A Closer Look at

Excessive Fee Litigation

May 26th – 2:00 EST

Our Speaker Today

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.

Agenda

- The goal of today's presentation is to take a more in-depth look at excessive fee lawsuits — beyond the superficial assessment as good or bad.
- We want to ask the more useful question: **Are the plaintiffs right** in alleging that the plan sponsor are overpaying for plan administration and investments?
- We want to analyze the cases in terms of what fees are actually being paid in plans subject to these lawsuits and whether there really is fiduciary mismanagement.
- We will look at the available benchmarks to analyze plan fees, and then assess what benchmarks plaintiffs are using to assert breaches of fiduciary duty.
- We will analyze:
  - What should be the proper motion to dismiss standard; and
  - What should be the proper damage model.
- Finally, how do Plan Sponsors fight back? We will suggest some ideas as to how plan sponsors can change their plans to prepare ahead of time, and how these cases can be better defended.

What is an Excessive Fee Lawsuit?

Three primary claims:

- Plan recordkeeping fees are too high
- Plan investment fees are too high
- Plan investment performance is too low

The lawsuits seek damages in the amount of purported excessive recordkeeping and investment fees, and purported amount of investment underperformance.

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Increasing Number of Cases Filed

The High Cost of an Excessive Fee Lawsuit

- **Defense of these cases costs millions of dollars**
- If you lose the motion to dismiss, given the risk of individual liability coupled with high damages model = plaintiffs have **undue leverage** to extract high settlement
- **Harder to secure quality fiduciary coverage**: premiums higher, retentions higher, and harder to secure sufficient limits – all large plans will now have a substantial excessive fee or class action retention.
- Fiduciary Coverage now becoming like D&O insurance, which has to contend with nuisance securities lawsuits
- Huge new cost to plan sponsors of defined contribution plans

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Plan Sponsors deserve more clarity on the proper fiduciary standard of care

If you agree that the cost an excessive fee lawsuit is high, we must reckon with two additional points:

- **The rules** must be transparent and easy to follow: i.e., is it a breach of fiduciary duty to use active funds? Do you need to conduct a formal RFP if you believe your fees are competitive – and if so, how often do you need to RFP?
- **The standard** to judge what fees are high or unreasonable must be reliable and trustworthy – a "meaningful benchmark"
- Finally, the **standard to judge a motion to dismiss** must be fair and uniform
  - Courts should only allow appropriate cases to proceed past a motion to dismiss: Meritless cases must be thrown out to avoid in terrorem settlements.
  - Plan sponsors deserve a uniform, national standard to judge fiduciary conduct related to plan fees and investment performance.

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The Universe of Defined Contribution Plans

<$10MM Plan	$10–50MM Plan
Assets: $925,854MM **Plans:** 754,701 **Participants:** 22,685,285	**Assets:** $864,922MM **Plans:** 45,315 **Participants:** 15,490,953

$50–200MM Plan	>$200MM Plan
Assets: $941,229MM **Plans:** 10,299 **Participants:** 14,938,663	**Assets:** $5,531,061MM **Plans:** 5,021 **Participants:** 58,559,073

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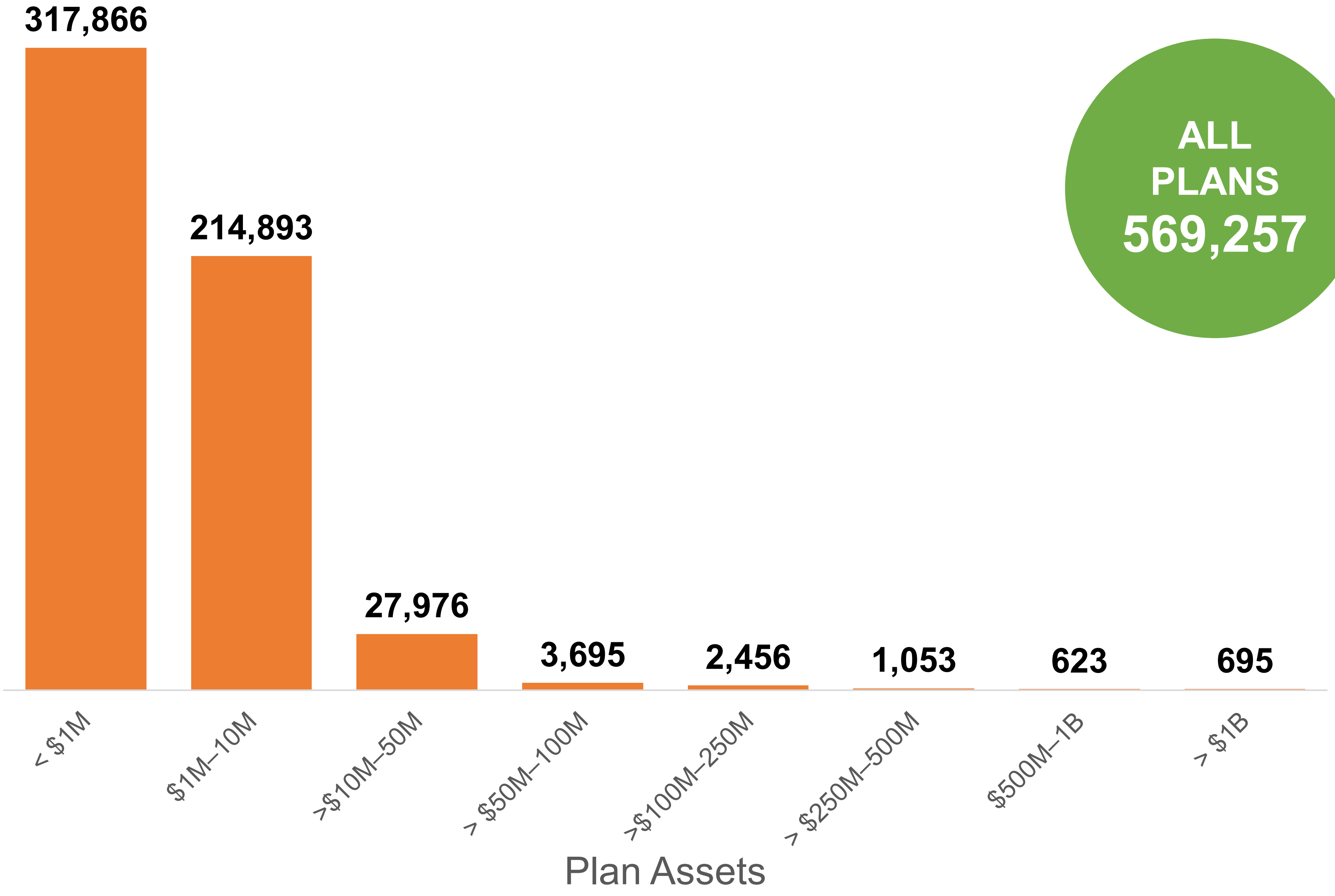
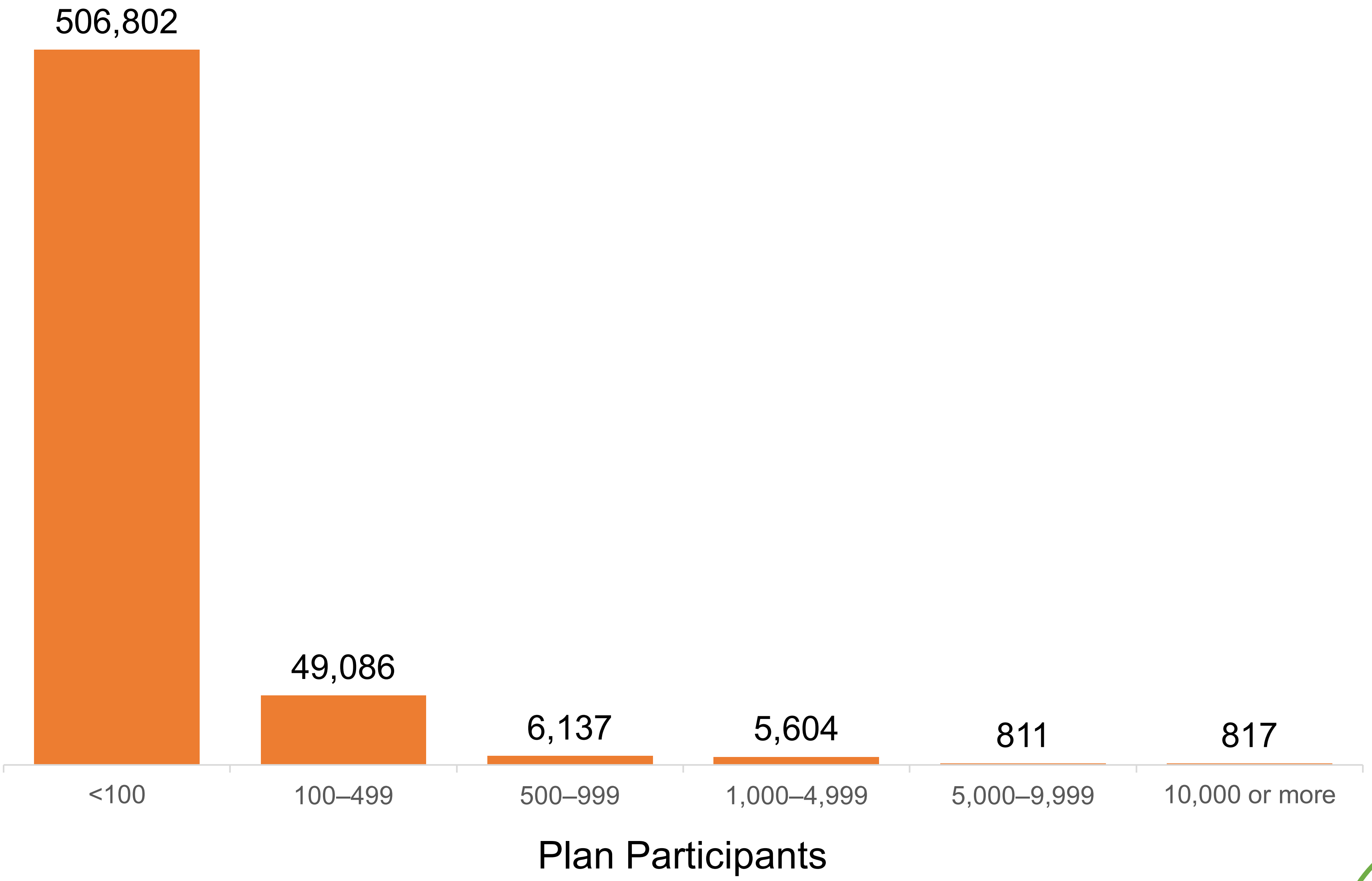
Universe of 401k plans by asset size



