The Dynamics of Fiduciary Liability Risk

2022 Fall Risk Conference

Our Speaker Today

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Agenda

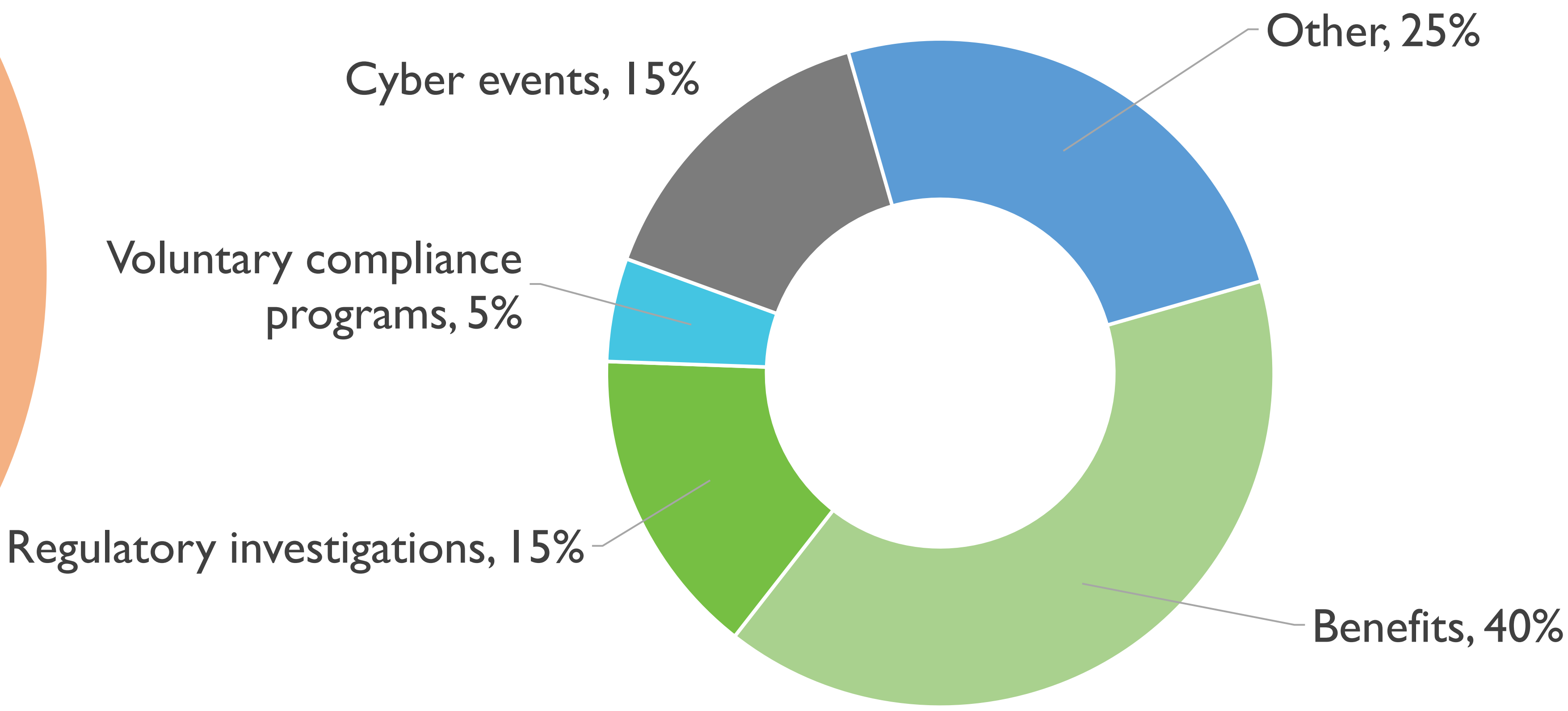
- **<u>Today's Goal</u>:** The goal of today's presentation is to take a more in-depth look at key fiduciary claim trends for governmental plans.
- **<u>Evolving Risks</u>:** We will then examine new risk trends challenging the reasonableness of plan fees and investment performance.
- **<u>How to Respond</u>:** Finally, we will suggest some ideas as to how governmental plan sponsors can reduce their chances of being sued, including plan changes.

