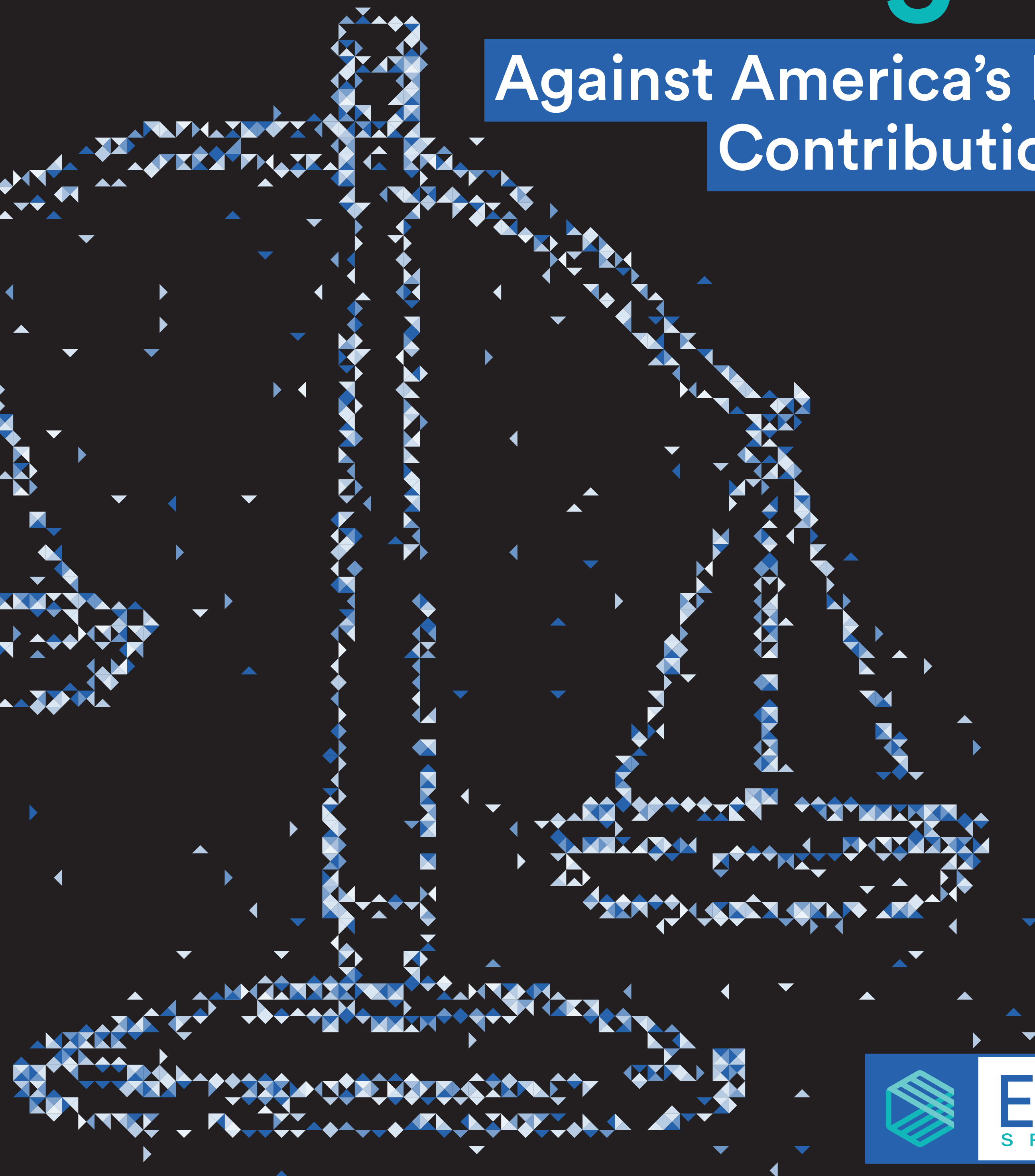
Exposing Excessive Fee Litigation

Against America's Defined Contribution Plans



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The Problem with Excessive Fee Litigation

Plaintiff law firms have flooded the federal courts with cookie-cutter ERISA class action litigation against defined contribution plans and the employees who agree to serve as fiduciaries for their company's retirement plans. The copy-cat lawsuits — now nearly 200 in number with over 90 filed in 2020 alone — attack retirement plan investment options that are commonplace and longstanding. These lawsuits allege that defined contribution plan administrative and investment fees are too high, and that any investment performance that lags any plaintiff-asserted benchmark — a moving target — is actionable negligence that should generate huge indemnity payments and high attorney fees to the firms bringing these lawsuits. Fiduciary liability insurance companies have paid an estimated $1B+ in settlements and well over $250 million in attorney fees to a growing network of plaintiff firms chasing these outsized fee awards. Fiduciaries of all defined contribution plans are at risk, particularly as new plaintiff firms are targeting smaller plans. These cases represent litigation profiteering in its most insidious form. Systemic reforms are necessary before American employers decide the cost and risk of offering voluntary defined contribution plans is too high.

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Perspective is needed.

The retirement plans being sued provide quality and safe investment options from reputable providers. The onslaught of excessive fee lawsuits is not a warning that retirees' savings are in jeopardy. In fact, the opposite is true: in nearly every case, the asset size of many of these plans being sued has increased — often by billions of dollars — in the long bull market of the last ten years. Nor do these cases allege or proffer evidence that any plan fiduciaries took illegal gratuities, that any plan fiduciary personally benefited from the alleged decision, or made any fiduciary decisions based on improper pressure. To the contrary, the plan sponsors being sued have an incentive to offer employees the best possible options to save for retirement — and many plans offer matching contributions to help them do so.

Going further, we have seen nothing to suggest that plan participants think their plan fees are too high. Lawyers opportunistically decided the fees were too high and are trolling the internet advertising their services to find a retirement plan participant — often a disgruntled employee — who is willing to sue their employers. The lawsuits are generated by lawyers who are taking advantage of a weakness in the ERISA fiduciary regulatory framework that allows easy access to courts.

The litigation bar is very low.

Plaintiff firms only have to claim negligence; assert a purported benchmark; and then hope to survive a motion to dismiss to leverage the crushing cost of litigation and huge damage models, coupled with the fear of individual liability under ERISA fiduciary law. The problem is that the corporations, universities and other plan sponsors being sued face immense pressure to settle any claims that survive the pleadings stage, because ERISA class actions are extremely costly to litigate, and the amount of money at stake with inflated damages models is staggering.

Inconsistent Rulings and Costly Litigation

Despite the unfairness and capricious nature of these lawsuits, all it takes is a plaintiff-friendly judge who does not understand real-world plan management and is persuaded that individual investors have somehow been harmed. Some courts have dismissed a small minority of cases, but not before expensive litigation. But other courts have embraced this new litigation, praising the plaintiff law firms as pioneers and trailblazers in reducing fees for the America's retirees. Retirement plan fees have indeed gone down, but not without wasteful litigation time and expense. Instead of ERISA serving as a uniform standard defined by regulators, as intended by Congress, plan sponsors now face the threat of expensive litigation and inconsistent rulings — rulings that depend on where the case is filed and whether the judge assigned to the case is conservative or progressive.

