DC PLAN FEE AND INVESTMENT LITIGATION

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ABA Employee Benefits Committee, Midwinter Meeting Nashville

PRESENTERS:
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Program Overview

Topics being addressed:

– 401(k) and 403(b) fee litigation
– Fiduciary risk on alternative investments
Duty of Prudence: Excessive Fees

Plan Sponsor – Claims against fiduciaries associated with plan sponsor for imprudent selection of investment options and administrative services.

Proprietary – Claims against plan sponsor fiduciaries for selecting affiliated funds and service providers.

Service Provider – Claims against service providers for 401(k) plans.
Claims and Issues Raised In Excessive Fee Cases

**Excessive Investment Fund Fees:** Fiduciaries imprudently selected or maintained plan investment funds that charged excessive fees by:

- Selecting retail-share class funds when less expensive institutional-share class funds were available;
- Selecting actively managed funds when less expensive comparably performing index funds were available; and
- Failing to consider separately managed accounts or collective trusts

**Excessive Administrative/Recordkeeping Fees:**

Fiduciaries failed to negotiate (through RFP or otherwise) reasonable recordkeeping fees or other service-related fees

- Allowed asset-based, rather than per capita, fees

**Revenue-sharing: The intersection of the above theories**

- Hidden revenue sharing (sharing of fees between fiduciaries and others)
- Excessive or conflict-driven revenue sharing
Fees and Expenses

• *Fiduciaries should know what plan is paying, directly and indirectly, to all vendors; fees must be “reasonable” and services “necessary”*

• *Fiduciaries should require service providers to fully disclose shared and indirect fee arrangements*
ERISA Fee Litigation: Theories

• Excessive Administrative Fees:
  • Fiduciaries failed to monitor or negotiate lower recordkeeping or other fees, including lack of request for proposals or benchmarking;
  • Asset-based, rather than per participant, fees;
  • “Float” — record-keeper retains interest generated when funds are in short-term awaiting withdrawal or a transaction.
ERISA Fee Litigation: Theories

• Revenue-sharing: intersection of these theories
  • Many mutual funds share revenue from plan investments with plan’s record-keeper for services the mutual fund otherwise would have to perform.
  • A legal and approved practice generally.
  • Biggest problems? When hidden, excessive, or conflict-driven, especially when it involves proprietary/affiliated investment funds.
  • Failure to negotiate a cap on the total amount of revenue-sharing.
ERISA Fee Litigation: Common Companion Theories

• **Prohibited Transactions:**

  • § 406(a) – plan fiduciaries engaged in transaction with party in interest that constitutes a direct or indirect benefit to other parties at the expense of plan participants and beneficiaries.

  • § 406(b) – plan fiduciaries engaged in self-dealing transaction with plan.

• **Plan service providers were paid excessively with plan assets to offset corporate services benefiting the employer.**
ERISA Fee Litigation: Current Landscape

- First wave of lawsuits filed around 2006; mainly filed against employers/plan sponsors. Raised broad challenges to investment fund expense ratios, conflicts of interest, and focus on procedural prudence. Many cases settled; some dismissed.
  - *Braden v. Wal-Mart Stores, Inc.*, 588 F.3d 585, 589-91 (8th Cir. 2009)
  - *Hecker v. Deere & Co.*, 556 F.3d 575, 578 (7th Cir. 2009), reh’g denied, 569 F.3d 708 (7th Cir. 2009)
  - *Loomis v. Exelon Corp.*, 658 F.3d 667, 671-72 (7th Cir. 2011)
  - *Renfro v. Unisys Corp.*, 671 F.3d 314, 319-20 (3d Cir. 2011)
  - *Tibble v. Edison Int’l*, 843 F.3d 1187, 1191-93 (9th Cir. 2016) (en banc).

