MULTNOMAH GROUP

Protecting Participant Data:

How to Monitor and Mitigate Recordkeeper Conflicts of Interest

Fee compression among recordkeepers began several years ago when lawsuits in the early and mid-2000s started to focus on excessive fee claims among the mega-sized 401(k) plans. Recordkeepers' fees and fee structures garnered additional attention in 2012 with the implementation of the Department of Labor's (DOL) fee disclosure regulations for participants and plan sponsors. At Multnomah Group, we complete an annual review of retirement plan costs, benchmarking fees against the plan's peer group. In 2020, our fee benchmarking and renegotiation efforts resulted in a reduction in fees of nearly $1.5M annually, combined for all clients. These reductions are generally directly impactful to the participants that pay these expenses.

As we discussed in our guide – *Resources to Identify, Manage, and Avoid Retirement Plan Vendor Conflicts* – some of the fee compression among recordkeepers can be attributed to vendor consolidation and scale, but why would billion-dollar financial services organizations continue to invest in recordkeeping capabilities where profits have traditionally been so thin? The answer is: they believe there is an opportunity to generate additional revenue beyond the recordkeeping fees for servicing retirement plans.

Generally, we believe there are six areas where recordkeeping vendors have tried to monetize their relationship with retirement plans:

- Proprietary Investment Management
- Managed Accounts
- IRA Rollovers
- Cross-selling retail financial products
- Annuitization
- Compensation

This plan sponsor guide focuses on the fourth way of generating excess revenue – **cross-selling retail financial products**. For plan sponsors, it is important to understand how recordkeepers cross-sell retail financial products and what the plan sponsor's obligation is to reduce or eliminate such cross-selling.

Participant Data and Cross-selling Retail Financial Products

Before we jump ahead to the cross-selling of retail financial products, it is first important to understand how recordkeepers and other service providers are well-positioned to make such additional sales.

To make a retirement plan function, there is a minimum threshold of data that a plan sponsor must provide to the plan's service providers, including the participants' name, social security number, contact information, deferral amount, investment selection, and beneficiary (at a minimum) (referred to herein as required participant data). There is additional functionality that can be optimized for participants if other data points are provided to the plan's recordkeeper. For example, salary information is often requested so that recordkeepers can assist with limits monitoring and participant education related to increased savings.

Other data points that may be provided to a recordkeeper include marital status, age, other accounts outside of the retirement plan, and investment history, among other data and information (referred to as additional participant data and jointly referred to with required participant data as participant data).[1]

In many respects, providing additional participant data can offer a lot of functionality for both the plan sponsor and participants. For example, many of the plan health reviews that recordkeepers present, which are useful in making plan design choices, are based on additional participant data. Other modeling and calculations such as lifetime income scores and projections that participants see in their own accounts are often based on additional participant data. While helpful, the use of additional participant data beyond required participant data may provide recordkeepers the information needed to sell additional services at the participants' peril.

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Through sophisticated contact management and customer interaction software programs, recordkeepers utilize the participant data obtained for retirement plan purposes and mine that data for use in other, more profitable capacities. It has been argued in multiple cases (discussed below) that the participant data in the contact management software is being used by the recordkeeper to "solicit the purchase of [non-plan] retail financial products and services[2]," including but not limited to:

- Individual retirement accounts
- Retail advisory accounts and options trading accounts
- 529 plans and accounts
- Non-plan managed account solutions
- High-interest credit cards
- Life insurance

[1] Harmon v. Shell Oil, No. 3:20-cv-00021, available at: https://www.bloomberglaw.com/public/desktop/document/HarmonetalvShellOilCompanyDocketNo320cv00021SDTexJan242020CourtDo/3?1622401043.

[2] *See* id.

- Banking products such as opening a new saving or checking account or loan for a mortgage

While not an exhaustive list, the concept of cross-selling is that participant data can be used to sell many additional products beyond those that are related to the retirement plan. These non-plan products and services are not governed by the Employee Retirement Income Security Act (ERISA). Thus, these non-plan products and services generally are not monitored by the plan sponsor.

Legal Landscape

Participants' accounts and assets that are covered by ERISA[3] are afforded a higher level of care than their life insurance policy or decision to open a 529 plan.

