
LEGAL UPDATE

They Are Back: New Theories from the Plaintiffs' Bar in 401(k) Litigation

Marcia S. Wagner, Esq.

The first wave of litigation challenging fees and expenses paid by 401(k) plans hit not quite 10 years ago, spurring change in the way plan fiduciaries approach their duties as well as regulatory reform. The targets of these cases were large plan sponsors and related plan committees,

managers, and investment providers. The complaints alleged that these defendants breached their fiduciary duties by failing to negotiate reasonable fees for investment and administrative services and neglecting to monitor and control hard dollar and revenue sharing payments made directly or indirectly

by plans. A few cases went to trial, notably *Tibble* and *Tussey*, but most were dismissed or settled. A practical result arising from one of the conditions of these settlements was recognition that retail class mutual funds were not appropriate plan investment options if cheaper institutional class funds with the same underlying investments were available.

Plan fiduciaries adapted to the new conditions and changed their practices to ensure that investment options were properly vetted and regularly monitored and that written records detailing the basis for fiduciary decisions were maintained. For a while, this culminated in a feeling of safety that was probably reinforced by the fact that many of the excess fee complaints filed in recent years seemed to focus on plans maintained by financial service providers who constructed plan investment menus consisting of their own proprietary funds. This facilitated claims that plan sponsors engaged in prohibited transactions by favoring their affiliates engaged in providing investment advisory or administrative services. Such is the nature of the recent complaint against Insuperity, the human resources provider, and Reliance Trust in which Insuperity was charged with a breach of its fiduciary duties for hiring a subsidiary as the plan's recordkeeper; it also was claimed that Reliance violated its trustee responsibilities by offering its proprietary funds as plan investments. These types of conflicts do not generally occur outside the financial services industry. Recently, however, the plaintiffs' bar has refined its theories of liability and renewed its assault on the 401(k) plans of large employers with the apparent goal of establishing bright-line tests that will automatically result in plan sponsor liability if fees or investment results fail to measure up.

The Anthem Complaint. Examples of this new wave of 401(k) fee litigation are the cases filed against Fidelity Investments and Anthem Health in December 2015. The new case against Anthem can be viewed as a bridge between the old and new liability theories, since it initially focuses on investments in more expensive Vanguard investor shares rather than cheaper Vanguard institutional shares, even though the alleged pricing differential ranged from 2 to 22 bps and was arguably significant only because the Anthem plan, with 60,000 participants and \$5 billion in assets, is so large. Anthem reformed its investment menu 30 months ago by replacing the investor shares with institutional shares, so the complaint also avers that "millions" could have been saved if the plan had (1) replaced actively managed mutual funds with passively invested mutual funds, and/or (2) replaced mutual funds altogether with collective trusts and separately managed accounts.

The plaintiffs in the Anthem case attempt to significantly narrow the discretion afforded plan fiduciaries over investment decisions by advocating that actively managed mutual funds be ruled out as an acceptable investment, because "no investment manager consistently beats the markets over time

after fees have been taken into account." This conclusion is not based on any statute, regulation, or guidance from an administrative agency but from journals and magazines, some of which were published over two decades ago. The idea is to place the burden of proving why mutual funds continue to be offered as plan investments on the plan investment committee. This will enable expensive and time-consuming discovery to determine if the defendants adequately investigated non-mutual fund alternatives, such as collective trusts and separately managed accounts.

The complaint employs the same tactic with respect to fees for recordkeeping services by asserting that the plan should have paid no more than \$30 per participant for such services. How this figure was derived is not explained; interestingly, the plaintiffs' attorneys argued that the standard was \$35 per participant in a lawsuit instituted against Novant Health in 2014. Since the \$42 charge to each participant's account for recordkeeping instituted by Anthem in 2013 is greater than the averred \$30 standard, the complaint argues that it was fiduciary breach. The complaint seeks to impose another new fiduciary standard by asserting that this problem should have been resolved by putting administrative services out to bid every three years.

From the plaintiffs' perspective, however, the \$30 benchmark serves what may be the more important purpose of allowing their attorneys to argue that any revenue sharing received by the plan's recordkeeper attributable to plan services should have been taken into account in evaluating the reasonableness of the recordkeeper's fees. The complaint argues that any excess revenue sharing should have been recaptured for the benefit of the plan. Even though revenue sharing is not, technically speaking, a plan asset, the defendants appear to be vulnerable on this point.

Dissatisfaction with Fidelity's Stable Value Fund. The new class action against Fidelity challenges the management of its stable value fund which was a pooled investment vehicle whose assets were held in a trust of which Fidelity was the trustee. It is worth noting that if the stable value fund in this case had been structured as a mutual fund, it would not have been possible to bring this action, because ERISA specifically provides that the underlying assets of a mutual fund are not plan assets, and consequently Fidelity would not have been an ERISA fiduciary with respect to the fund's management. Of course, there would more of this kind of lawsuit if the plaintiffs' bar got its way and mutual funds were to become a *per se* imprudent investment.

To make sense of the complaint, an understanding of how stable value funds work is needed. In this case, the fund's underlying investments consisted of bonds with three to four years duration, which provided a better yield than a money market fund whose assets are much shorter in duration. Since the market value of these longer-term assets corresponds to the rise and fall of interest rates, the fund manager needs to

buy guarantees from other financial institutions in order to smooth out the crediting of interest.

Fidelity was caught short by the financial crisis of 2008 due to the fact that it invested the stable value fund in mortgage-backed securities which lost significant value. Given that the stable value fund's underlying assets were debt instruments of several year's duration, this had a long-lasting effect, and Fidelity was required to invest the fund more conservatively than it might otherwise have done. The question posed by the new class action is whether Fidelity's investment strategy, which resulted in underperformance, but apparently not actual losses, for several years after 2008 is actionable

under ERISA. The plaintiffs' contention is that returns should have been higher by 70–170 basis points a year, but this may simply be a case where hindsight is 20/20. Similarly, the plaintiffs complain that the fund's expenses were 14 basis points above the norm. For plan sponsors, the question is whether retaining such a fund on a plan's investment menu would also constitute a fiduciary breach.

Marcia S. Wagner is the Managing Director of The Wagner Law Group. She can be reached at 617-357-5200 or Marcia@WagnerLawGroup.com.