Key Claim Trends

Key trends driving claims against fiduciaries of employee benefit plans:

- Increased Regulatory Enforcement
- Sharp Rise in Cyber Claims
- Increase in Early Retirement Disability Claims
- Increased Use of Voluntary Compliance Programs
- Direct Provider Claims Under Participant Assignments
- Continued Increase in Excessive Fee and Other High-Stakes Class Action Litigation Against Benefit Plans

Fiduciary Claim Distribution



Governmental Plans

KEY TREND

1. Significant Number of Denial of Disability benefit lawsuits
2. Class Action challenges to pension reform and benefit changes
3. Challenges to contribution assessments
4. New penalty assessments by the IRS for plan operational mistakes

Governmental Plan Claim Trends

- Benefit/Participant Claims
  - Miscalculation of retirement benefits
  - Pension spiking
  - Pro se whistleblowers
- Challenges to Plan Amendments/Benefit Changes
  - **Changes to benefits or how compensation is calculated is the number one indicator of claims against governmental plans.** Most are styled as class actions (or writ of mandates in states like California).

Governmental Plan Claim Trends (cont.)

- Objections to contribution assessments
  - See City of Chicago case filed August 29, 2019
  - ICERS
  - DeKalb County – class action alleges $250M in lost contributions when retirement plan ended for school teachers.
- Inadequate Funding Claims
  - Kentucky Retirement System
  - Singing River Plan in Mississippi

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Governmental Plan Claim Trends (cont.)

- DROP/Supplemental Benefit Plan challenges
  - Dallas Police & Fire (guaranteed interest rate)
  - Cal Fire – five years of airtime
  - City of Hollywood Firefighters
  - City of Miami Beach
- Long-Term Disability Claims – see CalPERS Long-term Care Plan challenge

Governmental Plan Claim Trends (cont.)

- Imprudent Investment claims
- Benefit Overpayment claims
- Voluntary Compliance claims
- IRS penalty claims
- Excessive fee exposure for defined contribution plans

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Emerging Risks

Challenges to Plan Fees and Investment Performance

What is an Excessive Fee Lawsuit?