Plan Sponsors are required to monitor and mitigate conflicts of interest and avoid prohibited transactions.

Under ERISA, plan sponsors (who are fiduciaries) are required to act for the exclusive benefit of the plan and its participants, and they are required to perform three primary areas of responsibility:

1. Prudently select and monitor investments
2. Prudently select and monitor service providers
3. Perform all of the administrative and operational functions related to the plan. This plan sponsor guide addresses selection and monitoring of service providers, which requires plan sponsors to monitor and mitigate conflicts of interest[4] and avoid prohibited transactions.

Conflicts of interest can present themselves in a variety of ways, which is difficult for plan sponsors because conflicts of interest are not always black-and-white. Recall that under ERISA Section 406(a), fiduciaries are broadly prohibited from entering either a direct (or indirect) transaction involving the plan or its assets that create a conflict of interest. There are clear instances that give rise to prohibited transactions, such as a plan fiduciary taking a loan from the plan assets.

Other instances are less clear and require either guidance from the DOL or case law to help plan sponsors understand if a conflict of interest, or perceived conflict of interest, is present. The use of participant data for purposes of cross-selling additional services is an instance that is unclear based on today's guidance and case law but, at a minimum, creates a perceived conflict of interest.

In some respects, cross-selling by using participant data may be helpful for participants who would not otherwise have access to additional services provided by a recordkeeper. Consider the participant that wouldn't otherwise know that a 529 option is available for their children's college savings. Consider the participant that is about to roll over their entire life savings to an individual broker at a no-name firm with very few compliance procedures. Would that participant be better off with an outreach from a major recordkeeper to discuss individual retirement account (IRA) rollover options? Cross-selling may also help some participants with aggregation of assets and

[3] This plan sponsor guide is limited to ERISA but many of the same concepts apply by extension to non-ERISA plans that have substantially similar state laws as ERISA.

[4] *See* Multnomah Group, Resources to Help Identify, Manage & Avoid Retirement Plan Vendor Conflicts, available at: https://www.multnomahgroup.com/retirement-plan-vendor-conflicts.

keeping track of their finances – allowing some participants to have a "hub" or "one-stop-shop" with the recordkeeper.

While true, other important considerations include:

1. Participants may pay higher fees for services that may not otherwise be appropriate and necessary
2. Recordkeepers may be earning unjust profits from the use of participant data, which hasn't been authorized by participants
3. Participants may not understand when the line is crossed from plan to non-plan products and services and what standard of care is applied by the service provider in rendering each product or service
4. Participants may think the services are being monitored and/or provided by their employer.

Most notably, the last two considerations, which are substantially intertwined, may be the least understood by plan sponsors, yet the most prevalent among plan participants. Because of the integrated services and strong brand identity between the retirement plan division and other divisions at major recordkeeping firms, it is very difficult for participants to understand the distinction between plan and non-plan products and services. For participants, there is largely an assumption that the non-plan products and services are the same as plan products and services, which are prudently selected and monitored by the employer.

There are pros and cons to using participant data to cross-sell additional products and services to participants in an ERISA-covered plan. Until case law or regulation say otherwise, allowing the cross-selling of additional products and services by recordkeepers remains a grey area and is not per se prohibited.

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However, as demonstrated by the cases below, it is a perceived conflict of interest, which at a minimum requires a well-documented process by the plan sponsor to demonstrate why allowing cross-selling with the use of participant data is appropriate.

SEC Complaint

Prior to any cases, the use of participant data to cross-sell additional products and services came into the spotlight with the 2017 whistleblower complaint filed with the Securities and Exchange Commission (SEC).

Highly publicized in the *New York Times*, TIAA was accused of using participant data to engage in abusive sales practices such as soliciting the purchase of non-plan products and services that resulted in higher fees to TIAA.[5]

By 2019, TIAA reached a settlement with the SEC that resulted in an internal review, updated TIAA disclosures, review of policies and procedures, updated training, and other actions by TIAA – all without acknowledging any fault.

