401(k) Plan Fee Litigation and the Heightened Fiduciary Liability Standard

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Introduction [*]

Buoyed by their success in fee litigation cases against plan fiduciaries, [1] plaintiffs' counsel are bringing more lawsuits seeking to impose heightened fiduciary standards for 401(k) plans. In an unprecedented surge, plaintiffs filed at least a dozen fee litigation lawsuits between December 2015 and February 2016. These suits include challenges against:

(i) 401(k) plans that offer Vanguard and Stable Value Funds (SVFs), which are typically regarded as low cost, conservative funds; [2]

(ii) non-traditional investments offered in 401(k) plans, such as through target date funds, that did not perform well in hindsight;

(iii) insurers offering what they believe are ERISA-exempt guaranteed benefit contracts; [3] and

(iv) investments in target date funds. [4]

[1] *See* Robert Rachal, Lindsey Chopin & Robert Sheppard, *View from Proskauer: 401(k) Fee Litigation—Practices to Mitigate Fiduciary Risk*, BNA Pens. & Ben Daily (Jan. 7, 2015)(03 PBD, 1/6/16).

[2] *See* Complaints, *Bell v. Anthem Inc.*, No. 1:15-cv-02062 (S.D. Ind. Dec. 29, 2015), ECF No. 1, amended March 16, 2016, ECF No. 23; *White v. Chevron Corp.*, No. 4:16-cv-00793 (N.D. Cal. Feb. 17, 2016), ECF No. 1; *Bristol v. Mass. Mut. Life Ins. Co.*, No. 3:16-cv-00139 (D. Conn. Jan. 29, 2016), ECF No. 1; *Pledger v. Reliance Trust Co.*, No. 1:15-cv-04444 (N.D. Ga. Dec. 22, 2015), ECF No. 1, amended Apr. 15, 2016, ECF No. 37; *Barchock v. CVS Health Corp.*, No. 1:16-cv-00061 (D. R.I. Feb. 11, 2016), ECF No. 1; *Ellis v. Fidelity Mgmt. Trust Co.*, No. 1:15-cv-14128 (D. Mass. Dec. 11, 2015), ECF No. 1; *Jacobs v. Verizon Commc'n Inc.*, No. 1:16-cv-01082 (S.D.N.Y. Feb. 11, 2016), ECF No. 1; *Moreno v. Deutsche Bank Americas Holding Corp.*, No. 1:15-cv-09936 (S.D.N.Y. Dec. 21, 2015), ECF No. 1, amended Mar. 30, 2016, ECF No. 27; *Rosen v. Prudential Ret. Ins. & Annuity Co.*, No. 1:15-cv-01839 (D. Conn. Dec. 18, 2015), ECF No. 1, amended Apr. 6, 2016, ECF No. 35; *Wittman v. New York Life Ins. Co.*, No. 1:15-cv-09596 (S.D.N.Y. Dec. 8, 2015), ECF No. 1; *Wood v. Prudential Ret. Ins. & Annuity Co.*, No. 1:15-cv-01785 (D. Conn. Dec. 3, 2015), ECF No. 1.

[3] *See Teets v. Great-West Life & Annuity Ins. Co.*, No. 1:14-cv-02330, at *22-23, 2016 BL 202591 (D. Colo. June 22, 2016) (granting class certification of a class of more than 270,000 retirement plan investors challenging the ERISA-exempt status of a guaranteed benefit contract).

[4] *See, e.g.,* Complaint, *Johnson v. Fujitsu Tech.& Bus. of Am.*, No. 5:16-cv-03698-NC, at 11, 120-134 (N.D. Cal. June 30, 2016), ECF No. 1.

The U.S. Department of Labor's new fiduciary rule could conceivably lead to even more fee litigations. [5] By expanding the scope of individuals and entities subject to ERISA's fiduciary requirements, the rule could likewise expand the potential targets for such lawsuits.