ALL PLANS
569,257

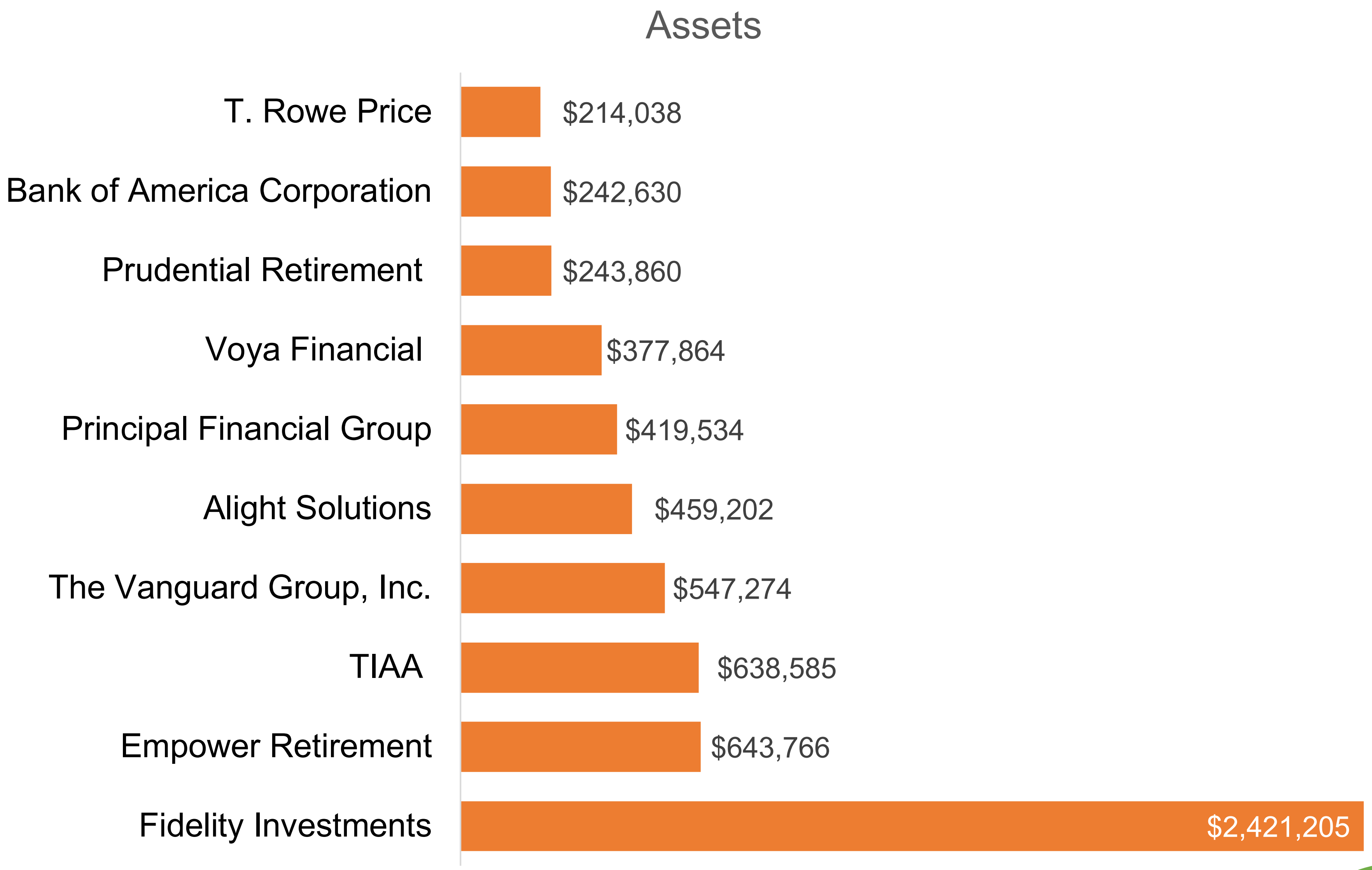
Universe of 401k Plans by Participant Count



The probability of being sued is high for a large plan

- This data also shows the high probability in any given year that a large plan with over $1B in assets will be sued.
- With 97 cases in 2020 alone – most against plans over $500M in assets – a plan over $1B in assets has at least a 10% chance of being sued in any given year, and a $500M plan has at least a >5% chance of being sued.
- The actual percentage for large plans is even higher because many large plans have already been sued.
- This also demonstrates why plaintiff firms have started working downstream to sue plans between $100m and $500m.

Top Recordkeepers



Source: 2020 Best in Class DC Providers - PLANSPONSOR

401k Plan Benchmarks

What is available to benchmark plan fees?

The search for a reliable and fair benchmark of plan fees

"Comparing apples and oranges is not a way to show that one is better or worse than the other."

Davis v. Washington Univ. in St. Louis,
No. 18-3345, __F.3d__, 2020 WL 2609865 (8th Cir. May 22, 2020).

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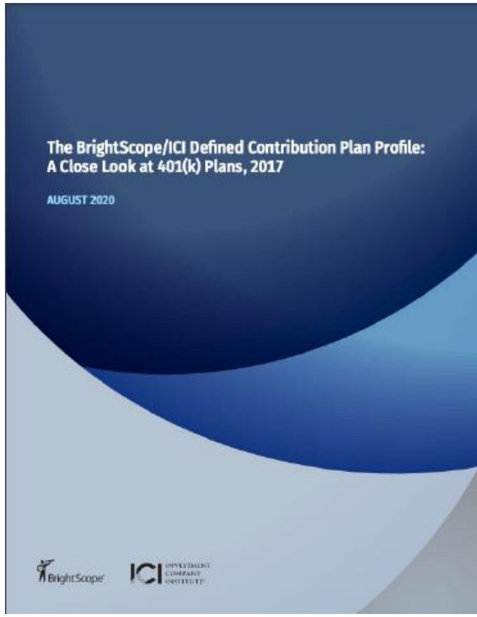
Benchmarks for Plan Fees

- BrightScope and the Investment Company Institute publish an annual survey of plan recordkeeping and investment fees.
- The most recent report was published in August 2020 entitled *The BrightScope/ICI Defined Contribution Plan Profile: A Close Look at 401(k) Plans, 2017.*
- The BrightScope/ICI Report is based on a sample of more than 60,000 private-sector plans – most with 100 participants or more in 2017.



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BrightScope Conclusions on Investment Options in DC Plans

This data gives helpful perspective on what investment options plans are offering:

- **Mutual funds held 45 percent** of large private-sector 401(k) plan assets; **CITs held 31 percent** of assets; guaranteed investment contracts held 7 percent; separate accounts held 4 percent; and the remaining 14 percent were invested in individual stocks (including company stock), individual bonds, brokerage, and other investments.
- **Target date funds** are becoming more common – **now in 82% of plans**.
- **Index funds** now hold more than **one-third of 401(k) assets** and widely available in all plan sizes. **More than 95 percent of 401(k) plans with more than $10 million in plans assets offered index funds** in their plans lineups in 2017, while 79 percent of 401(k) plans with less than $1 million did. Index funds, which tend to be equity index funds, generally have lower expense ratios than actively managed equity funds.