The Fiduciary Liability Insurance Market is in Crisis

Another critical factor is the availability of quality fiduciary liability insurance — the necessary lynchpin to protect fiduciaries against personal liability under ERISA. Settlements in excessive fee cases to date have been paid by insurance companies. But what started as a problem for fiduciary insurance companies has reached an inflection point. Given the capricious nature of these lawsuits in which nearly every large plan is at risk, fiduciary insurers have had no choice but to raise insurance premiums, increase policyholder deductibles, and restrict exposure with reduced insurance limits.

Large plans are now having trouble finding adequate and affordable fiduciary coverage because of the excessive fee litigation. Plan sponsors are facing sticker shock in their annual renewals. If plan sponsors cannot purchase adequate fiduciary liability insurance to protect their plan fiduciaries, the next step is to stop offering retirement plans to their employees.

This whitepaper is designed to highlight the problem of excessive fee lawsuits and present a sensible framework to restore sanity and fairness to the defined contribution landscape. ERISA was designed to provide plan sponsors, who have no requirement to provide their employees with a retirement plan, a uniform and predictable standard of care. Federal courts and the Department of Labor (DOL) need to act decisively to stop the litigation profiteering. Regulators need to articulate a fair and reasonable legal standard for plan fiduciaries and remove the uncertainty and crushing expense of liability through class action litigation. And courts need to enforce a more rigorous standard to plead fiduciary negligence to reduce in terrorem litigation.

But until this happens, all plan sponsors need to recognize that the cost and risk of offering a defined contribution plan has changed drastically. Plan sponsors must hire qualified independent consultants with expertise in defined contribution management to review their fees and investment performance. Plan sponsors cannot do this alone. They need expert help to fight back against the menace of excessive fee litigation with fee risk management.

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The Mechanics of Defined Contribution Plan Fees

Defined contribution plans are tax-advantaged savings vehicles in which individuals typically select the asset allocation of their accounts given the range of investment options offered by their plans. Fees can be paid directly by employers to cover all costs, but most plans are structured so that employers have no expense to offer the plan. In these plans, the fees to operate the plan are asset-based fees that come out of investments and/or recordkeeping fees that are charged against participant accounts. Plan participants pay these investment fees as they are deducted from retirement savings. These fees are often invisible to employees because they are included with investment expenses or they are not visible as line-item transactions. In addition, many plans have individual participant fees that are charged to participant accounts. These fees appear as transactions on participant statements along with a description of the service.

In general, 401(k) plan fees can be categorized as follows:

- **Plan administration** — Administrative support services of the plan are provided to the employer and participants in the form of recordkeeping (see below), consulting, legal, regulatory, compliance, communication and education services. This includes the process of designing, launching, monitoring, and terminating 401(k) plans. Plan administrators are responsible for developing a plan document that lays out the plan's rules. They also make sure the plan follows its own rules and any relevant laws.

- **Recordkeeping** — Recordkeeping fees are the specific type of plan administrative costs that involve tracking plan assets. The plan recordkeeper accounts for how much assets you have, and what type of money it is (pre-tax or after-tax, and employer matching). Recordkeeping services include posting payroll contributions, plan payments, earnings and adjustments; plan and participant servicing and communications; compliance testing and other regulatory requirements; and educational materials and services. Recordkeeping services are performed by a variety of service providers, including mutual fund companies, insurance companies, banks or third-party administrators (TPAs).

- **Investment management** — These are the fees for investing plan assets in stocks, bonds, and other instruments. Most 401(k) plans use mutual funds for this service. These asset-based fees are reported as an expense ratio of the mutual fund, separate account, commingled account, or other investment product in the plan.

- **Financial advice** — Some plans provide help with plan investments. The financial advisor is often a primary point of contact on small retirement plans, spending time with employers and plan participants and acting as an intermediary and translator between other service providers.

- **Consulting and other services** — 401(k) plans are complex, requiring specialized skills and guidance to keep the plan in good working order and to avoid taxes and penalties.

Payment for administrative services can be handled in a number of ways: the plan sponsor will determine if the employer or the participant pays the fees, and how it is addressed. Payment for administrative services is generally handled through one or more of the following methods:

- Dollar per participant fees that are paid for by the employer, participant or both;

- Dollar per plan fees that are paid by the employer, participant, or both;

- Asset-based fees (based on a percentage of plan or investment assets) that are paid by the employer, participant or both; and

- Specialized participant activity related fees, most often paid for by participants engaging in the activity (e.g. loans).

Asset-Based Versus Per-Participant Fees

Historically, the industry fee standard for recordkeeping services has been to charge recordkeeping fees based on a percentage of assets through revenue-sharing agreements, and not per participant fees. Just as investment managers for the mutual funds included in plan lineups charge asset-based fees, so do some recordkeepers, incorporating those fees into the expense ratios of the investments. Nevertheless, most excessive fee cases assert that asset-based recordkeeping fees are a per se violation of ERISA and subject to huge damages. A challenge to asset-based fees survived a motion to dismiss in *Sacerdote v. New York University* and *Cunningham v. Cornell University*, but was dismissed in *Divane v. Northwestern University*. In the *Northwestern University* case, the defense emphasized that a per-participant fee structure disproportionately discriminated against participants with smaller account balances. From this perspective, the judge concluded that it is not inherently imprudent to allocate fees on an equal percentage of assets.

Cammack Retirement Group, an expert in advising many of the types of university plans that have been targets of excessive fee lawsuits, has argued "[t]he concept that all recordkeeper fees should be no more than $35 per participant for most large plans is flawed because it assumes that all recordkeepers provide exactly the same services for all plans. Even plans that have an identical number of participants and the same total plan assets may have very different service models." For example, recordkeeper fees will vary based on service differentiation, because some plan sponsors use the recordkeeper to provide online education and advice to plan participants.

Revenue Sharing

Revenue sharing is another fee component of some plans. A confusing and controversial concept, **revenue sharing** within defined contribution plans is when the manager of an investment option agrees to pay a portion of its investment fee to a service provider to perform certain tasks. In the case of 401k plans, this is generally the recordkeeper. The revenue sharing amount is used to help offset the cost of administrative services which would otherwise be charged directly to the plans and/or participants. The investment providers' payment to the recordkeeper helps cover the costs of recordkeeping multiple accounts, while the investment provider services one large account. When plans use proprietary investment options — that is the investment provider is affiliated with the plan's recordkeeper — some of those asset-based investment fees can be used to cover administrative services. The Supreme Court ruled in *Hecker v. Deere* that "it did not violate ERISA to use revenue-sharing for plan expenses." But this has not stopped the excessive fee plaintiff bar from asserting that revenue sharing demonstrates actionable negligence.