- Second wave arose around 2011 presenting more targeted claims, including focus on financial service companies, insurance companies, proprietary funds, and revenue-sharing.
  - Again, however, common thread among claims was some allegation of self-dealing, conflict of interest, or kickbacks.
A1 I would say that some alleged conflicts of interest (Bechtel, Boeing, NY Life) but most alleged plan sponsors were asleep at the switch.
Author, 1/17/2019

A2 I would cut "Again, however", perhaps replace with "This time..."
Author, 1/17/2019
401(k) and 403(b) Litigation

Key Developments 2018
**403(b) Fee Litigation Developments**

- Cases filed against universities and hospitals that offer 403(b) plans.
- Continued resolution of motions to dismiss in 2018:
  - At least 6 rulings in 403(b) cases.
  - Claims alleging breach of duty of loyalty and that offered too many investments generally dismissed.
  - But claims that fees were excessive or that a particular investment was imprudent generally found to state a claim.
    - See, e.g., Short, 320 F. Supp.3d at 371 (recognizing a split in authorities on this issue).
Motions to Dismiss in Section 403(b) District Court Decisions

Dismissing allegations based on lack of individual facts

  – “Plaintiffs ignore the facts of this case in apparently adopting allegations from other cases that are unsuited to the Plans.”
  – Dismissed allegation based purely on “underperformance”
  – Dismissed claim of excessive fees for using recordkeepers for three entirely different current investment platforms—TIAA, Vanguard, and Fidelity.
    – Based dismissal on comparisons to other plans: faulted plaintiffs for failing to allege whether three recordkeepers “would agree to continue the same offerings at a lesser, or combined, recordkeeping price; nor have they identified any college or university that has accomplished that feat.”
    – Wilcox demanded facts specific to the Georgetown plan.
Motions to Dismiss in Section 403(b) District Court Decisions

Dismissing allegations based on rejection of underlying legal theory

  - Viewing complaint as “paternalistic,” accepting the argument that plan participants may want worse investments:
  - “Anyone who has paid attention to stock-market or investment-strategy news over the last decade would be hard-pressed to disagree with the notion that the average investor will do better investing in low-cost index funds rather than in attempting either to select individual stocks or to select actively-managed mutual funds. What is good for the average investor, though, is not necessarily what is good for any particular individual.”
  - Participants can choose lower-expense funds, and fiduciaries had no duty to scour the market for lower fees.
  - It “does not matter that some of those expenses were retail expenses and it does not matter that the plans offered additional funds that they did not want to choose”
Example of case mostly surviving motion to dismiss


• Plausible that fiduciaries failed to remove imprudent investments or recordkeepers because of the bundling arrangement.
  • “Even if bundling arrangements generally benefit participants of other defined-contribution plans, that does not necessarily mean that, under the circumstances here, the defendants prudently concluded that the bundling arrangement would benefit the Plan's participants.”
• Plausible that recordkeeping fees excessive based on comparisons to flat-fee arrangements.
• Plausible that defendants did not “reasonably weigh the benefits and burdens when selecting retail shares over institutional shares”
• Plausible arrangement was a prohibited transaction, and exemptions under ERISA section 408 are affirmative defenses.
Prohibited Transaction Claims under 406(a) and 406(b) Against 403(b) plans Have Uphill Fight in 2nd Circuit

- **Sacerdote v. NYU, 2017 US Dist LEXIS 137115 (S.D. NY 8/25/17)**
  - Allegations of expensive or imprudent options among the array of investment choices, inclusion of service producers own investment products and recordkeeping services, failure to remove poorly performing funds and prohibited transactions.
  - District Court dismissed all claims except a narrow defined prudence claim alleging procedural deficiencies.
  - Court found revenue sharing payments drawn from plan investments are not trust assets, and therefore cannot be the predicate for a prohibited transaction.
  - Likewise, no prohibited transaction where payments made from plan investments for “workaday record keeping transactions”
  - Court rejected prudence challenge on inclusion of poorly performing options unless the “investments at issue were so plainly risky “ that an adequate investigation would reveal their imprudence.
Prohibited Transaction Claims under 406(a) and 406(b) Against 403(b) plans Have Uphill Fight