[5] *See* 29 C.F.R. §2510.3-21 (2016); For a further discussion and analysis of the new fiduciary rule, *see also* Proskauer Client Alert, *U.S. Department of Labor Finalizes Fiduciary Definition and Conflict of Interest Rule*, (April 19, 2016), available at http://www.proskauer.com/publications/client-alert/us-department-of-labor-finalizes-fiduciary-definition-and-conflict-of-interest-rule/.

While these developments cause concern for plan sponsors and plan fiduciaries, they also can identify areas of potential exposure, and provide insights on best practices to mitigate the risk of what appear to be ever heightening fiduciary standards.

Overview of Fee Litigation Cases

As 401(k) plans supplemented the traditional defined benefit (pension) plan as the primary vehicle for funding employee retirement, beginning in 2006 plaintiffs' counsel commenced a wave of ERISA fiduciary lawsuits challenging the fees and expenses associated with 401(k) plans. [6] Initially, these fee litigation lawsuits challenged "revenue sharing" arrangements with plan service providers and claimed that the selection of various types of investment options, such as retail mutual funds and actively managed funds, charged plan participants excessive fees. [7]

[6] *See* Howard Shapiro, Robert Rachal, & Tulio Chirinos, *Fees and Expenses Litigation in Defined Contribution Plans*, in ERISA Litigation, 1033, 1034 (5th Ed. 2014 and 2015 Supp.).

[7] *Id*. at 1034-35.

Defendants prevailed in many of those cases; [8] however, several rulings resulted in substantial settlements and judgments. For example, three notable and long-running fee litigation cases settled in 2015 for over $220 million, including the payment of over $80 million in attorneys' fees. [9] Plaintiffs achieved these results despite losing on many of their claims. But fee litigation operates like hydraulic pressure, probing for any weak parts in plan management, even when the plan is overall well-managed. These recent developments have emboldened plaintiffs to push the envelope in fee litigation cases, including bringing claims against 401(k) plans that offer very low cost funds and against investment vehicles and providers previously considered exempt from ERISA, such as insurers offering investment policies with guaranteed rates of return.

[8] For a more complete analysis of the claims, issues and cases arising in fee litigation, *see supra* Shapiro et. al.

[9] *See Haddock v. Nationwide Life Ins. Co.*, No. 01-cv-1552, slip op. at 2 (D. Conn. Mar. 26. 2015), ECF No. 597 (Plaintiffs' Unopposed Memorandum in Support of Final Approval of Class Action Settlement); *Haddock v. Nationwide Life Ins. Co.*, No. 01-cv-1552, slip op. (D. Conn. Apr. 9. 2015), ECF No. 601, (Final Order Approving Settlement); *Abbott v. Lockheed Martin Corp.*, No. 3:06-cv-701 (S.D. Ill. July 2, 2015), ECF No. 520 (plaintiffs' memorandum in support of joint motion for settlement); *Abbott v. Lockheed Martin Corp.*, No. 3:06-cv-701 (S.D. Ill. July 20, 2015), ECF No. 526 (final order approving settlement); *Krueger v. Ameriprise Fin. Inc.*, No. 11-cv-2781, slip op. at 1-2 (D. Minn. July 13, 2015), ECF No. 624, (Final Order Approving Settlement); *Krueger v. Ameriprise Fin. Inc.*, No. 11-cv-2781, slip op. at 1-2 (D. Minn. July 13, 2015), ECF No. 623 (Order Granting Motion for Attorneys' Fees).

New Complaints Seeking to Impose Heightened Fiduciary Standards

In a significant new development, beginning in late 2015, plaintiffs' counsel began bringing claims against 401(k) plans that offer as investment options Vanguard and Stable Value Funds. These claims are surprising, because plaintiffs' counsel have previously argued that fiduciaries should use Vanguard funds in 401(k) plans because they often have relatively lower index-based fees as compared to other investment options. [10] Similarly, plaintiffs and courts alike have noted that

SVFs offer stability over money market funds, based on their holdings of longer-duration instruments, and that through various "wrap contracts" with banks or insurance companies they "guarantee the fund's principal and shield it from interest-rate volatility." [11]

[10] *See Leber v. Citigroup, Inc.*, No. 07 Civ. 9329 (SHS), 2010 BL 55992, 48 EBC 2418 (S.D.N.Y. Mar. 16, 2010) (plaintiffs alleged, in part, that defendants violated their ERISA fiduciary duty when they invested in funds that had higher fees than comparable Vanguard Funds).