Typical Allegations in Excessive Fee Litigation

Excessive fee litigation involves allegations that a plan is paying too much to its investment manager and recordkeeper. Specifically, the lawsuits allege that some of the plans' investment options charged excessive fees or performed inadequately, and that the costs to administer the plan are too high. Plan fiduciaries have a duty under ERISA fiduciary law to ensure that plan investment management and recordkeeping fees are reasonable, and that plan investments perform at a reasonable level. But Plaintiff firms are exploiting these duties by suing plans for conduct that used to be routine. Historically, the long-accepted key to reducing liability for the plan sponsors was to provide self-directed investment options to plan participants from top-quality investment managers like Fidelity and Vanguard. But plaintiff law firms are arguing that a higher standard of duty is required: that you must have the lowest possible fees available for plan administrative options and investment options, and only offer investment options that beat all possible benchmarks. These lawsuits have attacked commonplace and historical methods of defined contribution management, including asset-based fees and revenue-sharing agreements, as breaches of fiduciary duty that justify inflated damages models.

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The theories of liability continue to expand and evolve, but the **core themes of excessive fee litigation** are that: (1) the plan sponsor failed to manage the administrative expenses of the plan by ensuring the lowest possible recordkeeping costs; (2) failed to ensure the lowest possible cost of investment management; and (3) breached fiduciary duties by offering underperforming or ill-suited investment options to plan participants. The core premise for larger plans is that they failed to leverage their size to reduce administrative and investment management costs. The investment performance claims are more insidious because plaintiffs proffer their own carefully selected "benchmark" to allege underperformance. The damage models in this type of litigation can be staggering, because even a small reduction of plan expenses or purported investment loss is enormous for large plans with large assets.

The **core themes** break down as follows:

(1) Failure to monitor and control plan administrative expenses: The main premise of excessive fee litigation is that plan fiduciaries failed to monitor or prudently manage recordkeeping fees. The lawsuits allege that plan fiduciaries breached their fiduciary duties by failing to monitor and control the plan's administrative fees and causing the plan to pay excessive fees. Plaintiffs assert that prudent fiduciaries negotiate reasonable administrative fees, monitor all sources of revenue paid to plan recordkeepers, regularly monitor plan fees and compare them to competitive market rates, and diligently negotiate fee reductions to benefit participants.

- **Asset-based fees versus per-participant fees:** Plaintiffs assert that retirement plan fiduciaries allow recordkeepers to charge fees based on the assets in the plan, when they should charge a flat-dollar amount per participant. The argument behind this claim is that the cost for providing recordkeeping services to participants should be roughly the same, regardless of the amount of assets a participant has in their account. Some of the lawsuits cite industry experts claiming that the fees for most large plans should not exceed $35 per participant.

- **That revenue sharing paid to recordkeepers is improper and evidence of excessive fees to the extent not rebated to plan participants.** When some funds have revenue-sharing fees, but others do not, plaintiffs can allege that the cost of the plan are inordinately or unfairly born by certain participants and not others.

- **Failure to conduct record-keeping RFPs on a periodic basis, particularly as fees have come down dramatically in the last three years.** The plan sponsor did not conduct a regular competitive bidding process through a request for proposal (RFP) to obtain the most competitive recordkeeping and administrative services for the plan.

- **Use of related company as a recordkeeper or multiple active recordkeepers.** Having multiple providers allegedly led to significantly higher recordkeeping fees and subsequently lowered the account accumulations for the plan participants. Retirement plans may experience higher fees as a result of using multiple recordkeepers because each vendor in a multi-vendor environment must spend more resources to collect fewer contributions. This typically leads to the recordkeeper charging higher fees than if they were the exclusive provider.

(2) Failure to monitor/prudently manage investment fees: Breach of fiduciary duties by including plan investments with excessive and unreasonable investment management fees. Prudent retirement plan fiduciaries must select the lowest-cost available share classes for retirement plan investment alternatives.

- **Retail v. institutional funds — not ensuring that the investment option is the lowest cost share class offered by the investment company**

- **Less expensive investment options available**

(3) Inclusion of or failure to monitor imprudent investment options: Claims that the plan sponsor included one or more investments in the plan lineup that underperformed the benchmark for the fund's asset class.

- **Inclusion of poorly performing investment options**

- **Inclusion of employer's proprietary funds**

- **Failure to choose an appropriate option within investment category (e.g., stable value v. money market as capital preservation option)**

- **Active versus passive investments:** the manager failed to competently select the underlying holdings, which cost participants potential for investment return, and thus participants are not receiving any value for these higher fees. The claims thus argue that the fiduciaries should have used passive investment options instead of active ones in the plan.

- **Improperly offering only (more expensive) actively managed investments**

- **Too many investment options.** A frequent issue in excessive lawsuits is that the retirement plan offers too many investment options, causing "analysis paralysis" or confusion because of the "dizzying array" of duplicative funds. Another theory is that because some investment managers offer a better pricing structure to retirement plans as more assets are allocated to their investments, the distribution of plan assets among a large number of investment options can mean that the plan and participants do not receive the benefit of these price breaks within the funds.

- **Offer anything, but the absolutely cheapest share class available**

- **Offered money market funds in lieu of stable value funds as a plan's capital preservation**

- **Offered proprietary funds**

CASE STUDY: Anthem

A summary of the excessive fee lawsuit against Anthem filed by the leading Schlicter law firm that settled for $23,650,000 gives a good example of the typical playbook for excessive fee lawsuits. The Anthem complaint made three basic allegations:

(1) That the plan selected overly expensive share classes: Despite the allegations of excessive fees, most of the investments were nevertheless in Vanguard funds, which has a reputation for low-priced fees. For example, the plan offered the Vanguard Institutional Index Fund with a 4-basis point fee, but plaintiffs argued that the plan committee should have leveraged its multi-billion size to demand the 2 basis point fee that was available in a lower-cost share class. Plaintiffs also argued that the plan offered the Vanguard Extended Market Index Fund at 24 basis points when a 6-basis point share class was allegedly available. The plaintiff attorneys further asserted that collective trusts and separately managed accounts were available that were even cheaper, and that less expensive, but virtually identical, investments should have been used.

(2) That they overpaid the recordkeeper: The complaint alleged that the plan paid excessive administrative fees to the recordkeeper: "Because recordkeeping costs are not affected by account size, prudent fiduciaries of defined contribution plans negotiate recordkeeping fees on the basis of a fixed dollar amount for each participant in the plan rather than as a percentage of plan assets. Otherwise, as plan assets increase through participant contributions or investment gains, the recordkeeping compensation increases without change in the recordkeeping and administrative services, leading to excessive fees."

(3) That they offered a money market fund rather than a stable value fund: The complaint alleges that it was imprudent to have the money market fund in the line-up when stable value funds that paid much higher interest rates were available.