Three primary excess fee 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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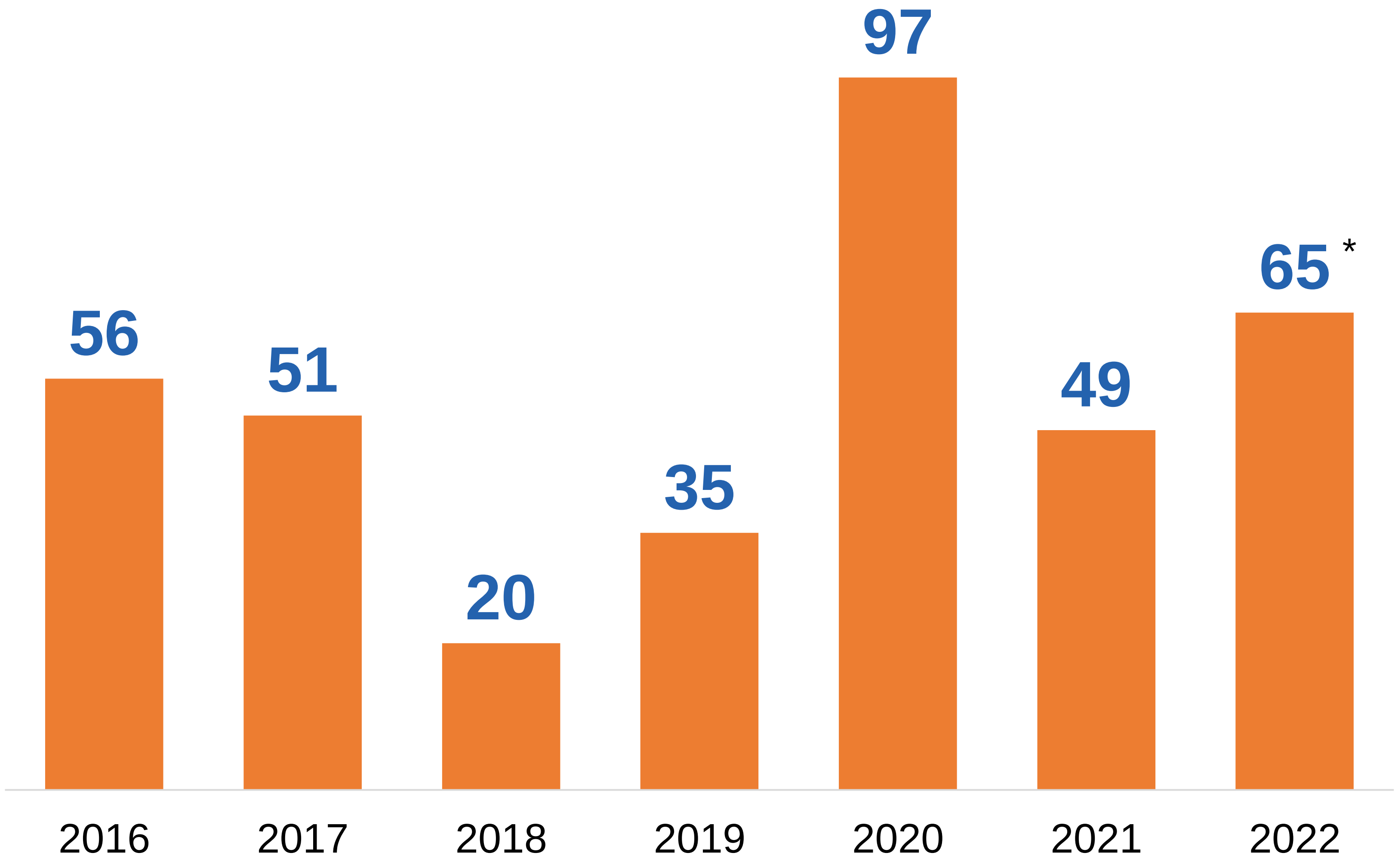
Increasing Number of Cases Filed