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BrightScope Fee Conclusions

- In 2017, the average total plan cost was 0.92 percent of plan assets – down from 1.02 in 2009. The average participant was in a lower-cost plan, with a total plan cost of 0.58 percent of assets in 2017 (down from 0.65 percent in 2009), while the average dollar was invested in a plan with a total plan cost of 0.37 percent in 2017 (down from 0.47 percent in 2009).
- Mutual fund expense ratios in 401(k) plans tend to be lower in larger plans and have trended down over time.
- For example, the **average asset-weighted expense ratio for domestic equity mutual funds (including both index and actively managed funds) was 0.798 percent for plans with less than $1 million in plan assets, compared with 0.34 percent for plans with more than $1 billion in plan assets in 2017.**

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The ICI-Brightscope Report – Average Expense Ratios of Mutual Funds in 401(k) Plans

Average Expense Ratios of Mutual Funds in 401(k) Plans, 2017

Asset-weighted average expense ratio as a percentage of mutual fund assets among plans with audited 401(k) filings in the BrightScope database by mutual fund investment objective and plan size

	Equity mutual funds		Balanced mutual funds		Bond mutual funds				
Plan assets	Domestic	International	Target date mutual funds*	Non-target date balanced mutual funds	Domestic	International	Money market mutual funds	Other	Memo: index mutual funds
Less than $1M	0.79	1.04	0.77	0.87	0.71	0.82	0.40	0.85	0.21
$1M to $10M	0.62	0.87	0.57	0.63	0.58	0.67	0.37	0.75	0.15
>$10M to $50M	0.54	0.75	0.49	0.51	0.49	0.63	0.35	0.73	0.12
>$50M to $100M	0.48	0.66	0.44	0.46	0.41	0.60	0.31	0.69	0.10
>$100M to $250M	0.45	0.62	0.40	0.40	0.37	0.58	0.27	0.67	0.09
>$250M to $500M	0.44	0.60	0.38	0.39	0.35	0.64	0.28	0.64	0.08
>$500M to $1B	0.41	0.54	0.39	0.35	0.31	0.59	0.19	0.63	0.07
More than $1B	0.34	0.49	0.40	0.30	0.29	0.61	0.15	0.46	0.07
All plans	0.43	0.58	0.43	0.40	0.36	0.61	0.22	0.62	0.09

Source: August 2020 The BrightScope/ICI Defined Contribution Plan Profile: A Close Look at 401(k) Plans, 2017.

The ICI-Brightscope Report – Average Expense Ratios of Mutual Funds in 401(k) Plans (Cont.)

Number of plan participants	Equity mutual funds: Domestic	Equity mutual funds: International	Balanced mutual funds: Target date mutual funds*	Balanced mutual funds: Non-target date balanced mutual funds	Bond mutual funds: Domestic	Bond mutual funds: International	Money market mutual funds	Other	Memo: index mutual funds
Fewer than 100	0.54	0.78	0.51	0.51	0.50	0.65	0.37	0.72	0.12
100 to 499	0.52	0.73	0.48	0.51	0.47	0.61	0.33	0.71	0.12
500 to 999	0.47	0.66	0.45	0.44	0.41	0.58	0.29	0.68	0.10
1,000 to 4,999	0.43	0.59	0.39	0.39	0.35	0.64	0.24	0.67	0.08
5,000 to 9,999	0.38	0.53	0.42	0.37	0.31	0.52	0.20	0.53	0.07
10,000 or more	0.37	0.49	0.41	0.31	0.31	0.63	0.15	0.47	0.07
All plans	0.43	0.58	0.43	0.40	0.36	0.61	0.22	0.62	0.09

* A target date fund typically rebalances its portfolio to become less focused on growth and more focused on income as it approaches and passes the target date of the fund, which is usually included in the fund's name.

Note: The sample is 44,365 plans with $1.9 trillion in mutual fund assets. BrightScope audited 401(k) filings generally include plans with 100 participants or more. Plans with fewer than four investment options or more than 100 investment options are excluded from BrightScope audited 401(k) filings for this analysis. See the box on page 60 for a description of the fee analysis. Equity, balanced, and bond mutual fund investment categories include both index and actively managed funds.

Sources: BrightScope Defined Contribution Plan Database and Morningstar

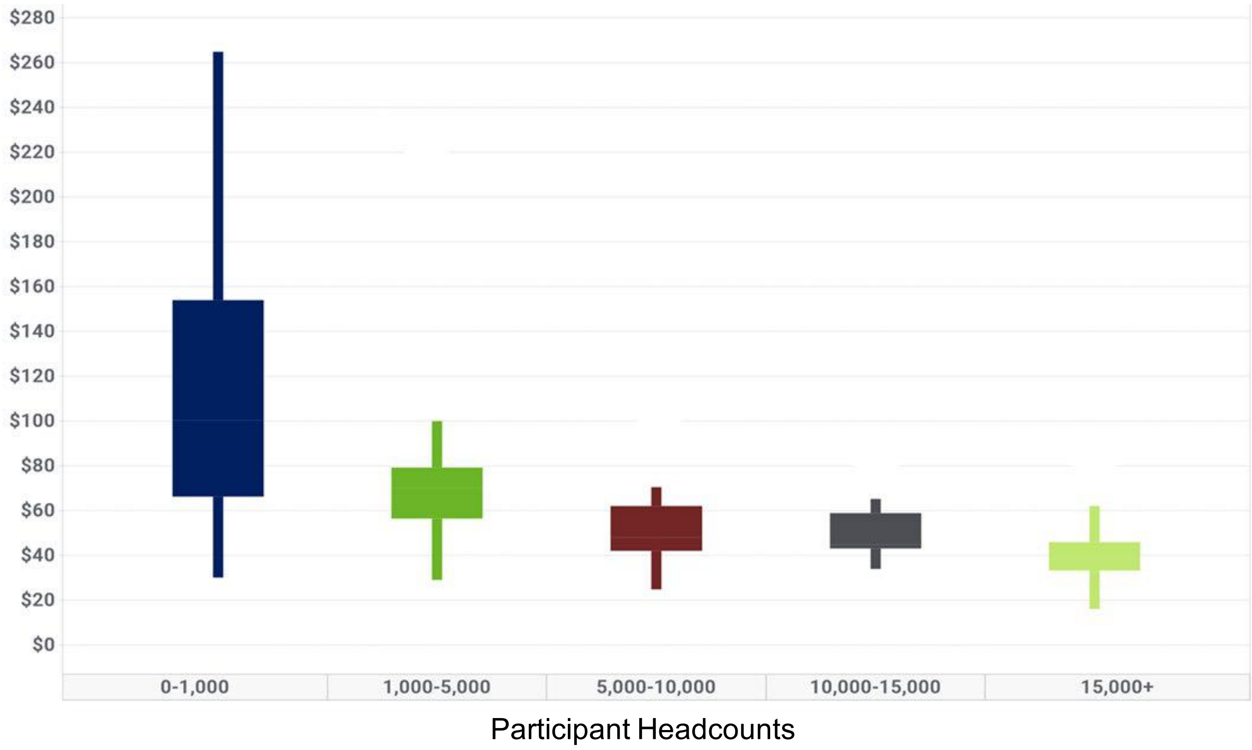
Source: August 2020 The BrightScope/ICI Defined Contribution Plan Profile: A Close Look at 401(k) Plans, 2017.

NEPC 2020 Defined Contribution Progress Report

- The second national survey of defined contribution plans is published for the last fifteen years by NEPC. The *NEPC Defined Contribution Plan & Fee Survey*, also known as the *NEPC Defined Contribution (DC) Progress Report*, uses a much smaller sample of 142 defined contribution plans with $191 billion in aggregate assets and 1.8 million participants.
- The average plan in the NEPC survey is $1.4 billion in assets and 13,377 participants; and the median plan is $618 in assets and 5,770 participants.
- Note the <u>small sample size</u> despite its disproportionate influence in excessive fee cases.