[11] *See Abbott v. Lockheed Martin Corp.*, 725 F.3d 803, 806, 2013 BL 216743, 56 EBC 2352 (7th Cir. 2013) (explaining that "SVFs generally outperform money market funds, which invest exclusively in short-term securities. To provide the stability advertised in the name, SVFs are provided through 'wrap' contracts with banks or insurance companies that guarantee the fund's principal and shield it from interest-rate volatility").

Vanguard Claims

Plaintiffs have brought two fee litigation cases against Anthem and Chevron based, in part, on their inclusion of Vanguard funds that plaintiffs claim charged excessive fees in relation to other share classes that were allegedly available.

- In *Bell v. Anthem Inc.*, plaintiffs alleged that Anthem's 401(k) plan, with assets worth over $5 billion, [12] failed to use its considerable bargaining power to demand lower cost investment options. [13] This type of claim is not new in fee litigation cases, but what is new is that at least 10 of the allegedly high cost investment options were Vanguard mutual funds; [14] one of the allegedly high-cost Vanguard funds [15] charged the Anthem plan a fee of 4bps, an extremely low fee compared to an industry where fees can average well over 25bps. [16] Nonetheless, plaintiffs alleged that the plan should have used its bargaining power to bargain for even lower cost share classes, in this case an identical lower-cost mutual fund that charged a fee of 2bps. [17] In total, plaintiffs alleged that Anthem's 401(k) suffered losses of $18 million as a result of the alleged higher-cost share classes for these funds. [18]

- In claims very similar to the ones asserted against Anthem, plaintiffs alleged that fiduciaries of the Chevron 401(k) plan (with assets over $19 billion) breached their fiduciary duty by, among other things, offering lower-cost Vanguard funds and a Vanguard money market fund instead of a stable value fund. [19] Plaintiffs alleged that Chevron's decision to offer the Vanguard money market fund instead of a stable value fund cost plan participants $130 million in retirement savings. [20] Plaintiffs also challenged Chevron's inclusion of 10 Vanguard mutual funds (some with fees as low as 5bp) because there were allegedly identical Vanguard funds with lower-cost share classes available. [21] Plaintiffs alleged that Chevron's use of the higher-cost Vanguard funds contributed to plan participants losing over $20 million through unnecessary expenses. [22]

[12] As alleged in the complaint. *See* Amended Complaint, No. 1:15-cv-02062, at 10 (S.D. Ind. March 16, 2016), ECF No. 23.

[13] *Id.* at 2.

[14] *Id*. at 25, 38-45.

[15] *Id*. at 38 (The Vanguard Institutional Index Fund (Instl) (VINIX)).

[16] Rebecca Moore, *Mutual Fund Expense Rations See 20-Year Low*, PLANSPONSOR (March 16, 2016) available at http://www.plansponsor.com/Mutual-Fund-Expense-Ratios-See-20-Year-Low/?p=1.

[17] *See* Amended Complaint, *Bell v. Anthem Inc.*, No. 1:15-cv-02062, at 38 (S.D. Ind. Mar. 16, 2016), ECF No. 23.

[18] *Id*. at 41.

[19] *See* Complaint, *White v. Chevron Corp.*, No. 4:16-cv-00793 at 37, 47 (N.D. Cal. Feb. 17, 2016), ECF No. 1.

[20] *Id.* at 38.

[21] *Id*. at 47-48.

[22] *Id*. at 55.