* 2022 as of 08/31/22

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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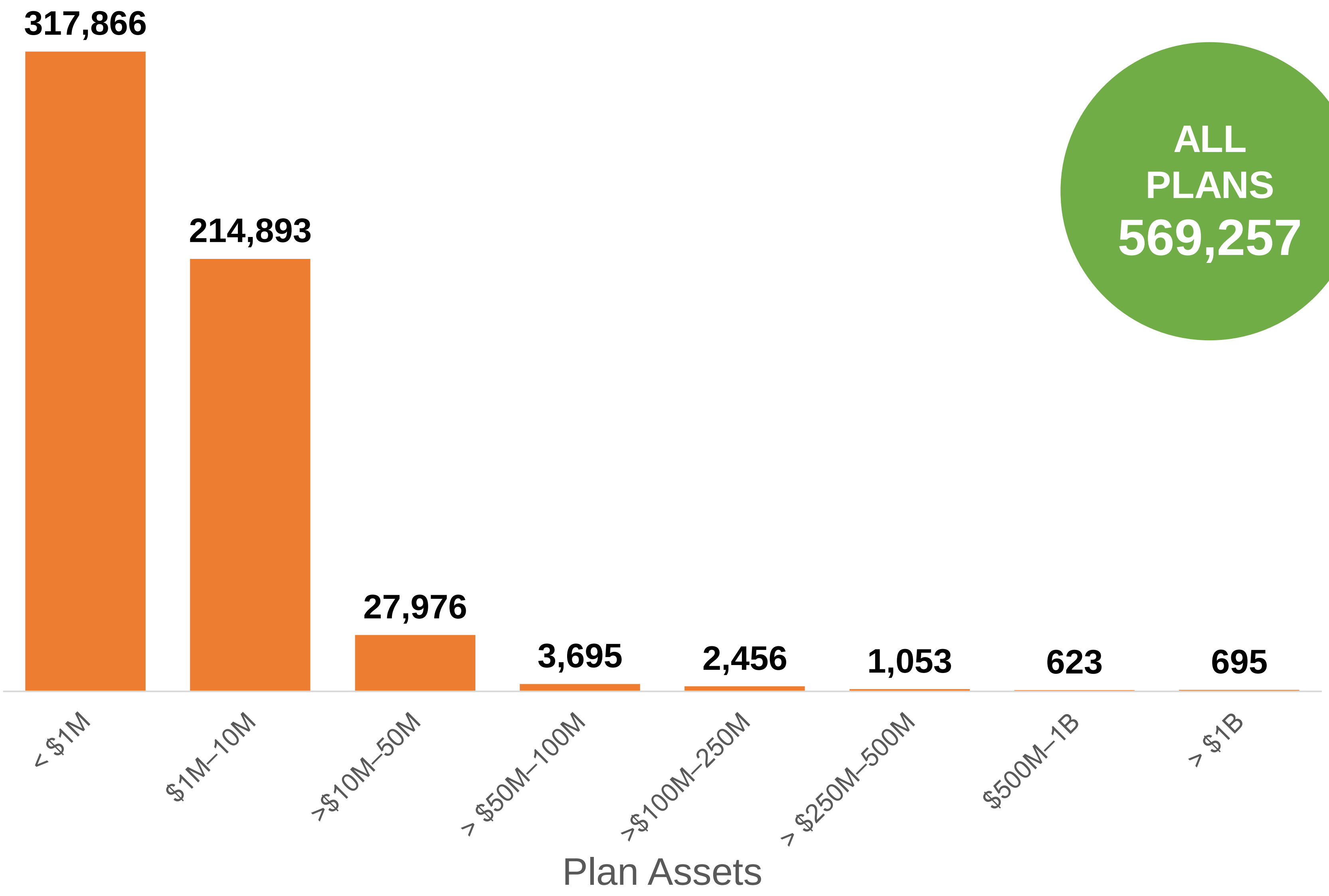
The Universe of Defined Contribution Plans