2020 Record-Keeping Fee Review

Record Keeping, Trust and Custody Per-Participant Cost by Plan Size

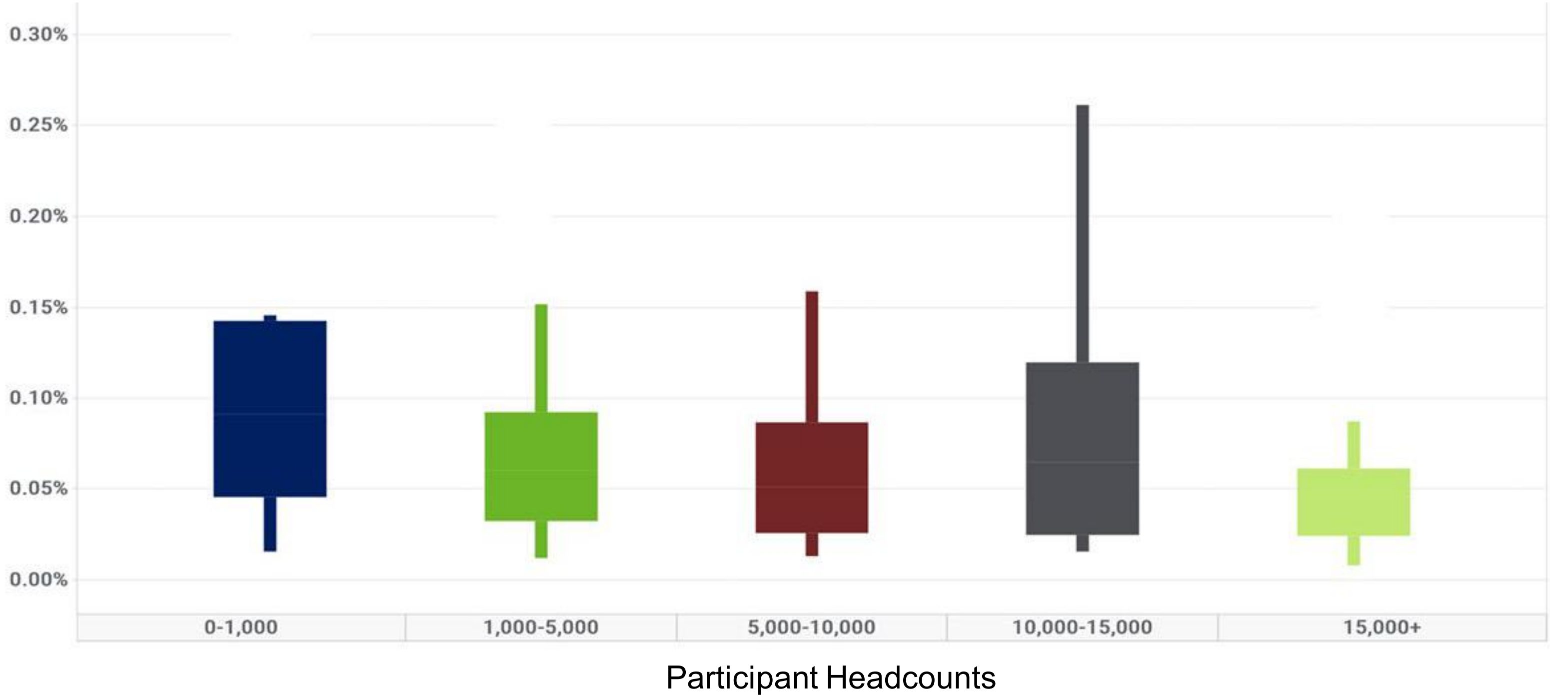


- All plans are not created equal. Higher (or lower) record-keeping fees are a function of plan size and complexity, and the package of services the plan sponsor has contracted for.
- While there is scale pricing (i.e., larger plans can access lower fees), operational complexity and service levels drive meaningful differentiation in price. Best practice is to compare fees and services through a record-keeping vendor search Request for Proposal ("RFP") process.
- Each box plot provides a pictorial representation of record-keeping, trust and custody costs by plan size, according to NEPC's 2020 Defined Contribution Plan & Fee Survey which included 142 defined contribution and deferred compensation plans. Fees were gathered from participating plans' service providers and recast in a uniform format. Displayed are the 95th percentile, 75th percentile, 25th percentile and 5th percentile plan cost points. The data represents broadly what plans pay and not how they pay.

Source: NEPC 2020 Defined Contribution Progress Report

2020 Record-Keeping Fees as a Percentage of Plan Assets

Record-Keeping Fees as a % of Plan Assets



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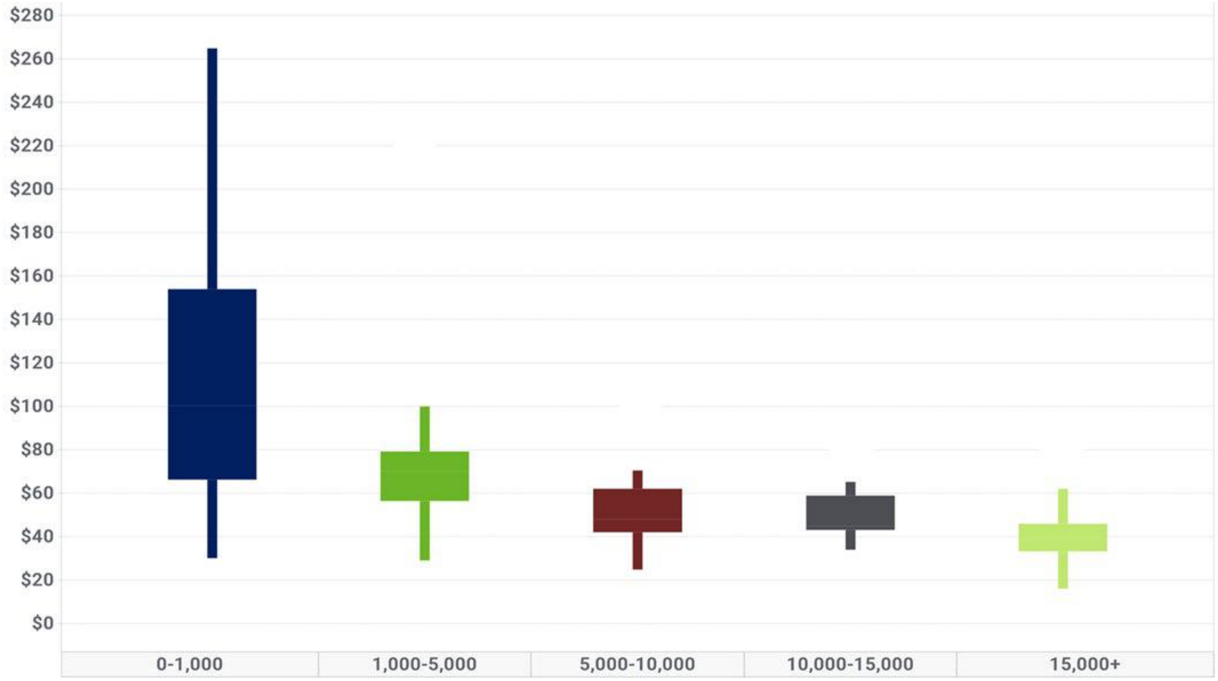
Source: NEPC 2020 Defined Contribution Progress Report

Asset Weighted Expense Ratios by Plan Size



Participant Headcounts

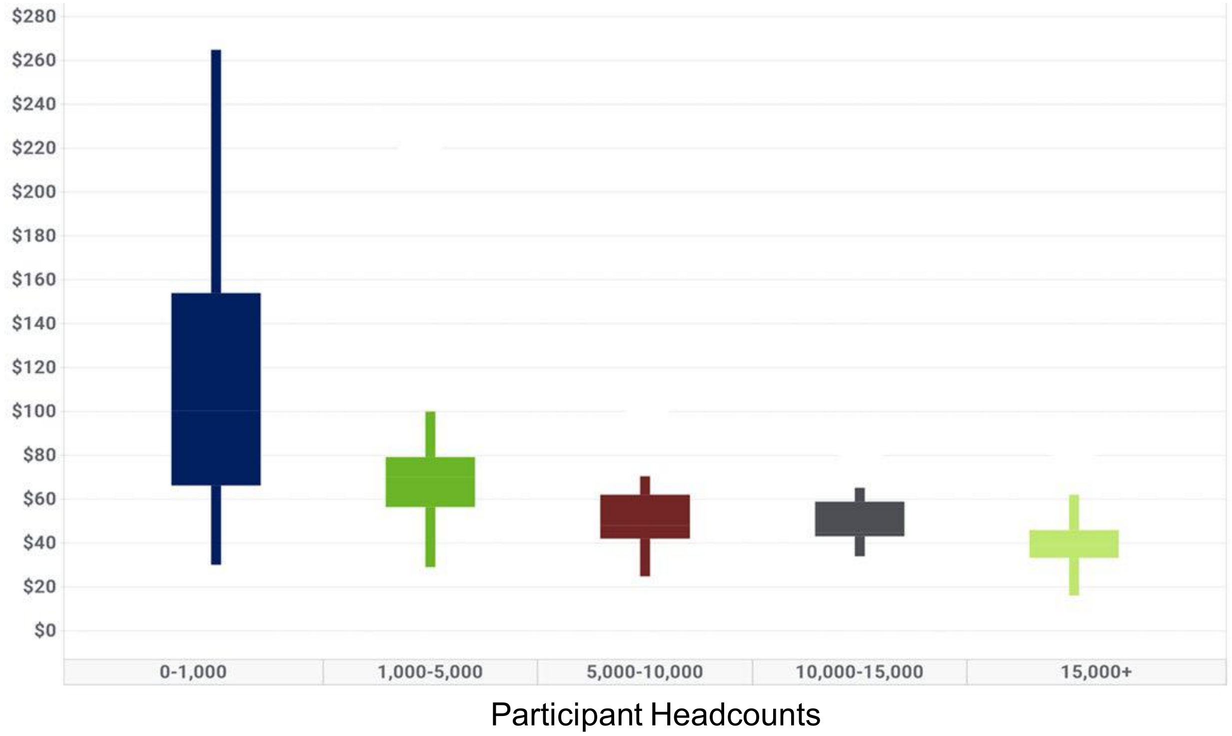
2020 Investment Fee Review

- Asset-weighted expense ratios are a function of how much plan investment options cost and where participants allocate their assets.
- The exhibit illustrates the range of pricing across plan sizes. Larger plans have lower asset-weighted expenses because of their access to scale pricing, less use of revenue sharing, and because a portion of plan assets (for corporate plans) may be invested in employer securities with low or no expense. Any plan with substantial index assets plots at the lower end of the range.
- Each box plot provides a pictorial representation of asset-weighted expense ratios by plan size, according to NEPC's 2020 Defined Contribution Plan & Fee Survey which included 142 defined contribution and deferred compensation plans. Investment options, asset balances and expense ratios were gathered from participating plans, with NEPC calculating the asset-weighted expense ratio. Displayed are the 95th percentile, 75th percentile, 25th percentile and 5th percentile plan cost points.