Active versus Passive Funds — The Brotherston Case

Some cases have gone further to allege that any plan offering actively managed funds, which necessarily will be more expensive than passive index funds, are a *per se* breach of fiduciary duty. Specifically, these complaints allege that plans with actively managed plans allegedly violate a fiduciary duty of care if these plans do not outperform a purported benchmark of market index funds with lower fees. In fact, the First Circuit Court of Appeals in *Brotherston v. Putnam Investments* adopted this view after asserting that "ERISA's borrowing of trust law principles is robust," and holding that "any fiduciary of a plan . . . can easily insulate itself by selecting well-established, low-fee and diversified market index funds. And any fiduciary that decides it can find funds that beat the market will be immune to liability unless a district court finds it imprudent in its method of selecting such funds and finds that a loss occurred as a result. In short, these are not matters concerning which ERISA fiduciaries need cry 'wolf.'" From our perspective, this is the most damaging and unfair decision to date, because it purports to establish a new standard that finds no support in the ERISA statute or DOL regulations. It also makes nearly every existing plan subject to excessive fee liability.

Cookie-Cutter, Copy-Cat Lawsuits

It does not take much cynicism to prove that excessive fee litigation is less about helping retirement plan participants than funding an opportunistic business model for America's plaintiff's bar. The approximately 200 excessive lawsuits follow a similar template, and new law firms are copying the leading law firms by filing copy-cat complaints. In fact, the clever defense lawyers of leading ERISA defense law firm Morgan Lewis & Bockius made this point very effectively in their July 2020 motion to dismiss the excessive fee case against the University of Miami, highlighting how law firms are copying previously filed complaints in order to chase high fee recoveries: the "Complaint is a *literal* copy-and-paste job: Its allegations, right down to the typos, are lifted directly from complaints in other cases about other plans offered by other universities . . ." In that case, the plaintiff law firm did not even take the time to ensure that the allegations from another lawsuit were updated and adjusted to the facts of a new plan.

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The State of Play

Excessive fee filings have become frequent in the last several months and it is difficult to track every lawsuit, and we do not pretend to have perfect statistics. But we nevertheless have a good pulse on the filings in order to provide an informed perspective. Since 2015, there have been close to 200 defined contribution investment fee and performance lawsuits filed [and some arbitration demands that do not make the public record], with the pace accelerating dramatically in recent months as new law firms enter the arena.

Motions to dismiss are filed in virtually every case, but only approximately one-third of the motions to dismiss have been granted on all claims. Approximately 10-15% of the cases filed over two years have made it to a decision on summary judgment, but only approximately 25% of filed motions have resulted in complete defense victories. Because most cases are settled when insurance companies are forced to pay to avoid bad faith failure to settle within policy limits, only six cases have gone to trial. By our count, four trials have resulted in complete defense victories, but one was reversed by the circuit court and later settled; one resulted in a complete plaintiff victory; and one resulted in a mixed ruling. Despite the poor showing of plaintiffs in the handful of cases that have gone to trial before a federal court judge, approximately sixty of the cases open for at least two years since 2015 have settled. The aggregate settlements exceed $1.2B million with approximately $285 million in attorney fees awarded. In 2019 alone, Plaintiffs secured over $231 million in fee litigation settlements, including receiving over $77 million in attorney fees.

Plaintiffs continue to refine their arguments and have pushed the novel fiduciary standards even further. Plaintiffs now argue that any fee above $30-50 recordkeeping fee per participant is imprudent depending on plan size. Plaintiffs are now challenging investments with ultra-low fee and very small under-performance. Significantly, plaintiffs are now targeting plans of all sizes — not just large plans. In the last two years, for example, plans with assets as low as $194 million, $52.2 million, $59 million, and $4.5 million have been sued.[1] Plaintiffs continue to develop and pursue new theories and trends, including bringing fee litigation involving relatively small 401(k) plans, claims based on investment options having modestly higher fees and/or slight underperformance as compared to plaintiffs' handpicked comparables, and claims based on service providers' use of participant data to market-related services.

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Disparate Outcomes:
A Comparison of two recent cases

As leading ERISA defense lawyers from Proskauer have aptly summarized, "[c]ourts are applying evolving, contemporary standards to evaluate fiduciary conduct."[2] The disparate results in the *White v. Chevron* and *Bell v. Anthem* cases — Chevron was dismissed while Anthem settled for $23 million despite similar plan designs — demonstrate the current unfairness in the system of allowing litigation to set a new standard of care. Both cases involved jumbo defined contribution plans in which Plaintiffs challenged the offering of Vanguard and other index funds in 401(k) plans, arguing that cheaper share classes of the same Vanguard funds were available and that plan fiduciaries allowed Vanguard to charge excessive recordkeeping fees.

Chevron's plan had assets over $19 billion. In the excessive fee case filed in 2016, plaintiffs alleged that participants lost over $20 million through unnecessary expenses because Chevron included 10 Vanguard funds, including some with fees as low as 5 basis points, for which there were allegedly identical Vanguard funds available with lower-cost share classes.

In *Bell v. Anthem*, Anthem's plan had total assets worth over $5 billion. Plaintiffs similarly alleged that the plan failed to leverage its large size to demand lower-cost investment options and administrative fees from its recordkeeper Vanguard. The allegedly "high-cost" investment options included Vanguard funds with fees as low as 4 basis points. Plaintiffs claimed that the plan fiduciaries should have used their bargaining power to obtain even lower-cost share classes, including an identical lower-cost mutual fund that charged a fee of 2 basis points.

While both Anthem and Chevron involved similar plan structures and excessive fee allegations, they resulted in widely disparate outcomes. Chevron was dismissed twice in the lower federal court and the dismissal affirmed in the Ninth Circuit, while Anthem survived a motion to dismiss, was certified as a class action, survived a motion for summary judgment, and then settled for $23 million [and after what was likely millions spent in defense fees]. Similar plans with similar plan investment options, but a different result. Why? Because the cases were filed in different jurisdictions.

A Market Under Duress

Fiduciary liability insurance represents malpractice insurance for fiduciaries of employee benefit plans. Fiduciary liability insurance covers plan fiduciaries and the plan itself against claims of breach of fiduciary duty or mismanagement of the plan. To date, insurance companies have defended the plan sponsors and fiduciaries in dozens of excessive fee cases. Insurance companies have paid well over one billion in settlements, but this economic model cannot continue.

We have reached an inflection point in the war against defined contribution plans because the risk has become virtually uninsurable. The lawsuits bring huge liability with the full policy limit at risk. And the risk cannot be eliminated by due diligence as long as courts allow even the smallest difference from a purported benchmark to drive potential damages — such as the difference between two and four basis points for a Vanguard index fund. Even when the defendants prevail on a motion to dismiss or summary judgment, the cost of defense can exceed $10 million in just three to four years of protracted litigation. And the settlements put the entire fiduciary insurance tower at risk. This is an unsustainable risk environment for a fiduciary liability insurer.