  - This Court “agrees that it would be nonsensical to let a party state a claim for a prohibited transaction in violation of ERISA merely by alleging a plan paid a person for a service.”
  - Allegation against TIAA-CREF for requiring plans to include the CREF Stock Account and to use TIAA-CREF as record keeper; (2) by not negotiating for a per capita record-keeping fee and by using two record keepers instead of one; and (3) by paying fees to TIAA-CREF and Fidelity when plan participants invested in funds offered by those entities.
  - While plaintiffs need to plead an exemption to the prohibited transaction, “[t]he Court concludes that plaintiffs have plead the ingredients of the defense, i.e., that the fees paid were reasonable, as a matter of law” because “the amount of fees paid were within the control of participants.”
Other Issues in Section 403(b) District Court Decisions

Class certification

- **Sacerdote v. NYU**, 328 F.Supp.3d 273 (S.D.N.Y. 2018)
  - Court certified class for excessive fee claims. The class does not have to be limited to only those who invested in these options.
  - While not every member of the class participated in the challenged fund options, the alleged foregone opportunities from funds that were not included and the alleged reduction in choice that resulted is an alleged injury in fact.

Standing

  - Plaintiffs dismissed on Article III standing grounds because one plaintiff did not invest in the “prudent” alternative and another individual plaintiff invested in a better performing investment even accounting for fees.
I'd revise to “… because plaintiffs complained about an early-withdrawal fee neither named plaintiff was charged and one invested in an allegedly imprudent investment that did better for him than the prudent alternative would have.”

Author, 1/17/2019
Other excessive fee cases in non-university settings


- Plaintiff asserts breaches of the duties of prudence and loyalty by offering investment options that carried excessively high fees instead of lower-cost alternatives.
- Plaintiff asserts breaches of the duties of prudence and loyalty based on the recordkeeping fees paid to Fidelity, which she asserts were excessive and unreasonable.
- Court found plausible breaches of prudence and loyalty in offering retail shares when institutional shares available.
- Court dismissed claims regarding recordkeeping, pointing to the renegotiations with Fidelity that resulted in benefits to the plan.


- Finds implausible the number of options and duplicative options constituted breaches of fiduciary duty because they provide more “choice”
- Finds plausible the claim that the recordkeeping fees were excessive.
  - “Although Defendants contend that a rebate program was in place that ‘reduced the [P]lans' recordkeeping expenses to the amount Plaintiffs [argue] should have been paid,’ that is a factual question not properly considered at this stage of the proceedings.”

• Found plausible claims that:
  • “Plaintiff purports that Defendants have failed to ensure that Transamerica’s share of revenue was equitable[,] . . .] Transamerica is subject to a conflict of interest whereby it is encouraged to hire and retain its affiliates as sub-advisers irrespective of how their funds are performing. [and . . .] that Defendants selected and retained funds with unjustifiable fees, some of which continue to underperform.”
Other excessive fee cases in non-university settings


- Allegations that “defendants breached their fiduciary duty of loyalty in connection with the selection of a money market fund instead of a stable value fund; with regard to the selection of fund options with high administrative and investment-management expenses; and with regard to the failure to replace the ARTVX Fund prior to the date they actually did so.”

- Found all claims implausible.
  - For duty of loyalty: no allegations Vanguard selected because of pro-management position.
  - For prudence: no facts allege failure in process for selecting money market
  - For fees: “The FAC pleads no facts regarding any process for choosing funds, and no facts relating to investigations into the appropriateness of various funds. The court previously ruled that merely alleging that a Plan offers retail-class rather than institutional-class funds is insufficient to state a claim for breach of the duty of prudence”
  - For removal of funds: no allegations other than underperformance.

- Ninth Circuit summarily affirmed.
## Settlements – Non-Proprietary Funds Cases

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<tr>
<th>Case</th>
<th>Recovery</th>
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<tr>
<td>Clark v. Duke Univ., No. 16-1044 (M.D.N.C.)</td>
<td>$10,650,000</td>
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<td>Daugherty v. Univ. of Chicago, NO. 17-3736 (N.D. Ill. 2018)</td>
<td>$6,500,000</td>
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<td>George v. Kraft Foods Global, No. 08–3799, slip op. at 2 (N.D. Ill. June 26, 2012)</td>
<td>$9,500,000</td>
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<td>Martin v. Caterpillar, Inc., No. 07–1009, slip op. at 7 (C.D.Ill. Sept. 26, 2010)</td>
<td>$16,500,000</td>
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<td>Smith v. Krispy Kreme Doughnut Corp., 2007 WL 119157 (M.D.N.C. Jan 10, 2007)</td>
<td>$4,750,000</td>
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<td>Spano v. The Boeing Co., 2016 WL 3791123 (S.D. Ill. Mar. 31, 2016)</td>
<td>$57,000,000</td>
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Settlements – Non-Proprietary Fund Cases

Many non-proprietary cases still had self-dealing elements to them, e.g.