Source: NEPC 2020 Defined Contribution Progress Report

2020 Total Fees As a Percentage of Plan Assets

Total Plan Fees (Investment + RK + Other) as a % of Plan Assets



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Source: NEPC 2020 Defined Contribution Progress Report

401k Averages Book

- Pension Data Source, Inc. publishes an annual ***401k Averages Book*** that provides specific scenarios for plans with 10, 25, 50, 100, 200, 500, 1,000, and 2,000 participants and are grouped by average participant account balances of $10,000, $50,000 and $100,000.
- The plan assets range from $1,000,000 to $200,000,000, but most of the plans described are considered small plans.
- For example, the book provides a breakdown of small plan 401k fees in a plan with 50 participants and $5 million in assets. For a plan of this size, the total plan cost trend has decreased from 1.19% in 2016; 1.18% in 2017; 1.17% in 2018; 1.16% I 2019; and 1.14% in 2020.
- For this plan, 1.14% total plan cost is described alternatively as 1.10% investment and 0.04% recordkeeping, and alternatively as 0.47% net investment and 0.63% revenue sharing.
- The range of cost per participant is $1,300 in the 75th percentile; $1,210 median; and $1,010 for the 25th percentile. The average investment costs are 1.35% International Equity; 1.12% large U.S. Equity; 1.05% Fixed Income; 1.00% target date; and 0.90% stable value.

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Most Plans are Benchmarked by Consultants

- Most plans are benchmarked by consultants.
- Some consultants like AON, Captrust and Cammack have their own benchmarking. Other consultants use proprietary databases, like Fiduciary Benchmarks.
- **Fiduciary Benchmarks Example:** $21M/165 participant/$129.1k average balance plan – a consultant benchmarked Voya fees .18% [.11 -.21 benchmark] + consultant fee of .20 [.13-.25 benchmark] = .38 total with Fiduciary Benchmarks database for plans $20m-$30m.
- The average participant balance of $129.1k would pay $491 for the administration of the plan – before investment fees ranging from [.37-.52 TRP TD I shares; Vanguard 500 Index .04]. Total plan fees = .86% of plan assets.

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How to Benchmark Investment Performance

- The best way to track investment performance is against results of major competitors
- Morningstar is the primary benchmark for mutual fund performance – rates funds from 1 to 99 percent [1 percent is the highest rating]
- But note: Morningstar does not make a distinction between different fund investment mixes, and even active and passive funds are listed in the same comparisons.

Morningstar Analyst Ratings for Target-Date Strategies

Strategy Name	Prospectus Adjusted Expense Ratio %	Morningstar Analyst Rating	People	Process	Parent
			Pillar Rating ↑Upgrades ↓Downgrades		
BlackRock LifePath Index	0.09	Gold	High	Above Average	Above Average
PIMCO RealPath Blend	0.17	Gold	High	Above Average	Above Average
JPMorgan SmartRetirement Blend	0.19	Gold	Above Average	High	Above Average
T. Rowe Price Retirement	0.52	Gold ↑	High	High ↑	High
MassMutual Select TRP Retirement	0.51	Gold ↑	High	High ↑	Average
Fidelity Freedom Index	0.08	Silver	Above Average	Above Average	Above Average
State Street Target Retirement	0.09	Silver	Above Average	Above Average	Average
Vanguard Target Retirement	0.09	Silver	Above Average	Above Average	High
American Funds Target Date	0.39	Silver	High	Above Average	High
BlackRock LifePath Dynamic	0.40	Silver ↑	High ↑	Above Average	Above Average
JPMorgan SmartRetirement	0.46	Silver	Above Average	High	Above Average
Fidelity Freedom	0.50	Silver	High	Above Average	Above Average
TIAA-CREF Lifecycle Index	0.10	Bronze	Average	Above Average	Average
Fidelity Advisor Freedom	0.50	Bronze	Above Average	Above Average	Above Average
Dimensional Target Date Retirement Income	0.25	Neutral	Average	Average	High

Morningstar Analyst Ratings for Target-Date Strategies (cont.)

John Hancock Multi-Index Lifetime	0.32	Neutral	Average	Average	Above Average
John Hancock Multi-Index Preservation	0.39	Neutral	Average	Below Average	Above Average
Principal Lifetime Hybrid	0.39	Neutral	Average	Average	Average
TIAA-CREF Lifecycle	0.45	Neutral ↓	Average	Above Average	Average
MFS Lifetime	0.46	Neutral	Above Average	Average	Above Average
American Century One Choice	0.54	Neutral	Average	Average	Average
Natixis Sustainable Future	0.60	Neutral	Below Average	Average	Average
John Hancock Multimanager Lifetime	0.61	Neutral	Above Average	Average	Above Average
MassMutual RetireSMART by JPM	0.65	Neutral	Above Average	Average	Average
Principal LifeTime	0.68	Neutral	Average	Average	Average
Schwab Target	0.71	Neutral	Average	Average	Above Average
Voya Solution	0.80	Neutral	Average	Average	Average

Source: Morningstar Direct. Data as of 2/25/2020.

How Plaintiffs Benchmark Fees

What Benchmarks are Used in Excessive Fee Cases?

1) Recordkeeping Fees
2) Investment Fees
3) Investment Underperformance

Recordkeeping Fees

How Plaintiffs Allege Plan Administrative Fees Are Too High

Recordkeeping Fees are Too High

THREE BASIC RECORDKEEPING FEE CLAIMS:

- Recordkeeping fees too high on per-participant basis
- Recordkeeping fees too high – based on assets and not flat, per-participant fees
- Failure to conduct RFPs for lower RK fees

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Recordkeeping fees are too high – using 401k Averages Book

Nvidia Corporation

[$1.0B asset/7,822 participants] Capozzi 08/28/2020.

- $63 flat recordkeeping fee to Fidelity – reduced to $52 in 2017 – not including $458,130 in revenue sharing: for 2018 ($11,701) direct + $458,130 revenue sharing (indirect) = $446,429.00

Paragraph 126: "By way of comparison, we can look at what other plans are paying for recordkeeping and administrative costs. One data source, the *401k Averages Book* (20th ed. 2020) studies Plan fees for smaller plans, those under $200 million in assets. Although it studies smaller plans than the Plan, it is nonetheless a useful resource because we can extrapolate from the data what a bigger plan like the Plan should be paying for recordkeeping. That is because recordkeeping and administrative fee should **decrease** as a Plan increases in size. **For example, a plan with 200 participants and $20 million in assets has an average recordkeeping and administration cost (through direct compensation) of $12 per participants**. *401k Averages Book* at p. 95. **A plan with 2,000 participants and $200 million in assets has an average recordkeeping and administration cost (through direct compensation) of $5 per participant**. *Id.* At 108. Thus, the Plan, with between a half-billion and a billion dollars in assets and over 7,000 participants throughout the Class Period, should have had a direct recordkeeping costs below $5 average, which it clearly did not."

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Misrepresentation of the 401k Averages Book

- **401k Averages Book:** The 200 Participant/$20M asset plan has been misrepresented by the Capozzi law firm: The actual recordkeeping costs are stated as $0 low; $12 average; and $190 high.
- BUT the overall bundled costs of the same plans are $136/$982/$1,284 – not $12. This means that the recordkeepers for small plans are taking most of its compensation from revenue sharing from the investment managers – likely hundreds of dollars in the average plan.
- The 2,000 participant/$200M plan in Chart 24.8 has a $5 recordkeeping fee as Capozzi asserts: BUT they leave out the $160 per participant of revenue sharing on the chart – with $501 net investment costs – the example is $666 total bunded costs for this plan. **This is much higher than the Nvidia plan – and thus the Complaint is disingenuous, at best.**

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Comparisons to other filed cases

- Other lawsuits compare to recordkeeping fees cited in other cases.
- *Spano v. Boeing*: 2014 plaintiffs' expert opined market rate of $37-42, supported by defendants consultant's stated market rate of $30.42-$45.42 and Boeing obtaining $32 fees after the class period.
- 2016 Declaration in Boeing case that recordkeeping fees should have been $18 per participant.
- *George v. Kraft Foods Global, Inc.*: 2011 case – plaintiffs' expert opined market rate of $20-$27 and plan paid recordkeeper $43-65.
- *Gordon v. Mass Mutual*, 2016 settlement committing the plan to pay not more than $35 per participant for recordkeeping.

Use of NEPC data for alleged high RK fees

United Surgical [$290M/15,000+] sued by Capozzi law firm on 4/30/21

- "According to the ICI Study, the median total plan cost for a plan between $250m and $500m is 0.43% of total plan assets" compared to 0.82% in 2018 and 0.79% in 2016 – "83% higher" than peers.
- Used form 5500 for direct + indirect recordkeeping fees: 2018 - $328,716 + $1,304,352 = $1,633,068 = $98.35 per participant.
- "NEPC's survey found that **no plan** with over 15,000 participants paid more than $69 per participant in recordkeeping and administrative fees."
- **Takeaways:** (1) high participant count plans will be targeted even when assets <$500m; (2) Form 5500 RK revenue overstates the RK costs, because other revenue is included – very misleading for plaintiffs not to disclose this; and (3) remember the small size of the NEPC survey.