In response, fiduciary insurance companies are limiting their exposure to this capricious liability by reducing limits, raising premiums, limiting excessive fee retentions, and sometimes capping — or sublimiting — the amount of excessive fee or class action exposure. While most plans focus on premium increase, the key change in the fiduciary market is the increased level of policyholder retentions. Many large plans now face retentions of one to five million dollars. Plan sponsors can no longer rely exclusively on fiduciary insurance to fund and absorb these losses. Change is needed to ensure a functioning fiduciary insurance market to protect fiduciaries exposed to individual liability. Indeed, it is important to remember that many trustees serve as volunteers with no additional compensation. A viable fiduciary liability insurance market is essential to protect against individual liability for ERISA fiduciaries.

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Reforms Needed to Restore a Fair and Uniform Fiduciary Standard of Care

A Response to Excessive Fee Litigation

Some courts are treating the Schlicter law firm and other plaintiff firms as national heroes in uncovering misconduct. For example, the District Court in Maryland recently approved $4.7 million in attorney fees requested as part of the $14 million settlement involving the $4.3 billion Johns Hopkins University 403(b) Plan. The Court praised the "ground-breaking nature of the work of Schlicter, Bogard & Denton" and "unique and unparalleled foresight for this novel area of litigation" that has reduced fees by as much as $2.8 billion in annual savings for American workers and retirees. Yet another court sanctioned the Schlicter law firm up to $1.5 million when it "recklessly pursued" its case against Great-West Capital Management to trial while ignoring red flags with the expert witness it relied on to calculate damages related to the company's mutual fund fees.[3]

It is hard to argue against reduction of fees for plan participants. But if reduced retirement plan fees are the desired public policy goal, there is a better way to achieve this outcome. As we noted in the introduction, we have not seen a single case of serious wrongdoing: no allegations of undue benefits to individual fiduciaries, or kickbacks from recordkeepers or investment providers. Nor have we seen, outside certain proprietary fund litigation, instances in which the individual plan fiduciaries were motivated by personal benefit. ERISA was enacted to limit the cost of providing an optional benefit, not to punish plan sponsors with litigation profiteering from plaintiff law firms. This perspective has been completely lost in the litigation battles involving high-priced lawyers.

We have seen many articles trying to provide advice to plans to minimize excessive fee exposure. The articles advise that plan committees need to do a better job documenting their decision processes, and further recommending that plans engage in frequent requests for fee proposals from new vendors to drive down plan expenses. But even this well-intentioned advice recognizes that there is no silver bullet against the serious liability and litigation risk given the capriciousness of the litigation tactics and standards. While every plan needs to address plan expenses, more broad-scale systemic change is needed, starting with intervention from the regulators responsible for overseeing the retirement system.

Euclid recommends the following reforms to restore fairness and balance to the fiduciary liability regulatory framework for retirement plan fiduciaries:

REFORM #1

The Need for a Uniform and Rational Standard of Care from Federal Regulators

Plan sponsors deserve a uniform ERISA standard that is predictable, achievable and rational. They should not be subjected to the high cost and burden of litigation. The Department of Labor must step in and define a uniform, rational standard of care, instead of allowing plaintiff firms to establish a painful, ad-hoc new standard of care through punishing and expensive litigation. Without regulatory intervention, we will endure different outcomes for years until higher courts can restore some sanity.

The Department of Labor in 2012 instituted rule 408(b)(2) fee disclosures to plan participants. DOL clearly cares about plan fees and took important steps to provide more transparent fee disclosures to plan participants. But DOL focused on the plan recordkeepers and the investment providers to provide fee transparency. As the primary regulator for retirement plans, DOL focused on fees, but did not articulate the higher standards being advocated in excessive fee lawsuits. Specifically, DOL did not set any rule that plans must engage in RFPs for recordkeepers every three years, and there is no such rule in ERISA. DOL did not outlaw revenue sharing or require that all plans — regardless of the size of participants accounts — must have recordkeeping fees on a per participant basis as opposed to a percentage of assets. And DOL did not require passive-only index funds for defined contribution plans. None of these rules exist in the ERISA statute or any related fiduciary regulations, but all of these purported standards have been asserted in excessive litigation and embraced by some courts — at least to the point of allowing cases to proceed to discovery, which creates the dynamic of in terrorem settlements based on inflated damage models and fear of exhausting available fiduciary coverage.

Ad-hoc negligence standards was not the intent of ERISA. To the contrary, ERISA was enacted to replace state-by-state regulation with a comprehensive regulatory framework.

Ad-hoc negligence standards was not the intent of ERISA. To the contrary, ERISA was enacted to replace state-by-state regulation with a comprehensive regulatory framework. Its purpose was to provide a uniform regulatory regime over employee benefit plans. As noted previously, employers are not required to establish benefit plans for their employees, but ERISA encourages them to do so by assuring a predictable set of liabilities, under uniform standards of primary conduct. ERISA attempts to balance the need for employers to offer quality retirement plans against the need for proper fiduciary governance. Like many statutes, ERISA reflects the legislature's balancing of competing objectives. The statute seeks to ensure that employees receive the benefits that they were promised, but without discouraging employers from establishing benefit plans. As the Supreme Court has explained, Congress took care "not to create a system that is so complex that administrative costs, or litigation expenses, unduly discourage employers from offering welfare benefit plans in the first place."[4] ERISA aims to provide "uniform standards of primary conduct" in place of a patchwork of state laws.[5]

One of ERISA's core features is a standard of care for plan fiduciaries. Fiduciaries must act loyally — solely in the interest of the participants and beneficiaries; and prudently — "with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims.[6] A fiduciary is personally liable if they breach these duties, and must "make good to such plan any losses to the plan resulting from each such breach."[7] The law gives discretion to fiduciaries to meet the needs of their participants without a formulaic standard.

The current litigation landscape undermines ERISA's promise of uniformity and predictability.

We note two important caveats. First, once DOL articulates a standard, plans need time to adapt to the new standard of care. If DOL agrees with the heightened standard, then plans need time to engage consultants to change their plan fees — without liability for past acts. In the current environment, even when plans made significant changes, starting with a RFP for lower plan recordkeeping fees, the plaintiff lawyers use this as proof that the prior practices were somehow flawed. The principle of subsequent remedial measures must apply to give plans a chance to meet a transparent standard articulated by responsible regulators.

Second, we further note an important exception when proprietary investments are involved. There is an old saying that "bad facts make bad law." This risk comes into play when the investment option in the plan is related to the investment adviser. These proprietary cases raise different issues and should be judged by a different standard. We fully recognize the potential conflicts of interests that exist when a recordkeeper recommends investments from a related investment manager. At the same time, rulings in proprietary cases should not be used to define what constitutes an ERISA fiduciary breach when the investment options offered have no conflicts of interest. The test for fiduciary negligence must be different when the recordkeeper or investment manager is not offering its own investment products.

REFORM #2

Federal courts must apply a uniform, rigorous standard in ruling on a motion to dismiss in excessive fee cases.

ERISA's promise of uniform standards of primary conduct cannot be fulfilled when courts treat identical allegations differently under inconsistent pleading standards.[8]

As the Supreme Court has said, motions to dismiss are "important mechanisms for weeding out meritless claims." *Fifth Third Bancorp v. Dudenhoeffer*, 573 U.S. 409, 425 (2014). This bedrock principle is supposed to apply in ERISA cases. But it is not working out that way.