Kruger v. Novant Health, Inc., 2015 WL 10008719 (M.D.N.C. Nov. 9, 2015) – Alleged “extensive business relations” between Novant and the service provider alleged to have received excessive fees.

Tussey v. ABB, Inc., 850 F.3d 951 (8th Cir. 2017) – Affirming trial judgment for plaintiffs because investment selection included “too many coincidences to make the beneficial outcome for ABB serendipitous”

## Settlements – Proprietary Funds Cases

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<td>$3,800,000</td>
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<td>Figas v. Wells Fargo, No. 08-4546 (D. Minn.)</td>
<td>$17,500,000</td>
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<tr>
<td>Leber v. Citigroup 401(k) Plan Inv. Comm., No. 07-9329 (S.D.N.Y. 2018)</td>
<td>$6,900,000</td>
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<td>Main v. American Airlines, Inc., 16-cv-473 (N.D. Tex.)</td>
<td>$22,000,000</td>
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<td>Moreno v. Deutsche Bank Am. Holding Corp., 2018 WL 2727880 (June 6, 2018)</td>
<td>$14,000,000</td>
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<td>Richards-Donald v. Teachers Insurance and Annuity Association of Amer., No. 15-8040 (S.D. N.Y. 2017)</td>
<td>$5,000,000</td>
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<td>Sims v. BB&amp;T Corp., No. 15-732 (M.D.N.C. 2018)</td>
<td>$24,000,000</td>
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<td>Urakhchin v. Allianz Asset Mgmt. of Ameri., LP, No. 15-1614 (C.D. Cal. Feb. 2, 2018)</td>
<td>$12,000,000</td>
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Proprietary Fund Developments

• Proprietary fee litigation continued to develop in 2018.
  • Proprietary fee cases = plan is offering funds in which employer or affiliated company has an interest, e.g., Putman funds in the Putman 401(k) plan.
  • Claims may include §404(a)(1) breach of fiduciary prudence and loyalty duties, as well as §406(a) and (b) prohibited transactions of fiduciaries and parties in interest

• Plaintiffs generally survive motions to dismiss if they could allege a loss to the plan/participants and some fact consistent with defendant acting in the employer/fund provider’s interest, e.g.:
  – limiting funds to proprietary funds.
  – having higher cost proprietary index funds.
  – using plan investments to seed new proprietary funds.
Proprietary Fund Developments

- **Brotherson v. Putnam Inv., LLC, 907 F.3d 17 (1st Cir. 2018)**
  - Vacated and remanded portions of D. Mass. 2017 Decision in favor of Putnam. District court’s decision failed in following manner:
    - On PTE 77-3 defense analysis, should not have considered discretionary contributions Putnam made as *employer* to determine fairness of dealings with plan as *fiduciary*.
    - On PTE 77-3 defense analysis, should have considered full effect of Putnam dealings with plan in determining whether “less favorable” than dealings with other Putnam customers.
    - On procedural prudence loss analysis, if find procedural prudence deficiencies in selecting proprietary fund offerings as whole, must consider returns of *portfolio of funds* offered against benchmark.
    - Burden of Proof on remand: If plaintiff proves loss and procedural prudence deficiency, burden of persuasion shifts to defendant on lack of causation between deficiency and loss (circuit split).
**Proprietary Fund Developments**