New trend: Compare Form 5500 Data

Kimberly-Clark [$4B/16,792] 4/15/21

- Walcheske & Luzi lawsuit alleges unreasonable recordkeeping fees – solely using estimates from Form 5500 filings of Kimberly-Clark and other companies.
- Estimated K-C RK and took the average from 2015-2019 of $1.36m, even though they declined every year from $2.0M to $720k [$1,360,044 divided by 17,377 = $78 – true 2019 number as $720,175 divided by 16,792 - $42.88]
- Plaintiffs submitted a chart of other companies purported RK fees from Form 5500 filings, ranging from $28 for Vibra Healthcare Retirement Plan [9,750/$107.6M] to $49 for Multicare Health System 403(b) Plan [11,437/$559.8M].
- NOTE: the Form 5500 revenue for a recordkeeping includes transaction costs and other non-recordkeeping revenue, and may not include revenue sharing – not apples to apples.
- The rule 408b2 plan fee disclosure would give exact numbers to judge fairly, but not included in the complaint.
- See also **Wesco [$750M/8,870] – Chimicles:** $178 RK fee to Wells Fargo – chart of other plans from Form 5500 – “should have been $40”

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$14 Fidelity Recordkeeping Fee

- In a more recent April 2021 filing against **Humana Inc.[$5.3B/46,000]**, Capozzi estimated the Human RK fee of $60.75 and compared it to Fidelity testimony about its own plan: "Recently, Fidelity – a recordkeeper for hundreds of plans – stipulated in a lawsuit that a Plan with tens of thousands of participants and over a billion dollars in assets could command recordkeeping fees as low as $14-21." *See Moitoso v. FMR LLC*, 451 F. Supp. 3d 189, 204 (D. Mass. Mar. 27, 2020)
- **Koch Industries** – Nichols Kaster 10/16/20 lawsuit **[$8.1B/60,000]** – alleged $57-75 RK fees excessive: "a prudent and loyal fiduciary of a similarly-sized plan could have obtained comparable recordkeeping services of like quality for as low as $14 per participant during that same time period." Citing *Moitoso v. Fidelity*.

Investment Fees

How Plaintiffs Allege Investment Fee are Too High

Investment Fees – Common Allegations

The standard Capozzi complaint template will make the four same claims:

1. **Investment fees too high – less expensive options available**
2. **Retail v. institutional fund classes – failure to secure the lowest fund share class**
3. **Passive options cheaper than active funds**
4. **Failure to consider collective trusts or separate accounts**

The Schlicter law firm concentrates on bigger targets with alleged proprietary Investments from plan sponsor, recordkeeper and/or investment manager [example Schneider Electric (AON proprietary investments); Wood Group (NFP proprietary investments)

Capozzi Complaint Example

Nvidia [$1B/7,882] – 08/28/20 – Capozzi.

1. **High-cost active funds:** T. Rowe Price .68-.72 versus ICI median of .65%
2. **Lower-fee share classes:** TRP I Share .40-.59
3. **Lower cost collective trusts:** TRP .46%
4. **Lower cost passively managed funds:** Fidelity Freedom Index Investor 0.12%; American Funds R6 .33-.38%

"Too little, too late": complaint admits that "[i]t appears that in 2018, nearly **four years** into the Class Period, the Plan switched to the collective trust versions of the T. Rowe Price target date funds. But this was too little too late as the damages suffered by Plan participants to that point had already been baked in."

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Another Capozzi example – so you can see the cut-and-paste work product

Cintas [$1.8B/53,357]: 12-13-2019 – Capozzi

1. **Investment fees too high:** T. Rowe Price TD funds .86-.92 versus ICI Median .56; Domestic Bond Pimco 1.23 v. ICI .18; Dodge & Cox Int'l .63 v. .49 ICI; Artisan MidCap 1.18 v. .31 ICI; Dodge & Cox Income .42 v. .18% [note that TRP fees much higher than prior Nvidia example]
2. **Lower-share class:** TRP I Shares .53 to .59%; TRP TR-A .46 -- .50%.
3. **Lower cost passive alternatives:** Fidelity Freedom Investor .12%; or JP Morgan SmartRetirement .29%

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High Target Date Fund Plan Fees – T. Rowe Price

- **United Surgical Partners** [$455m/15,000+] – Capozzi lawsuit 4/30/21: T. Rowe Price Advisor - .83 to .96% v. ICI TD Median of 0.35%
- **Cerner Corporation** [$2.2B/23,915] – Capozzi lawsuit filed 01/21/20: T. Rowe Price TD Retirement TRRDX .72% versus ICI Median 0.56% [alternative TRP I Class 0.50%; Tr-A Class .46%] [passive alternative Blackrock LifePath Index K 0.10%; JP Morgan Smart Retirement Blend R6 0.29%]

NOTE: The TRP target date funds have performed well and are rated in the highest category by Morningstar – **<u>Question</u>**: is it a breach of fiduciary to pay more for TRP by approximately .20% when the return is 1%+ higher than comparable TD funds – no one making this argument.

High Target Date Fund Fees – Fidelity Freedom

- **Bronson Healthcare [$528M/9,915]** – sued 5/06/21 by Walcheske & Luzi: Fidelity Freedom Income K .42 -- .65% minus .20% revenue sharing + .22-.45% versus Fidelity Freedom Index Instl .08%
- "The Index suite has outperformed the Active suite in four out of six calendar years: 3-year trailing return 4.03% to 5.38% compared to 5.05 to 6.39 – a difference of 1.02% v. 1.43%"
- **Universal Health Services [$1.9B/41,872]:** Fidelity Freedom K Share .53-.65% versus ICI Target Date median of .47% versus FIAM Blend Q Fund .32% versus passive Fidelity Freedom Index Investor Class .14% and Institutional .08%

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American Red Cross – Northern Trust Target Date Funds

- **American Red Cross [$1.2B/22,000] – Capozzi lawsuit 03/02/21**: Northern Trust ARC-NTAM Focus Target Date Funds – 0.22% for branded CITS -- but underlying expense ratio is .07%]

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Total Plan Costs

Is total plan costs a fairer standard in which to judge a plan?

- See April 13, 2021 Capozzi lawsuit against **Humana**: “According to the ICI Study, the median total plan cost for plans over $1 billion is 0.22% of total assets in a plan. ICI Study at 57. Here the total plan costs during the Class Period ranged from a high of 0.51% in 2018 to a low of 0.45% in 2017. Total plan costs were .46% in 2019.”
- If you use the ICI standard benchmark, any plan with active target date plans will be above the benchmark.

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Poor Investment Performance

How Plaintiffs Assert Investment Under-Performance

Investment Under-performance

Walgreens [$10B+/100,000+]: 8/19/2019

- Allege underperformance of Northern Trust target date funds – 34.99%/7.96% return over four years compared to Fidelity 41.66/9.30%; TRP 44.88/9.93%; Morningstar 41.75/9.32%; S&P 500 TD 37.23/8.42%.
- **MTD filed:** argued that the NT funds cost only .06% and cannot challenge imprudence for underperformance because they are less risky TD funds with less stock in the funds; and only 1% disparity in return is not imprudence.
- **MTD denied:** these arguments better advanced in summary judgment motion – enough to assert imprudence.

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United Health – Wells Fargo Target Date Funds

- **4/23/21 case against UnitedHealth Group Inc.** – retained poorly performing Wells Fargo target date funds ($7B invested) for five straight years
- Compared to Morningstar benchmark: performed in the 70th to 97th percentile of their peer funds [compound performance 2016-21: -5.89%/-.085% annual compared to Fidelity and -15.57%/-2.18% TRP]

Stable Value Funds

- Plaintiffs have alleged that plans failed to offer a higher returning stable value fund instead of a money market funds, but other cases allege that the stable value fund was either too risky or not risky enough.
- **Failure to Offer a Stable Value Fund: Anthem; Chevron**
- **Too Risky: KeyCorp: $2.9B/29,000] 06/04/2020 –** Nichols Kaster – alleged that plan used proprietary KeyBank EB MaGIC stable value that underperformed the market [2.06% versus 2.57%]
- **Not Risky Enough: CVS Health**

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Do the Settlements Make Sense?

Analyzing the Actual Fees in Recent Settlements

$4.05M Cerner Settlement

Cerner [$2.28B/23,915] – filed by Capozzi on 1/21/2020 – settlement announced in February 2021 of $4.05M

- Investments stayed the same – alleged 72% higher than ICI median fee: T. Rowe Price TD .64-.72 versus .56 ICI median; TRP had lower cost I-share class at .50-.54 and .46 Tr-A class; and passive alternatives of Blackrock Lifepath K .10% or JP Morgan SmartRetirement R6 .29%; other investment example: used Fidelity Spartan Index 500 at .04 when FXAIX alternative at .02
- RK fees too high [used Form 5500 numbers]: Fidelity $60.53 -- $99.98 – plaintiff alleged should be less then $50 – citing Boeing, Kraft Foods and Mass Mutual [same cookie-cutter allegations as other Capozzi lawsuits]

Norton Healthcare - $5.75M

Norton Healthcare [$714M/13,000+ participants] – filed by first-time plaintiff firms

- March 2021, Norton Healthcare settled for $5.75m – split one-half with Lockton Advisors
- Complaint alleged that the plan switched in 2012 from Transamerica to Principal, and invested $138M in a riskier Principal's fixed income product that underperformed by 100 bps.
- Most funds had lower share class alternatives.
- Asset-based recordkeeping fee over $70 with $45-175k revenue sharing – should have been no higher than $50 – no proof given.

