Invesco

DATA ON TRIAL

Three recent lawsuits shed light on issues surrounding the sharing of participant data with recordkeepers.

What are the guiding principles for fiduciaries when it comes to participant data shared with recordkeepers?

The fiduciary standard for retirement plans – Employee Retirement Income Security Act's (ERISA) prudent man rule – is principles-based. It requires plan committees, in their fiduciary role, to act with care, skill, diligence and prudence. Since the standard is principles-based, it evolves as circumstances change. As a result, plan committees need to be aware of emerging issues.

A significant emerging issue is the use of participant data by plan recordkeepers. For recordkeepers to do their jobs, plan sponsors need to give them information about their participants – e.g., compensation, birthdates, social security numbers. The transfer of that information may seem clerical; however, viewed from ERISA's perspective, plan committees, acting as fiduciaries, are giving sensitive data to the recordkeeper.

That raises a question about the fiduciary responsibilities of plan committees to protect the data and limit its use by recordkeepers. Three recent lawsuits have alleged that recordkeepers are using the information to sell non-plan investments and services to participants, with the following outcomes:

1. **DIVANE V. NORTHWESTERN UNIVERSITY:** Resulted in a trial court decision
2. **CASSELL V. VANDERBILT UNIVERSITY:** Settled by the parties
3. **KELLY V. THE JOHNS HOPKINS UNIVERSITY:** Settled by the parties

Unfortunately, the law on participant data is not well-defined. As a result, additional lawsuits can be expected in the future. All three universities are private schools and their 403(b) plans are governed by ERISA. As such, the law is the same as for 401(k) plans.

Committees should understand how their participant data is being used and consult with their attorneys on risk management strategies. Below we discuss the outcomes of these cases and considerations for plan committees.

CASE 1

NORTHWESTERN UNIVERSITY

In the Divane v. Northwestern University case,[1] which held for the University (but is currently under appeal), the plaintiffs allege two violations:

1. The fiduciaries – plan committee members – breached their duties by not preventing the recordkeeper from using participant information to sell non-plan investments and services.
2. The committee engaged in a prohibited transaction by giving away the participant data for free.

The trial court, in finding for Northwestern, said:

"[I]t is in no way imprudent for defendants to allow [the recordkeeper] to have access to each participant's contact information, their choice of investments, their employment status, their age and their proximity to retirement. [The recordkeeper] needed that information in order to serve as recordkeeper ..."

The court was reluctant to be the first to open a new avenue of litigation by finding a fiduciary duty to manage the use of the participant data by service providers. However, appellate courts may be less reserved, particularly since this involves the application of a principles-based rule to an emerging issue.

The court was conservative in its approach to the prohibited transaction claim, saying that it would not be the first to find that participant data was a plan asset. However, a court of appeals may feel less restricted. The opinion says that "a compilation of the information" about participants has some value to the recordkeeper, but that it could not be sold to "fund retirement benefits." But, if a recordkeeper would reduce its fees to obtain the information, that would be analogous to selling a plan asset to pay those fees. Because of that inconsistency, and the fact that this is an issue of first impression for the appellate court, it's possible the decisions will be reversed.

The trial court's decision has already been appealed to the Seventh Circuit Court of Appeals. The bottom line for committees? This decision may not be the final word on the fiduciary responsibilities of plan committees for participant data and prohibited transactions.

CASE 2

VANDERBILT UNIVERSITY

In the Cassell v. Vanderbilt University case,[1] the plaintiffs alleged the University and its fiduciaries mismanaged its retirement plan by paying excessive fees and maintaining poor investment options. They also claimed the committee breached its duties and participated in prohibited transactions by allowing the recordkeeper to misuse confidential participant information for its own benefit. The complaint alleged the recordkeeper used its position to gain "valuable, private and sensitive information including participants' contact information, their choices of investments, the asset size of their accounts, their employment status, age and proximity to retirement, among other things."

After almost three years of litigation, the case involving Vanderbilt's two 403(b) plans was settled earlier this year for a monetary amount and additional non-monetary conditions. The agreement requires the school to pay $14.5 million into a settlement fund, review existing investment options and recordkeeping arrangements, and provide employees information about the plan's investments and instructions on how to reinvest their accounts. Last, and creating the most industry attention, is that Vanderbilt must take additional steps to protect confidential participant information.