In *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 554, 557 (2007), the Supreme Court held that allegations that are "merely consistent with" antitrust violations — but "just as much in line with" lawful behavior — fail to state a claim for relief. The Court reaffirmed that principle in *Ashcroft v. Iqbal*, 566 U.S. 662, 678, 684 (2009), stressing that *Twombly* provides "the pleading standard for 'all civil actions.'" In *Fifth Third Bancorp v. Dudenhoeffer*, 573 U.S. 409, 426 (2014), it held that "the pleading standard as discussed in *Twombly* and *Iqbal* governs breach of fiduciary duty claims under the ERISA. But despite this clear guidance from the Supreme Court, appellate courts have not all used the *Twombly* standards in excessive fee cases. For example, in *Sweda v. University of Pennsylvania*, a divided Third Circuit panel decline[d] to extend *Twombly*'s antirust pleading rule to such claims and revived an excessive fee class action against the university.

The difference is stark. In the four circuits that apply the more rigorous *Twombly* standard to excessive fee ERISA claims — the Second, Seventh, Eighth and Ninth Circuits — courts have dismissed complaints at the pleadings stage. But when the *Twombly* standard is not rigorously enforced, cases are allowed to proceed to the discovery stage, which gives plaintiffs undue leverage to demand huge settlements. Under the *Twombly* standard, merely alleging some of the plan's investment options charged excessive fees or performed inadequately is insufficient, regardless of the sound reasons that would support the decision to make sure investment options are available to plan participants. Unless the allegations "show that a prudent fiduciary in like circumstances would have acted differently," they do not clear the *Twombly* threshold. Stated differently, the *Twombly* standard requires an excessive fee case to be dismissed if the conduct alleged to be negligent is equally consistent with competitive business strategy in the market as they are with a fiduciary breach.

Where there is a concrete, obvious alternative explanation for the defendants' conduct, a plaintiff may be required to plead additional facts tending to rule out the alternative. If the complaint's allegations are merely consistent with liable acts, the complaint stops short of the line between possibility and plausibility. When both lawful and unlawful conduct would have resulted in the same decision, a plaintiff should not survive a motion to dismiss by baldly asserting that unlawful conduct occurred. For example, the recent Ninth Circuit ERISA ruling in *White v. Chevron* grounded its statement of the pleading standard for fiduciary breach claims in one of the court's application of *Twombly* to securities claims: "[w]here there are two *possible* explanations, only one of which can be true and only one of which results in liability, plaintiff cannot offer allegations that are merely consistent with its favored explanation but are also consistent with the alternative explanation."[9] "Something more is needed, such as facts tending to exclude the possibility that the alternative explanation is true, in order to render plaintiff's allegations plausible within the meaning of *Iqbal* and *Twombly*."[10]

Under the proper *Twombly* standard, under-performance allegations can be little more than a "hindsight critique of returns" which cannot show that a fiduciary acted imprudently at the time the fiduciary made the challenged decision. Plaintiffs must show that a reasonable fiduciary "would have acted differently" — for example by not offering the investment because it was so plainly risky or by offering a superior alternative instead. Most excessive fees cases would be dismissed under this heightened standard from the Supreme Court, but it is not being used uniformly.

Plaintiffs in the Northwestern ERISA case that was dismissed by the Seventh Circuit, upholding the district court's dismissal of the initial complaint, have appealed the decision to the U.S. Supreme Court. The Seventh Circuit's decision held that courts must credit the defendant's explanation for not offering lower cost options for the retirement plan before allowing a well-pleaded complaint to proceed. The Supreme Court asked the acting U.S. Solicitor General for an opinion as to whether they should accept the appeal. The Plaintiffs are represented by the Schlicter law firm, who filed a Petition for a Writ for Certiorari, pointing out that the Seventh Circuit's position conflicted with how courts have handled motions to dismiss excessive fee cases in three other federal circuits. The Supreme Court should accept this case and establish a rigorous pleading standard to weed out frivolous antitrust cases.

Plan sponsors deserve a consistent and predictable standard for weeding out the many copy-cat meritless cases in which new law firms are chasing a business model of suing defined contribution plans to leverage an easy settlement. The alternative is subjecting every plan sponsor to millions of dollars in defense costs to defend an excessive fee case, and damages of ten to fifty million dollars if they lose the motion to dismiss. ERISA's promise of uniform standards of fiduciary responsibility cannot be fulfilled when courts treat identical allegations differently under inconsistent pleading standards. Federal courts need to act like responsible gatekeepers to eliminate unfair litigation against most retirement plans and limit excessive fee cases to the plans with the most egregious fees or lack of diligence and plans that contain over-priced proprietary products.

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REFORM #3

Federal courts must apply a damages cap and limit attorney fees to reduce the outsized damages.

It does not take much cynicism to understand that the surge in excessive fee lawsuits has been driven by the quest for huge attorney fees, and not to increase the retirement savings of America's workers. The core theory of excessive fee cases is that plan fiduciaries have allowed the plan to pay too much to its recordkeeper and investment manager. This is simple negligence. But the damages model of $25 million to $200 million in most lawsuits is not congruent for a claim of simple negligence. Federal courts, as gatekeepers to these lawsuits, must rein in the absurd damages models that are driving the litigation and forcing reluctant settlements. The same goes for attorney fee awards. Allowing attorney fees of twenty-five to one-third percent of these outsized settlements should be eliminated. Attorney fees should be capped to stop the frivolous litigation that threatens to eliminate the availability for employer-subsidized employee benefit plans.

REFORM #4

Recordkeepers and investment providers to America's DC plans must take responsibility and bear the burden of allegations of excessive fees.

If a court finds a recordkeeper overcharged a plan, they should bear a share of the responsibility and return the fees — or offset future fees to fund the alleged overpayments.

Fidelity recently settled its own proprietary fund litigation for its employees for $28.5M. Press reports indicate that the settlement was funded by Fidelity's professional liability insurers. This case is the poster child for how perspective has been lost in the excessive fee lawsuits. Fidelity was accused of charging too high of fees to its own employees. In other words, the damages represent amounts allegedly overpaid to Fidelity itself, but Fidelity somehow bears no ultimate responsibility by not having to return any alleged overpayments. Fiduciary liability insurers should not have to pay this amount. If there was any wrongdoing — and courts continue to allow outsize damages models ranging from $10 million to $50 million — it is the recordkeeper or investment manager that should bear the burden of reimbursing plan participants for alleged excessive fees — not the plan sponsor, fiduciaries or their fiduciary liability insurance carrier.