  - Affirming D. Minn. dismissal of breach of fiduciary of prudence and loyalty claims for failure to survive *Twombly/Iqbal* Rule 12(b)(6) standard.
  - Alleging breach based on selecting “inordinately expensive and underperforming” proprietary Wells & Fargo target date funds requires more than alleging other available target date funds were cheaper or performed better.
  - Must make allegations that offered proprietary funds were imprudent based on other alternative funds that “provide a sound basis for comparison—a meaningful benchmark.”
  - Alleging that other target date mutual funds had better returns and lower fees not sufficient for breach of prudence or loyalty claim plausible, if comparator funds had different investment strategies.
Proprietary Fund Developments

**Other Noteworthy 2018 Decisions**

- **Bekker v. Neuberger Berman Group LLC**, 2018 WL 4636841 (S.D.N.Y. Sept. 27, 2018) (401(k) participant has standing to allege claim against fiduciary if alleges selected fund underperformed in comparison to benchmark fund; no fiduciary breach pled unless allegations of benchmark fund show similarity to proprietary fund; §406(b) claim survives as defendant has burden to establish reasonableness of fees under §1108(b) exemption).
- **Sims v. BB&T Corp.**, 2018 WL 3128996 (M.D.N.C. June 26, 2018) (summary judgment denied where recordkeeping performed by employer affiliate, fees alleged excessive, not rebated to plan; employer stock offered in unitized fund structure not imprudent, even if represents large part of investments).
General Developments

- Claims challenging low-cost funds because allegedly could have offered cheaper share classes or funds have had mixed results:

- On claims challenging inclusion of retail versus institutional share class, courts are looking at (i) whether actually had ready access to institutional share class, and (ii) whether extra fees paid on retail shares were reimbursed to the plan under revenue sharing.

- Plaintiffs have generally lost on claim should have offered stable value fund instead of money market fund.

- Plaintiffs lost to date on claims challenging fees robo advisors pay recordkeepers. Courts said no fiduciary conduct when recordkeeper disclosed arrangement to plan fiduciary, who agreed to it.
Fiduciary Risk Alternative Investments

- In 401(k) and 403(b) plans, plaintiffs have challenged target-date and other plan funds that contained non-standard mix of investments that underperformed against market benchmarks.
  - Claims challenging investments in defined benefit plans have faced issue of whether plaintiffs have standing/injury-in-fact if plan is well funded.

- Courts generally rejecting these claims on 401(k) and 403(b) plans when (i) fund’s investment strategy was disclosed, and (ii) participants had opportunity to invest in other more plain-vanilla investments.

- A “Sequoia Fund” case concerning Ruane, an investment advisor
- The Sequoia Fund is a “non-diversified, long-term growth mutual fund”
- The Fund allegedly “over-concentrat[ed] its investments in one, high risk stock: Valeant Pharmaceuticals”
- “[C]ontrary to National Indemnity's argument, its offering of ‘eighteen other investment options’ in the underlying Plan is not dispositive of Muri's breach of prudence claim.”
- Plausible that fiduciary failed to monitor the stock, which would reveal the “red flags” surrounding Valeant.


- Dismissed similar claims against Sequoia Fund
- Dismissed prudence claim because complaint “offers no direct allegations of flaws in Defendants' process.”
Deviations from Stable Value Funds

_Barchock v. CVS Health Corp., 886 F.3d 43 (1st Cir. 2018)_
_Ellis v. Fid. Mgmt. Tr. Co., 883 F.3d 1 (1st Cir. 2018)_

• First, in _Ellis_, the First Circuit “rejected a claim that an ERISA fiduciary imprudently managed a stable value fund by, among other things, establishing too conservative of a benchmark (despite disclosing and then exceeding that benchmark) and not investing in higher-risk, higher-return instruments.”

• Then in _Barchock_, the First Circuit rejected a claim that the manager’s “imprudence can be inferred solely from their complaint's charge that [the fiduciary’s] cash-equivalent allocation ‘departed radically’ from both industry averages and the underlying financial logic of stable value management.”

• Plaintiffs “need to point to something more than merely that the CVS fund's cash-equivalent allocations were higher than those means in order to state a claim of imprudence under ERISA. Otherwise, in the plaintiffs' words, we are left with ‘just cavils about deviation from industry standards.’”