One condition imposed was that the plan committee engage in a Request for Proposal (RFP) process to select a new recordkeeper with the following provision:

"[T]he Plan's fiduciaries shall contractually prohibit the recordkeeper from using information about Plan participants acquired in the course of providing recordkeeping services to the Plan to market or sell products or services unrelated to the Plan to Plan participants unless a request for such products or services is initiated by a Plan participant . . ."

Understanding that it could take a year or two to go through the RFP process, the settlement included a provision requiring the plan sponsor to limit the activities of the incumbent recordkeeper as per above.

Since this wasn't a court decision, it doesn't carry any legal weight. However, it does reflect the views of the plaintiffs' attorneys and should be considered by plan committees. They are taking the position that plan sponsors, and their committees, can provide participant information to recordkeepers (and, by analogy, to other plan service providers) to administer the plan, but not to sell other investments or services to the participants.

When it comes to non-plan sales and services, the plaintiffs' attorneys would say that only the participants can agree to the use of their personal information, and consent must be "initiated" by the participant.

CASE 3

JOHNS HOPKINS UNIVERSITY

In Kelly v. The Johns Hopkins University,[1] the University reached a settlement with the participants in its 403(b) plan, agreeing to pay $14 million and implement a series of changes in plan management and administration to address allegations of ERISA violations. Participants alleged fiduciary breaches for providing "unreasonable compensation" to multiple recordkeepers, failing to "prudently monitor and control" recordkeeping expenses, and failing to "solicit bids" from other recordkeepers.

Similar to the Vanderbilt case, one of the plan management changes requires plan fiduciaries to instruct future recordkeepers to refrain from soliciting plan participants "for the purpose of cross-selling proprietary non-plan products and services." The recordkeepers will be chosen via a settlement-ordered RFP.

The cross-selling prohibitions cover individual retirement accounts, non-plan managed accounts, life or disability insurance, investment products and wealth management services "unless a request is initiated by a plan participant," according to the settlement document.

[1] Divane v. Northwestern University, No. 16-8157 (N.D. Ill. May 25, 2018), Cassell v. Vanderbilt University, No. 3:16-cv-2086 (M.D. Tenn. April 22, 2019), Kelly v. The Johns Hopkins University, No. 1:16-cv-02835-GLR.

CONSIDERATIONS FOR PLAN COMMITTEES

Where does that leave plan committees?
The Northwestern trial court said there isn't a fiduciary responsibility under ERISA to limit a recordkeeper's use of participant data, but the decision has been appealed. However, two different plan sponsors, Vanderbilt and Johns Hopkins, were willing to enter into an agreement to settle its case by limiting its recordkeeper's use of that data. And, the plaintiffs' attorneys — the same law firm for all three cases — have said that the issue will continue to be litigated.

First, and foremost, committees should consult with their ERISA attorneys. This is a complex issue in an undeveloped area of the law. The committee's lawyers should be invited to a committee meeting, the issues should be fully explored, and the committee should devise a risk management strategy.

Beyond that, and subject to any advice that lawyers give to committees, I suggest the following:

- Review your recordkeeping agreement to see what, if anything, it says about the use of participant data by the recordkeeper. Plan fiduciaries, including committee members, are expected to know what their plan documents and agreements say. Does the agreement reflect the understanding and preferences of the committee members?
- Invite a representative of the plan's recordkeeper to a committee meeting to explain how the recordkeeper uses the data to provide non-plan sales or marketing to participants. Did the committee intend for all, or even some, of that marketing be provided to participants? Is it acceptable for those services to be provided to participants? Do they add value to the participants?
- If the committee's lawyers determine that it is permissible for the committee to allow the recordkeeper to use that information to provide non-plan sales and services, determine which of the services provide value to participants and whether appropriate practices and safeguards are in place.
- Determine if the recordkeeper considers the use of the information in establishing the cost of the recordkeeping services and, if so, document that fact.
- Document that process and the decisions, and then implement the decisions with the recordkeeper. The agreement with the recordkeeper should be amended accordingly.

While these steps don't completely cover the range of considerations for oversight of participant data, they are a starting point for a thoughtful approach. The key is to recognize the issue and to take steps to mitigate that risk.

Fred Reish
Partner/Chair of Financial Services ERISA Team and Chair of the Retirement Income Team at Drinker Biddle and Reath

11/19 NA9004