[5] *New York Times*, The Finger-Pointing at the Finance Firm TIAA (October 2017), available at: https://www.nytimes.com/2017/10/21/business/the-finger-pointing-at-the-finance-firm-tiaa.html.

403(b) Cases

TIAA's spotlight undoubtedly gave rise to the birth of cross-selling cases in 403(b) plans. The first settlement that garnered the attention of plan sponsors was in the case of *Cassell v. Vanderbilt University*.[6] The plaintiffs in *Vanderbilt* argued, among other claims, that the plan sponsor breached its fiduciary duty and engaged in a prohibited transaction by allowing the recordkeeper to use 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." In reaching a settlement for $14.5 million, one of the settlement terms reached in the case was that the plan sponsor would "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."

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Since *Vanderbilt*, several other settlements involving the prestigious institutions of Emory, John Hopkins, MIT, and Columbia, have been reached, all resulting in similar terms that prohibit the recordkeeper from using participant data to cross-sell other services. Most importantly, in the 7th Circuit, the lower district court first entertained the notion of participant data claims in court. In the case of *Divane v. Northwestern University*, the district court denied the plaintiffs' request to amend their complaint to include a cause of action for cross-selling. The district court noted that the plaintiffs failed to cite any other cases related to cross-selling using participant data (which makes sense since this was the first one). Further, the district court disagreed with the plaintiffs' arguments that participant data is a plan asset. In fact, the lower court acknowledged that there is some value to participant data but found that it is not a plan asset and hence, no prohibited transaction issues attached.

The plaintiffs appealed to the 7th Circuit who declined to hear the issues, though declined as a result of the pleading and not on the merits of the cross-selling claim itself. Plaintiffs filed a *writ of certiorari* to the United States Supreme Court.

Shell Oil Case

Meanwhile, for 401(k) plans, plan sponsors were also introduced to cross-selling cases. Though not the only case involving cross-selling claims, the most notable is the case of *Harmon v. Shell Oil Company,*[7] where another district court reached the conclusion that cross-selling using participant data should be dismissed.

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[6] *Cassell v. Vanderbilt University*, No. 3:16-cv-2086 (M.D. Tenn. April 22, 2019).

[7] *Harmon v. Shell Oil Company*, 2021 WL 1232694 (S.D. Tx. Mar. 30, 2021).

> The *Shell Oil Company* case is unique because unlike most of the ERISA class action cases (including all the participant data cases until the *Shell Oil Company* case), the recordkeeper – here, Fidelity – was also named as a defendant.

The same claims persisted against Shell Oil Company that persisted in the *Vanderbilt* case (discussed above); in addition to the typical excessive fee and failure to monitor claims, the plaintiffs alleged that Shell Oil Company as the plan sponsor allowed Fidelity "to use plan participants' highly confidential data, including Social Security numbers, financial assets, investment choices and years of investment history to aggressively market lucrative non-plan retail financial products and services, which enriched Fidelity defendants at the expense of participants' retirement security." This argument was not the novel argument, however.

The arguments against Fidelity are the new and novel argument in which the plaintiffs argued that Fidelity was a fiduciary to the plan under ERISA because of its "control over participant data." Plaintiffs argued that Fidelity (as the recordkeeper) breached its fiduciary duties by sharing the participant data with Fidelity affiliates that benefited from such data, which was not for the "exclusive purpose of providing benefits to Plan participants and beneficiaries" (a core responsibility of plan fiduciaries). This argument hinges on participant data as a plan asset, which the lower district court ultimately said was not, by citing the *Northwestern University* case.

Implications and Action Items for Plan Sponsors

Given that two district courts have now dismissed the notion of participant data claims, does it make sense for plan sponsors to ignore these issues? While that may be your first reaction, plan sponsors should continue to pay attention to these important issues, given that plan sponsors are responsible for identifying and mitigating conflicts of interest and not engaging in prohibited transactions. Because these were first impressions for the lower district courts, it is likely that there will be many more cases to come, which may not have the same result as the *Shell Oil Company* case and *Northwestern University* case. Both cases were dismissed, in part, on the notion that participant data is not a plan asset. If participant data is later determined to constitute a plan asset, the trajectory of these cases will change.