Stop Blaming the Victim

If there is a retirement plan fee problem in America, the process is backwards in that the victim is being blamed: the lawsuits criticize the plans for purported excessive fees paid to recordkeepers and investment managers. By comparison, when drug companies are accused of charging excessive prices for drugs, we do not allow lawsuits by patients against hospitals and healthcare companies for purportedly failing to leverage their size to pay lower drug prices. Instead, we blame the drug companies directly. By contrast, the excessive fee lawsuits attempt to assert a new and higher standard of care under fiduciary law that plan fiduciaries are somehow not getting the lowest possible fees from Fidelity, Vanguard and other major gatekeepers of American defined contribution assets. Instead of seeking remedies against Fidelity and Vanguard to provide fee transparency and lower their fees for all retirement plans — or help from regulators to reduce the fees charged by plan recordkeepers [like what is being done for drug prices] — the plaintiff bar is instead alleging that the stewards of America's retirement plans have engaged in wide-scale mismanagement and negligence. They have hijacked the federal ERISA statute to drive huge attorney fees by creating new liability by judicial fiat. Every plan sponsor is at risk because the standard is capricious and the tactic carries huge liabilities.

Vanguard, Fidelity, TIAA CREF and other recordkeepers and investment managers must bear the burden of the alleged excessive fees. These recordkeepers must offer the lowest share class funds available and certify that they are the lowest share-class available. These recordkeepers should be added as additional defendants to these lawsuits. If anyone has primary liability, it is the party who received the fees — not the party who paid them. If lower class shares are available — and a court requires that lower-cost share as the fiduciary standard — then the recordkeeper should be liable, not the plan committee.

Finally, until equity and fairness are restored to the system, plan sponsors should demand that recordkeepers and investment managers certify in writing that they have been offered the lowest-possible share price for every investment, and the lowest possible record-keeping offered for similar priced plans. The investment managers should have the responsibility to provide transparent pricing and fee structures. Regulators must demand that recordkeeper and investment managers disclose all fees that they charge and demonstrate where on the spectrum of fees each plan is paying. Instead of allowing plaintiff lawyers to seek justice through inefficient litigation, the vendors need to be held accountable if lower fees are required under new ERISA fiduciary standards.

If anyone has primary liability, it is the party who received the fees – not the party who paid them.

De-Risk Your Plan For Excessive Fee Risks

As this whitepaper has demonstrated, every defined contribution plan is now at risk and must change how it is doing business. If you want to offer a retirement plan, you must engage in risk management to reduce plan recordkeeping and investment fees.

Heightened Risk Management: Plan sponsors must hire an experienced consultant to review plan fees and investment performance annually.

Every plan fiduciary must take the following list into every quarterly plan meeting to ensure that your plan has a documented approached to ensuring the plan fees are as low as possible:

- **Document Your Fee and Performance Reviews:** Review plan fees and investment performance every quarter and document the due diligence. Benchmark that your plan fees are reasonable based on industry benchmark. Use flat-per-participant fees when possible, but document why any percentage-based recordkeeping fees are used in the plan (i.e., if your plan has many accounts with small asset levels).
- **Low Fees that are not tied to a percentage of assets:** Ensure that all plan recordkeeping fees are offered on a low, flat fee, instead of a percentage of assets.
- **Formal RFPs to Reduce Fees:** Engage in a formal Request for Proposal with plan vendors at least every three years. Fees have gone down dramatically in the last five years. If you have not acted to reduce fees, then your plan fees are likely above peer plans.
- **Low-Cost Index Funds:** Ensure that your plan has low-cost index funds, even if you have actively managed funds in your plan's investment lineup.
- **Lowest-Cost Share Fees Available:** Make your investment manager certify that you have the lowest cost funds available.
- **Eliminate Revenue Sharing:** Reduce all recordkeeping expenses, or have these fees applied to participant accounts.

Hire a Plan Expert to Reduce Plan Recordkeeping and Investment Fees

Even if your plan committee has diligently addressed and documented a thoughtful process to reduce plan fees, you still need an expert to de-risk your plan and reduce fees. This is a new cost of doing business. The fiduciary standard alleged in the typical excessive fee lawsuit cannot be achieved by mere mortals. You cannot do this yourself. Fidelity, Vanguard, T. Rowe Price and others have multiple mutual fund offerings with complex fee structures, and only an experienced expert can tell you if you have the lowest possible class of mutual fund shares. Only an expert can explain the hidden fees and other pitfalls. Risk management is more than just purchasing fiduciary insurance. Plan committees must hire an expert to de-risk their expense exposure.

Only an expert can explain the hidden fees and other pitfalls. Risk management is more than just purchasing fiduciary insurance. Plan committees must hire an expert to de-risk their expense exposure.

The standard needs to be defined and reduced to something that is reasonable and achievable — as noted above — but until this happens, most plan fiduciaries are without investment expertise and thus cannot achieve the standard that the plaintiff law firms are claiming is the new ERISA standards. Again, let us be clear: federal judges must reject this purported standard and limit outsized damage awards. But until that happens, plan fiduciaries must hire an expert to review plan fees and investment performance. It is a new cost of doing business if an employer wants to sponsor a defined contribution plan. Without expert help, you are subjecting the plan and its fiduciaries to serious liability — liability that may no longer be funded exclusively by fiduciary insurance.

Plan sponsors with small plans need to consider the new PEP options to reduce fees by joining with other companies.

The Setting Every Community Up for Retirement Enhancement (SECURE) Act, beginning in 2021, will allow for the creation of Pooled Employer Plans (PEPs), which are a close analog to open multiple employer plans (MEPs). As the size threshold diminishes for plans at risk of excessive fee cases, even plans with less than $100 million are at risk of liability. Every small plan that cannot leverage lower recordkeeping and investment fees should consider pooling its retirement plan with other plans in a PEP. This will not eliminate liability, but it creates the opportunity to lower costs and offer a better retirement plan for your employees. The PEP system is still in its infancy, but it is an opportunity that should be fully explored by every small employer.

Conclusion

A resetting of perspective and expectations is needed to guide the proper level of fiduciary responsibility for the nation's defined contributions system. Core changes and reforms are needed to restore fairness to the system: (1) the Department of Labor needs to set a uniform standard and guidance on the appropriate level of fees based on plan size and participant count; (2) federal courts must weed out meritless cases with the proper standard; and (3) the financial providers and recordkeepers need to take responsibility if the regulators believe that the fees charged are too high.

We do not dispute that lower fees help America's retirees. But litigation should not be the vehicle to address this issue. The Department of Labor needs to provide clarity and uniform guidance for plan sponsors, and limit damages and litigation to bad actors. Changes to the standard of care should be driven by regulators and addressed to the recordkeepers and financial providers, not the plan sponsors who are merely the customers of these services. Plaintiff law firms have unfairly hijacked ERISA fiduciary liability to drive lower fees. If this is a desired regulatory goal, there is a better way to achieve this, and it starts with the Department of Labor. In the meantime, federal courts need to put a break on meritless excessive fee lawsuits and enforce an achievable, fair, and uniform standard of care that ERISA was designed to provide.