Stable Value Fund Claims

Plaintiffs have sometimes demanded that SVFs be provided (as they did in the *Chevron* case above), but at other times they have claimed that SVFs are bad investments when they fail to perform as hoped because they allegedly deviated from the investment mix "typically" offered by SVFs. [23] These "Goldilocks" type claims are continuing:

- In *Ellis v. Fidelity Management*, one of plaintiffs' central claims concerns a fund they claimed was a SVF offered by Fidelity as an investment option in the Barnes & Noble 401(k) plan. [24] Plaintiffs alleged that the fund performed poorly because Fidelity adopted an unduly conservative investment strategy by investing in shorter average duration securities, like money markets, instead of investing in longer duration bonds. [25] Plaintiffs claimed that Fidelity had previously engaged in an overly aggressive and imprudent investment strategy for this fund but overcorrected with an overly conservative investment strategy. [26] Plaintiffs also alleged that Fidelity allowed wrap contract providers to charge excessive fees, and in turn Fidelity charged its own excessive fees. [27]

- In *Pledger v. Reliance*, plaintiffs alleged that Reliance, the trustee of Insperity's $2 billion dollar 401(k) plan, [28] breached its fiduciary duty by offering money market funds that did not keep pace with inflation instead of SVFs that could have earned an additional $14 million. [29] Plaintiffs made this claim despite the fact that Reliance added a SVF to the list of available options to participants of the plan in 2014. [30] Plaintiffs claim that the SVF was not an established enough fund because it was in existence for less than a year and underperformed other SVFs. [31]

[23] *See Abbott v. Lockheed Martin Corp.*, 725 F.3d 803, 811, 2013 BL 216743, 56 EBC 2352 (7th Cir. 2013) (explaining that Plaintiffs "aim to show that the SVF was not structured to beat inflation, that it did not conform to its own Plan documents, and that Lockheed failed to alter the SVF's investment portfolio even after members of its own pension committee voiced concerns that the SVF was not structured to provide a suitable retirement asset").

[24] *See* Complaint, *Ellis v. Fidelity Management Trust Co.*, No. 1:15-cv-14128, at 1, 12, 20 (D. Mass. Dec. 11, 2015), ECF No. 1.

[25] *Id*. at 2, 47.

[26] *Id*. at 47.

[27] *Id*. at 2.

[28] As alleged in the complaint. *See* Amended Complaint, *Pledger v. Reliance Trust Co.*, No. 1:15-cv-04444, at 2 (N.D. Ga. Apr. 15, 2016), ECF No. 37.

[29] *Id*. at 128-136.

[30] *Id*. at 135.

[31] *Id*.

Claims Against ERISA-Exempt Guaranteed Benefit Policies

In several slightly different cases, plaintiffs have challenged the ERISA-exempt status [32] of SVFs offered by insurers, including New York Life, Prudential and Great-West Life, which are ERISA-exempt to the extent that they are guaranteed benefit policies. [33] Plaintiffs' principal argument

against ERISA exemption is that because the insurers can unilaterally set the rate of return on the investments, the investments are not truly guaranteed benefit policies. [34] If the investments are found to not offer guaranteed benefits then, according to plaintiffs' theories, the insurers that manage the funds are subject to ERISA fiduciary standards. In *Teets v. Great-West Life*, the district court certified a class of over 270,000 participants to resolve, in part, the issue of whether ERISA's fiduciary standard applies to Great-West's management of a guaranteed stable value fund and whether the fund falls under ERISA's guaranteed benefit policy exemption. [35]

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[32] Under ERISA a "guaranteed benefit policy" is exempt to the extent that such "policy or contract provides for benefits the amount of which is guaranteed by the insurer." 29 U.S.C. §1101(b)(2)(B).

[33] *See* Complaints, *Wittman v. New York Life Ins. Co.*, No. 1:15-cv-09596 (S.D.N.Y. Dec. 8, 2015), ECF No. 1; *Wood v. Prudential Ret. Ins. & Annuity Co.*, No. 1:15-cv-01785 (D. Conn. Dec. 3, 2015), ECF No. 1.