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Norton Health Settlement after Loses MTD

- Norton lost MTD because court accepted all conclusory statements from plaintiffs – that the plan should have done a RFP every three years and that $50 should be the maximum RK fee – conclusory statements with no proof [not an experienced law firm]
- Norton court took plaintiffs conclusory allegations as true and said that these claims cannot be decided on a MTD.
- But the loss of the MTD led to a quick settlement afterwards.

Brenntag $2.3M

Brenntag [$439K/4,755] sued on 01/08/20: – below $500M -- Brenntag settled for $2.3M within nine months [finalized recently]

- Primary investments were American Funds Target Date R2E class: 1.13% - 1.20% versus ICI median of .65%
- Lower share class R6 was .36 -- .41%
- Cheaper alternatives: Blackrock K .10 or JP Morgan SmartRetirement R6 .29%
- Transamerica recordkeeping – alleged $381.86 per participant [$252,353.00 direct + $1,563,388.00 indirect in 2018 = $381.86 per participant] versus Capozzi “should have been less than $50 standard” from Boeing, Kraft Foods and Mass Mutual examples.

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Large settlements – highest settlements involve proprietary investments

- **Reliance Trust $39.8M** [$14M attorney fees] – used Reliance Trust TD funds [.53% with 25 bps admin fee share with Insperity (10 bps) and investment management fee up to 18 bps] and [alleged underperformance – example 13.19% v. 13.77% JP Morgan; 15.85% Vanguard; and 18.05% TRP in 2013]
- **McKinsey & Co. $39.5M**
- **SunTrust Banks Inc. $29M**
- **Fidelity Investments $28.5M**
- **BB&T $24M**
- **Deutsche Bank $21.9M**
- **Wells Fargo case –** allege that $5B moved into untested Wells Fargo TD funds that underperformed the benchmark by 2%

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Smaller Plans

- **Exela Enterprises [$154M/8,868]: settled for $750,000**: alleged fees for all funds too high, including T. Rowe Price TD funds at 1.01% when other share classes available like Advisor at .76 or .61% Institutional; (2) .27% asset-based RK fee to Transamerica + revenue sharing (.40 in TRP TD funds) = RK fee is $147.17 per participant [$56.43 + $90.47 revenue share] against allegation that RK fee should be $35 without any proof.

403b Plans – University Cases

- 20 cases filed in the initial flurry from 2016-18.
- University of Miami was sued in 2020; and now the smaller University of Tampa plan [$139M/1,406] was sued in 2021.
- Over $85m in settlements, and mixed results in the federal courts: compare _Sacerdote v. NYU_ (complete defense victory) and *Wilcox v. Georgetown University* (dismissed on MTD) **with** *Sweda v. University of Pennsylvania* (initially dismissed in district court, case revived by 8th Circuit, 2021 $13M settlement) and *Davis v. Washington University* (8th Circuit reverses and allows challenge to recordkeeping and investment fees)

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Case Law Results

The rulings are arbitrary – every case is a crapshoot

MTD denied despite super-low fees

Walgreens [$10B+/100,000+]: 8/19/2019 –

- Allege underperformance of Northern Trust target date funds – 34.99%/7.96% return over four years compared to Fidelity 41.66/9.30%; TRP 44.88/9.93%; Morningstar 41.75/9.32%; S&P 500 TD 37.23/8.42%.
- **MTD filed:** argued that the NT funds cost only .06% and cannot challenge imprudence for underperformance because they are less risky TD funds with less stock in the funds; and only 1% disparity in return is not imprudence.
- **MTD denied:** these arguments better advanced in summary judgment motion – enough to assert imprudence.

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Quest MTD Denial

Quest [$3.9B/56,000] – Shepherd Finkelman

- **High Investment Fees:** Plan offered Fidelity Freedom TD funds as QDIA – 37-41% of plan – K Shares .42-.65% v. .08 for Fidelity Index Funds
- **Underperformance:** Missed Russell 300 Index benchmark by 2.56-3.24%: March 2018 Reuters Report – "risky path to retirement"' 1.09-1.47% three-year training performance of K active shares to the Institutional (5-year .31% to .76%)
- Morningstar gave 5 Stars to the Index Suite, but none to the active suite.
- **Alleged High Recordkeeping: $31 reduced to $30** to Fidelity, but alleged with revenue sharing = $40.67 in 2017 and $38.18 in 2018.
- District of N.J. rejects MTD: gives "every favorable inference" to plaintiffs, citing 3rd Circuit in Sweda and Princeton University case – even allows index suite to act as active suite benchmark.

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California's Evolving Standard

Intel [$11.82B/71,000] – 08/09/19

- Allege that plan invested in target date (TDF) and Global Diversified Funds (GDF) that had one-third in alternative investments – higher fees and underperformed the market
- **High fees:** 12 Intel TDF with expenses between 1.07 and 1.09% in 2014 and .92-1.04% in 2015; Intel GDFs 1.25 in 2014 and 2015 – compared ICI 2014 TDFs .46% and non-TD funds .33% for plans > $1B.
- **Lower cost alternatives:** Vanguard TD Inst. 10 bps; Vanguard Investor 16 bps; American Funds R6 36 bps.
- **Underperformance:** example, in 2017 Intel TDFs 11.19% versus 11.50% Vanguard TDs; and 2020 12.75% v. 14.08%
- **Our take:** high investment fees; weak underperformance case.

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Intel Dismissal

CA judge dismissed the case.

1. Investment under-performance: failed to compare to an "adequate benchmark" – need a "meaningful benchmark"
2. Excessive fees: Fees must be evaluated against "comparable investments." Need a "sound basis for comparison" – a "meaningful benchmark"
3. Including hedge funds not a breach – do not need to mimic the market.

Salesforce, Genentech, and Trader Joes

Salesforce [$2B/25,849] – 3/11/2020 Capozzi

- **Same Capozzi investment fee template:** JP Morgan SmartRetirement Inst'l .66-.73% v. ICI Median .56; lower cost R6 .45-.48 and R5 .55; index alternatives .09 for Vanguard Inst'l TD.
- **Alleged that you cannot justify actively managed funds over passive –** requires 1.38 to 4.36% higher return to be effective.
- Court dismissed two times – second with prejudice:
  - ICI Median and Average Fee reflects the fees of both passively and actively managed funds – thus not "meaningful benchmarks" for actively managed funds
  - Revenue sharing to pay recordkeeping fees is "an obvious alternative explanation" for why the Plan did not offer the lowest-cost share class for those funds.
  - "passively managed funds are not meaningful benchmarks for actively managed funds given their essential differences." citing Davis v. Wash. U: finding claim based on comparison of actively and passively managed funds subject to dismissal; noting "[c]omparing apples and oranges is not a way to show that one is better or worse than the other"]
  - One-, three-, and five-year returns "are not sufficiently long-term to state a plausible claim of imprudence"; and "a small disparity in performance" over a three-year and five year period for JP Morgan TD funds– biggest being .55%. Citing **Genentech 02/09/21 decision.**
  - "There is nothing imprudent about offering a concentration of actively managed funds." Citing **Trader Joe's Co. 11/30/20 decision.**

Euclid Conclusions from the Case Law

- The court system is a crapshoot – even the best fiduciary process is not immune from the excessive fee lawsuits because the standard on a motion to dismiss is inconsistent and unfair.
- Many courts will allow a generic claim that plans should only use passive index funds, lower share classes (without revenue sharing), and/or use collective trusts instead of mutual funds, or used "proprietary" funds from the recordkeeper or investment manager.
- The most unfair claim – because it is inherently subjective – is a claim that you trailed a purported investment benchmark or return – courts are not substantiating what level of "underperformance" constitute a viable claim that should be litigated.
- Failure to use passive funds is also unfair because not required under ERISA or DOL regulations – and should not be legislated by the judiciary. It should not be a breach of fiduciary duty to use active funds unless Congress or the DOL says so.
- The six-year statute of limitations damages model is unfair – the standard of care has changed, but courts give no consideration that a new, higher standard is evolving; and that fees have come down in the last 6 years.
- Even using a plan investment advisor will not insulate you.
- The defense loses most MTD filings because they are often defending cases with high fees – seeking a dismissal with bad facts.