About the Author

Daniel Aronowitz is the Managing Principal and owner of Euclid Specialty, a leading fiduciary liability insurance underwriting company for America's employee benefit plans. Dan has nearly thirty years of experience in the professional liability industry as a coverage lawyer and underwriter, and is a widely recognized fiduciary liability expert and thought leader. He is the author of Euclid's Fiduciary Liability Insurance Handbook and the fiduciary liability insurance chapter of the Trustee Handbook published by the International Foundation of Employee Benefit Plans. He is a graduate of The Ohio State University and Vanderbilt University School of Law and has achieved the RPLU+ designation from the Professional Liability Underwriting Society.

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Euclid Specialty Managers, LLC is an insurance program administration company specializing in fiduciary liability insurance coverage for America's employee benefit plans. Euclid offers best-in-class fiduciary, crime/ERISA fidelity, cyber liability, employment practices, and other professional liability insurance coverages to protect the fiduciaries of U.S. employee benefit plans. Our underwriters and claim professionals are experts in complex fiduciary liability and crime exposures, with decades of fiduciary liability experience and expertise.

Endnotes

1 See *Davis v. Stadion Money Mgmt., LLC,* No. 1:19-cv-00119 (M.D.N.C. Jan. 25, 2019) (excessive fee case involving plan with only $29.4 million in assets); *Torres v. Greystar Mgmts. Servs., L.P.,* No. 5:19-cv-00510 (W.D. Tex. May 13, 2019) (excessive fee case involving plan with $194 million in assets); *Savage v. Sutherland Global Servs, Inc.,* No. 6:19-cv-06840 (W.D.N.Y. Nov. 13, 2019) (excessive fee case with plan of $52.2 million in assets); *Diaz v. BTG Int'l Inc.,* No. 2:19-cv-01405 (C.D. Cal. Feb. 25, 2019) (excessive fee case with only $59 million in plan assets); *Draney v. Westco Chems,, Inc.,* No. 2:19-cv-01405 (C.D. Cal. Feb. 25, 2019) (excessive fee case with only $4.5 million in plan assets).

2 *Fee Litigation 2019 Round-Up: Recent Developments and Best Practices to Mitigate Risk,* Robert Rachal, Myron D. Rumeld & Tulio D. Chirinos. Benefits Law Journal. Spring2020, Vol. 33 Issue 1.

3 *Obsleo v. Great West-West Capital Management,* No.16-cv-00230-CMA-SKC (September 28, 2020).

4 *Varity Corp. v. Howe,* 516 U.S. 489, 497 (1996).

5 *Rush v. Prudential,* 536 U.S. at 379. [need full citation]

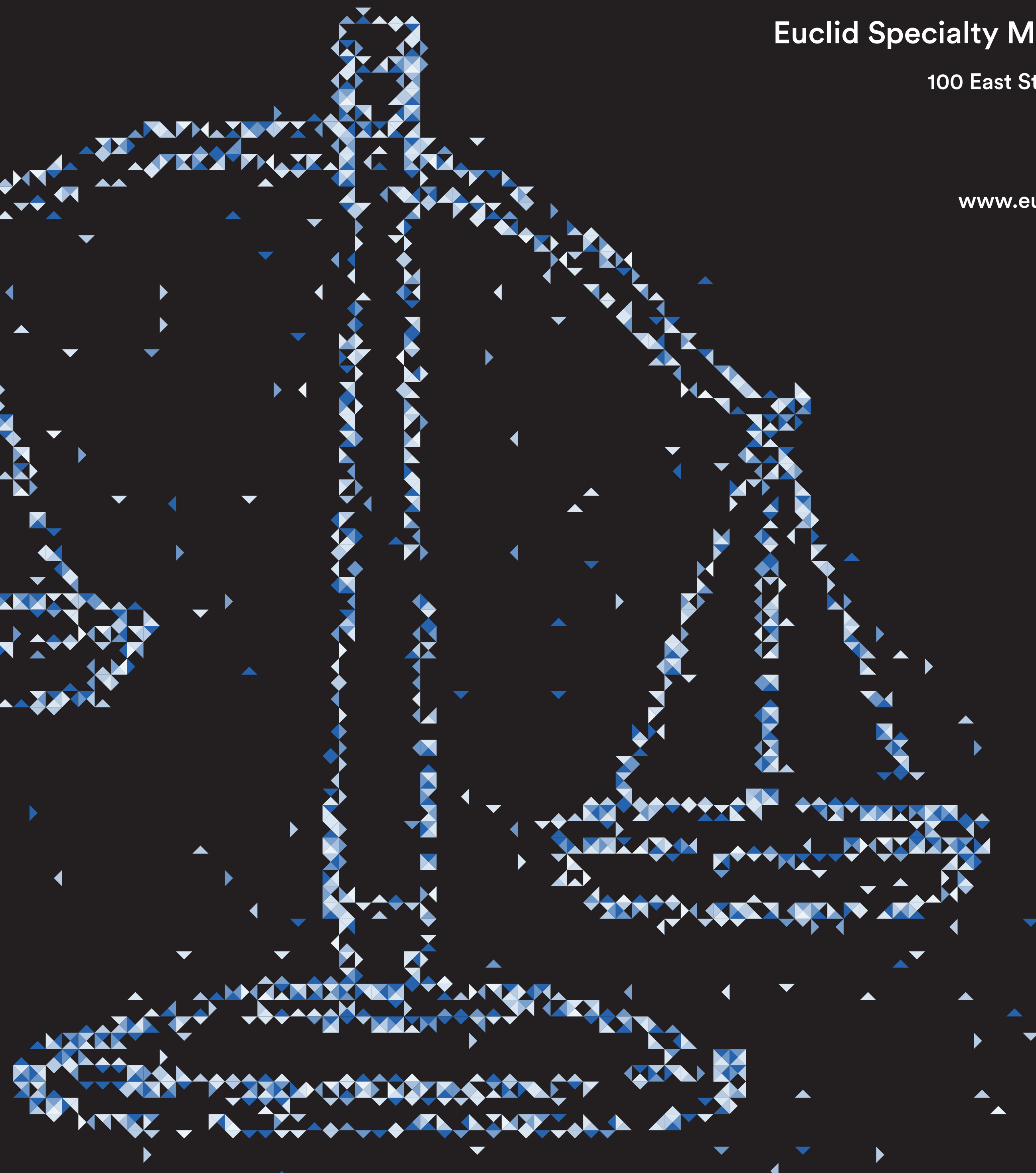
6 29 U.S.C. 1104(a)(1)

7 29 U.S.C. 1109(a).

8 The best explanation of the importance of the *Twombly* standard is the Petition for A Writ of Certiorari filed in the *University of Pennsylvania v. Jennifer Sweda* before the Supreme Court, which was authored by David B. Salmons and other attorneys of Morgan, Lewis & Bockius. Euclid Specialty thanks the Morgan Lewis ERISA Practice for raising this critical issue in such an effective manner.

9 *White v. Chevron Corp.,* 752 Fed Appx. 453, 454 (9th Cir. 2018) (quoting In re Century Aluminum Co. Sec. Litig. 729 F.3d 1104 108 (9th Cir. 2013).

10 Id. At 454-455.



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