[34] *See Teets v. Great-West Life & Annuity Ins. Co.*, 106 F. Supp. 3d 1198, 1203, 2015 BL 162974, 60 EBC 2391 (D. Colo. 2015) (denying motion to dismiss because the insurer's ability to unilaterally set the rate of return on the investment at issue raises a genuine issue whether a reasonable rate of return is guaranteed); *Rozo v. Principal Life Ins. Co.*, No. 14-cv-000463, 2015 BL 309423, 60 EBC 2263 (S.D. Iowa Sept. 21, 2015) (denying motion to dismiss because of fact issue as to who bore investment risk where insurer could influence interest rate risk based on how it set rates for new contracts).

[35] *See Teets v. Great-West Life & Annuity Ins. Co.*, No. 1:14-cv-02330, at *22-23 (D. Colo. June 22, 2016).

In *Teets*, the 270,000 plan participants came from 13,600 different retirement plans. [36] Plaintiffs have previously had mixed results when attempting to satisfy Rule 23's "commonality" and "typicality" requirements against service providers who offer multiple plans (sometimes thousands) with substantial variability in the services and structure offered from one plan to another. [37]

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[36] *Id.* at 13.

[37] *See Ruppert v. Principal Life Ins. Co.*, 252 F.R.D. 488, 2008 BL 194733, 44 EBC 2727 (S.D. Iowa 2008) (denying class certification because there was substantial variability in the services offered by the service provider from one plan to another and that such variability precluded the plaintiff from satisfying the "commonality" and "typicality" class requirements under Rule 23 of the Federal Rules of Civil Procedure); *cf. Haddock v. Nationwide Fin. Servs. Co.*, 293 F.R.D. 272, 2013 BL 238899, 56 EBC 2189 (D. Conn. 2013) (certifying a class against a service provider who allegedly engaged in revenue sharing in violation of ERISA in the 24,000 ERISA Plans it serviced).

Claims Challenging Alternative Investments

Plaintiffs are also attempting to prove new theories of liability related to alternative investments offered in 401(k) plans. For example, in *Johnson v. Fujitsu*, plaintiffs challenged investments in target date funds that allegedly included too many unique and non-traditional asset classes, such as natural resources and real estate limited partnerships. [38]

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[38] *See* Complaint, *Johnson v. Fujitsu Tech. & Bus. of Am.*, No. 5:16-cv-03698-NC, at 11, 124 (N.D. Cal. June 30, 2016), ECF No. 1.

Preventive Measures

The cases discussed above are all in the early stages of litigation, and at least eight have pending motions to dismiss. Regardless of the outcomes in these cases, they illustrate the ever heightening scrutiny being applied to plan fiduciaries, *e.g.*, even index funds with fees of 4bps can be targets. The low interest rate environment after the Great Recession has also put substantial pressure on money market and stable value funds, which are delivering low returns in this

environment. Low returns and poor market performance has also led to a search for alternative investments, which can also increase risk and hindsight-based second-guessing.

Plan fiduciaries can, however, engage in preventive measures that should help them defend against these newly minted claims:

- Periodically investigate share classes and fee options to ensure that the 401(k) plan is obtaining the lowest cost option for which it qualifies. This process should be well documented to defend against any later claims that a cheaper share class was readily available.

- Consider and document the fiduciary process that led to the selection even of what are considered low-risk investment options, such as money market, stable value, and target-date funds. This will help to defend against the risk of hindsight-based claims whenever any option fails to perform against benchmarks, or if plaintiffs want to challenge why certain investment options, such as SVFs, are not offered. [39]

[39] For a further discussion of practices that can lessen fiduciary risk, *see* Robert Rachal, Lindsey Chopin & Robert Sheppard, *View from Proskauer: 401(k) Fee Litigation—Practices to Mitigate Fiduciary Risk*, BNA Pens. & Ben Daily (Jan. 7, 2015) (03 PBD, 1/6/16).

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