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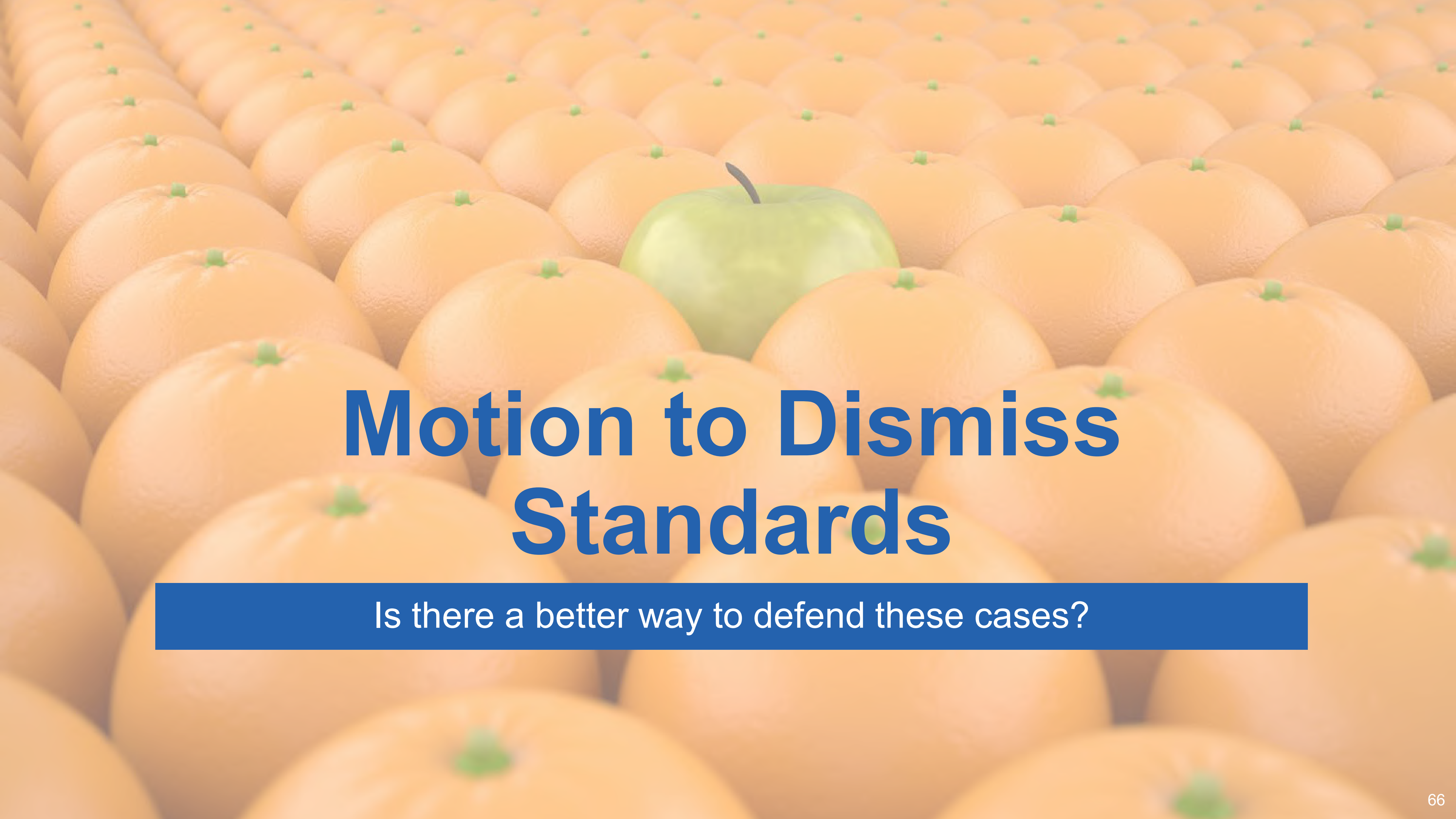

Motion to Dismiss Standards

Is there a better way to defend these cases?

Motion to Dismiss Standard

- In analyzing a motion to dismiss, a district court must accept as true all material allegations in the complaint and construe them in the light most favorable to the nonmoving party.
- Factual allegations must be enough to raise a right to relief above the speculative level.
- But courts are not bound to accept as true a legal conclusion couched as a factual allegation.
  - No ERISA requirement for frequent RFPs
  - No ERISA requirement to use only passive funds
  - No ERISA requirement not to use revenue sharing
- *Iqbal/Bell Atlantic v. Twombly* – allegations that are "merely consistent with antitrust violations, but **just as much in line with lawful behavior**" fail to state a claim for relief.
  - Example: revenue sharing is "an obvious alternative explanation" for why plans may not be in the lowest possible share class.

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The Limitations of the Motion to Dismiss

- Defendants file a motion to dismiss in nearly every case – and only succeed 25-33% of the time.
- The defense is limited to the plaintiff's complaint in responding.
  - More defendants need to ask for judicial notice of the rule 408b2 plan fee disclosure if the recordkeeping and investments are overstated or incorrect; or to show the totality of alternative investment options [for example, in the Wood MEP cases, the plan had super low-cost index funds as an alternative for all three funds from the 3(21) advisor.
- Strategy Question: Should defendants file a motion to dismiss in every case?
  - Sometimes the record can be better at the summary judgment stage.
  - In many cases, plaintiffs file an amended complaint – the MTD teaches them how to perfect their case.
- Companies need to strategize more effectively in the rule 104 information requests.
- Question: if the results in every case are an arbitrary crapshoot, do you really need to use the same three or four super expensive defense firms?

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Proper Motion to Dismiss Standard

- Given that ERISA is a law of process and not results, fiduciaries have discretion and flexibility. Their conduct should not be challenged in hindsight with expensive and time-consuming litigation.
- The MTD standard should:
  1. require a meaningful benchmark that properly analyzes the fees and performance;
  2. only challenges to egregious fees or underperformance should be allowed;
  3. allow alternative explanations that are consistent with good fiduciary conduct, including the overall mix of plan investments and administrative fees.
  4. need something more, like self-dealing, to challenge subject conduct that requires judgment.

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How Can Plan Sponsors Fight Back?

We are blaming the victim

- If recordkeeping and investment fees are too high, the Department of Labor needs to regulate the service providers – <u>the victim is being blamed</u>.
- The system has lost perspective – note the case against Fidelity's own plan, which settled for $26.5M.
- The damages represent fees paid <u>**to**</u> Fidelity – the recordkeeper and investment managers have no responsibility, even when they are 3(21) or 3(38) fiduciaries.
- The damages models need to change – plan sponsors should have to guarantee all purported fee overpayments that represent judgment calls.

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Litigation Tactics

- **Think before filing a MTD:** A motion to dismiss is not appropriate in every case. Do not seek a MTD on bad facts, or an incomplete record.
- **Get Fee Disclosures on the Record:** Do not allow plaintiffs to argue they need discovery because the record is incomplete: ask the court to take judicial notice of DOL required 404a5 and 408b2 fee disclosures – which have everything needed for perspective on fees and performance.
- **Information Requests:** Start fighting the case when you receive the rule 104 fee request – give plaintiffs exculpatory conduct.
- **Fight class certification stage of case** – many named plaintiffs do not have the offending investments or are not in the plan in certain years.
- **Try to control the damages period:** Add one-year statute of limitations to limit the damages time period. *See Cumulus Media* – court threw out Capozzi challenge to $185.3m/5,230 plan because plan had one-year time period to sue, and named plaintiff had left the plan in 2016.

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Euclid's Advice to Insulate Your Plan from Excessive Fee Risks

- **Pay the recordkeeping out of corporate assets** – eliminate the issue for $50 or so per employee.
- **Conduct frequent RFPs:** If you don't pay the recordkeeping fee, make sure you conduct a recent RFP to take advantage of recent fee compression; and make sure your RK fee is on a flat, per participant basis with no revenue sharing – fully transparent.
- **Avoid Perceived Conflicts:** Do not use investment options from your recordkeeper – if you use Fidelity, choose from Vanguard, Blackrock or JP Morgan passive TD funds.
- **Passive Investments:** Use only low-cost index target date and other funds; or have an alternative index fund for every investment category.
- **Document Performance Reviews:** Review investment results quarterly, and document your work in plan minutes.
- **Demand Accountability from Service Providers:** Demand in your contracts that your investment provider certify in writing that your plan has the lowest potential fees offered by that firm for eligible class size, or the manager will be responsible to rebate the difference.

Takeaways

- Until a national standard is created, you are stuck with your six-year fee legacy, and no plan sponsor is safe from arbitrary and expensive litigation.
- Many of the excessive fee lawsuits involve plans with recordkeeping and investment fees that are higher than the reliable benchmarks.
- But plaintiff law firms are often disingenuous about the facts and intentionally leave out essential data points that give a better perspective.
- The investment underperformance allegations are unfair and usually about a small percentage of under-performance.
- The MTD reviews are arbitrary and unfair – courts have inconsistent results and apply different standards.
  - Some courts allow any excessive fee or underperformance claim based on improper legal conclusions of purported fiduciary conduct, without considering the high cost and that it would mean that every fund can be sued – surely not the purpose of ERISA.
  - Defendants may have to change their strategies and stop developing bad law based on incomplete records on a MTD.
  - Plan sponsors deserve a consistent and reliable standard of review.
- The six-year damages model is unfair – making changes does not lessen your legacy risk ["Too little too late"]
- All large plans – and even smaller plans – are at risk of an excessive fee lawsuit under the arbitrary handling of these cases where most law is coming from incomplete records on a motion to dismiss.
- The DOL or Congress needs to set more concrete rules:
  - Is it a breach of fiduciary duty to choose active funds?
  - What is an unreasonable level of underperformance – can you stick with the same fund if it has several down years? What judgment are fiduciaries allowed to demonstrate.

Resources

- Check out the new Euclid Specialty website: **euclidspecialty.com**
- Euclid Perspectives including whitepaper – "Exposing Excessive Fee Litigation" **euclidspecialty.com/euclid-perspective/**
- Sign-up for The Fid Guru Blog: **euclidspecialty.com/blog/**
- Download PDF of the Fiduciary Liability Handbook: **euclidspecialty.com/fiduciary-handbook**
- Resources – Apps, Forms, Brochures: **euclidspecialty.com/applications-brochures**

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Thank You

Questions?

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