question. By contrast, plan sponsors have not always fared as well in cases where plaintiffs alleged that some of their investment offerings were imprudently chosen—when the sponsor offered a mutual fund that charged, say, 80 basis points, when a comparable fund charging 40 basis might have been available. In 2011, Wal-Mart Stores and Merrill Lynch, a unit of Bank of America, agreed to pay $13.5 million to settle a suit claiming that Wal-Mart negligently offered high-priced retail-class funds in its 401(k) plan rather than lower-priced institutional funds.

Blocker cited four reasons that plaintiffs' attorneys are now looking more closely at stable value funds. First, he said, they have recognized that stable value funds represent a sizeable chunk of the defined contribution plan marketplace. "Big dollars draw lawyers," Blocker said.

Second, stable value funds are not terribly well understood by either the plaintiffs' bar or the judges who adjudicate claims, which means plaintiffs' attorneys are prone to try to apply previous claims involving mutual funds to stable value funds—banking in part on the judiciary's unfamiliarity with the products.

Third, he said, stable value funds, conservative in nature, tend not to be the highest returning options in a plan's investment lineup, attracting scrutiny. Finally, lawsuits revolving around stable value funds represent a natural extension of the claims already being made against 401(k) plans. Blocker elaborated and said lawsuits targeting stable value investments are likely to make one or more of three claims: that the fund underperformed some benchmark, that it imposed excessive fees, or that offering it represented general imprudence on the part of a plan. He cautioned that while some plaintiffs' attorneys may not understand stable value funds very well, the plaintiffs' bar has become very conversant with ERISA and "knows where to poke holes." And, he said, some of these lawyers are very well financed. Still, the idea that they will prevail in claims involving stable value funds isn't a given. Blocker outlined three exemplary cases, including one that has already been settled.

In Abbott v. Lockheed Martin, the plaintiffs allege that the stable value fund in Lockheed Martin's retirement plan delivered subpar performance because it held the bulk of its assets in short-term investments more commonly found in money market funds. Lockheed Martin has countered that the strategy and composition of the fund were fully disclosed, that the fund was listed as a stable value/money market fund, that the prospectus warned that the fund's returns may not exceed inflation, that there is no uniform definition of a stable value fund, that the fund's composition was prudent, and that even if the fund was effectively a money market fund it is acceptable to offer a money market fund in a 401(k) plan, as many plan sponsors already do. Blocker said the case is scheduled to go to trial within a few months.

In Austin v. Union Bond & Trust Co., filed in May 2014, the plaintiffs make two claims. One is that stable value wrap providers in the stable value fund in question were earning extra, undisclosed and excessive compensation via the spread on synthetic GICs. The other is that wrap issuers manipulated the stable value fund crediting rate to their advantage, resulting in a rate that was low when benchmarked against a stable value index maintained by Hueler Companies. The defense in that case, Blocker said, is that there is no spread on synthetic GICs and no way for wrap issuers to earn a spread. He also noted that a stable value crediting rate is determined by a preset formula that cannot be manipulated, and that comparing the stable value fund in question to the Hueler Index is an inappropriate apples-to-oranges comparison. In short, Blocker said, "the plaintiffs have made allegations that make no sense." The defendants, in addition to Union Bond & Trust, include Principal Life Insurance Co. and Morley Capital Management.

Finally, in the already resolved Tibble v. Edison International case, the plaintiffs argued, among other things, that it was imprudent for Edison International's retirement plan to offer a money market fund rather than a stable value fund. The court ruled against the plaintiffs, holding that the plan sponsor had undertaken a prudent process in choosing the money market fund. "It maybe was not the choice you would have made, but it was a prudent process," Blocker said.

Blocker said that may not be the last salvo on that front. "We could see plaintiffs making an argument in the future that it is just flat-out imprudent to choose a money market fund when (plan participants) could earn a greater return on a stable value fund." Still, he suggested, the case should hearten plan sponsors and plan providers in that it validated the value of a prudent process in selecting investment options. SVIA