In addition, recent guidance from the DOL may also inform where this issue is going in the future. The DOL's recent position in April 2021 guidance is that plan sponsors have an obligation as part of the fiduciary duties to protect confidential participant information and to mitigate it from the risks of cybercrime.[8] If the DOL believes that participant data is required to be protected by plan sponsors from cybercrime, it may set the tone that participant data is worth protection.

Given the current climate and unknown path forward, plan sponsors may consider the following action steps:

1. Understand the current litigation and regulatory landscape

[8] DOL, Cybersecurity Program Best Practices, available at: https://www.dol.gov/sites/dolgov/files/ebsa/key-topics/retirement-benefits/cybersecurity/best-practices.pdf.

2. Inquire of your current service provider(s) to understand how they are handling participant data and what conflicts of interest that may present
3. Develop procedures for future selection of service providers to avoid conflicts of interest
4. Update criteria for procurement and legal related to service providers
5. Develop ongoing due diligence for service providers reflective of this framework
6. Work with an experienced consultant to navigate these steps. For example, review the approach Multnomah Group takes with its clients below.

Multnomah Group's Approach

We have been tracking this issue for several years – long before the *Vanderbilt* case. Multnomah Group helps plan sponsors with their selection, monitoring, and replacement of service providers to the plan. Specifically, our team assists with the following on an ongoing basis:

Monitors the Litigation and Regulation

We monitor the status of participant data claims and regulations, as discussed above. Our Technical Services Committee[9] regularly meets to review recent cases and how these cases impact plan sponsors and their participants.

Consults regularly with recordkeepers

Through the Vendor Services Committee, we interview recordkeepers to better understand how participant data is utilized and the ways in which additional revenue is captured using participant data.

Enhanced Request for Proposal Process

Utilizing our toolkit for service provider selection[10], we enhanced the selection process to ensure that recordkeepers are asked about the use of participant data and cross-selling practices from the outset of the relationship.

Documentation Process for Service Provider Monitoring

On an ongoing basis, Multnomah Group works with clients to identify any of the six areas where recordkeepers may be capturing additional revenue.

Through a series of open-ended questions such as the following, we help plan sponsors to identify cross-selling of retail products and then document those practices. Examples of open-ended questions that plan sponsors may ask their recordkeeper may include but are not limited to:

a. **Can plan sponsors strike specific communications or categories of communications from delivery to participants?** For example, if communications regarding banking products and 529 plans are sent to participants (using their contact information obtained for plan purposes), can the plan

[9] Multnomah Group has three core committees: (1) Technical Services Committee, (2) Vendor Services Committee and (3) Investment Committee.

[10] See Multnomah Group, Recordkeeping RFPs: How to Prepare, Review, and Evaluate Vendors, available at: https://www.multnomahgroup.com/recordkeeping-rfps-toolkit.

sponsor direct the recordkeeper to stop sending these communications? Some recordkeepers have historically said that there is not a mechanism to stop these communications.

b. **What job titles are authorized to provide employee communication services to participants in the plan, and which, if any, of those titles receive compensation from commission?**
For example, is an "investment advisor" or "wealth manager" allowed to send additional communications to participants for non-plan purposes?

c. **What are the mechanisms for reviewing the performance of plan representatives?**
Recordkeepers should be able to produce reporting to assist plan sponsors related to both plan and non-plan representatives.[11]

d. **Are you willing to engage in non-solicitation arrangements with clients when requested?**
As discussed in the cases above, there are several settlements where non-solicitation arrangements were struck. While successfully negotiating this into the contract may sometimes be difficult, it is helpful to document the process to seek this type of arrangement.

The challenge for the plan sponsor is identifying these ancillary services that result in additional revenue for recordkeepers, including cross-selling additional products and services using participant data. Regardless of whether participant data is deemed to be a "plan asset," plan sponsors remain responsible for identifying and mitigating conflicts of interest.

This plan sponsor guide should provide the roadmap to understanding the issues and how plan sponsors can work with an experienced consultant to mitigate the risks for the plan sponsor as well as for participants that might already be overwhelmed.

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[11] As a plan sponsor, it is important to review and document information that is received; otherwise, do not request the information.