<$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

Universe of DC Plans by Asset Size



ALL PLANS
569,257

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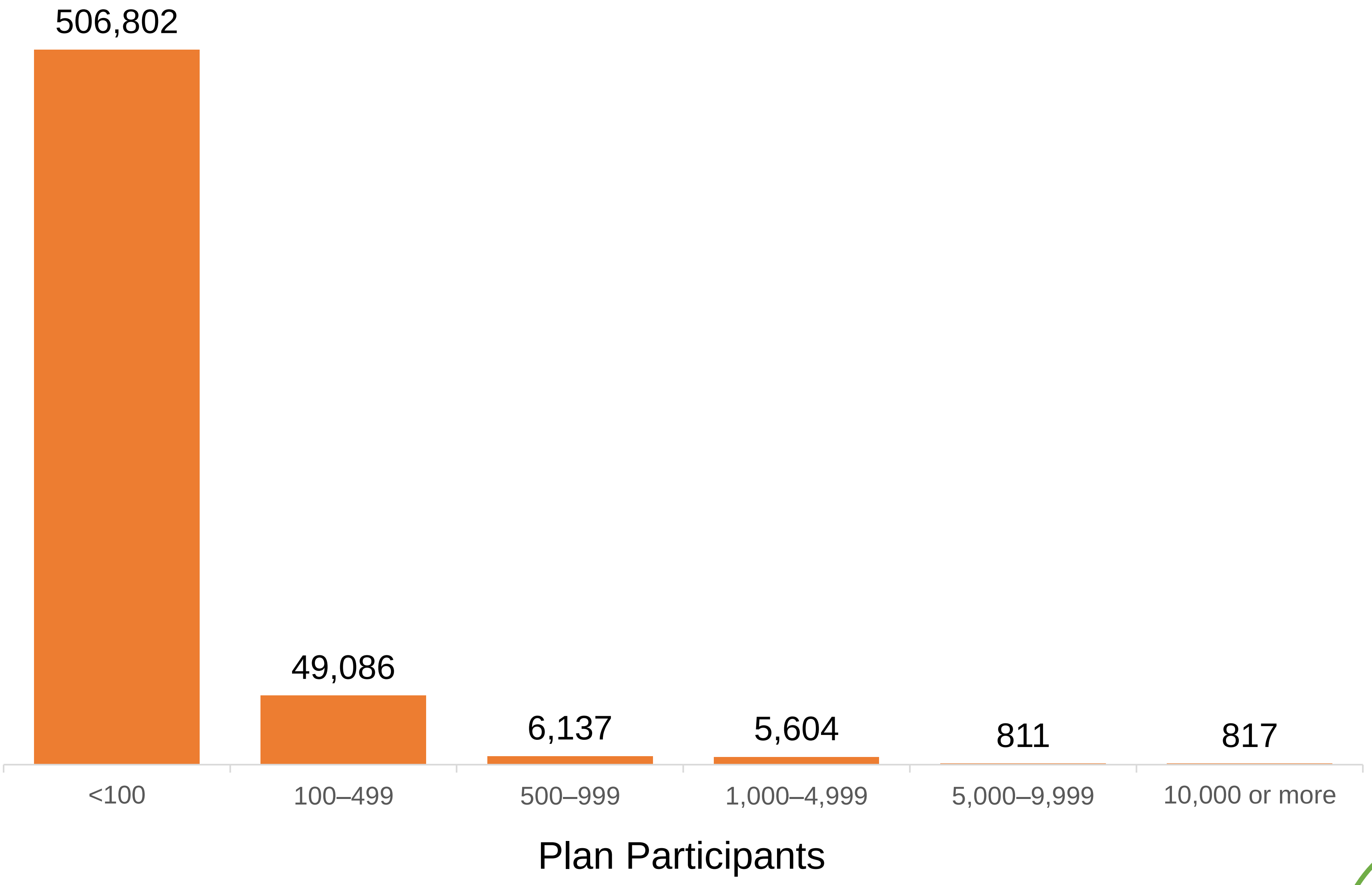
Universe of DC Plans by Participant Count



The Probability of Being Sued is High for a Large Plan

- This data 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.

Most Excessive Fee Cases are Settled

- Already 9 cases have been filed in the first two months of 2022.
- Most cases survive a motion to dismiss [at least 70%], and the rate of dismissal continues to decline.
- **Settlement pressure because of high damages model:** Most cases that survive a motion to dismiss are settled, with very few litigated to summary judgment or trial.
- Over 50 settlements since 2020 – more than $350m with over $110 million in fees [over $130m in 20 university cases filed in 2016].
- Court decisions on motions to dismiss have been inconsistent – providing no coherent standard for how to determine whether an excessive fee case is viable.
- The problem of excessive fee cases is beyond frequency – now low-fee plans are being sued [example: AT&T with a $20 recordkeeping fee; Walgreens with .08% expense target-date funds; and Kroger with a $30 recordkeeping fee.

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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% -- settled for **$32.5M**

Settlements in most cases that survive a MTD

- Only a handful of cases have proceeded to summary judgment or trial.
- This means that most cases have settled even if they have low fees:
  - Example: Walgreens case settled after losing the MTD for $13.75m even though the plan had super low-cost target-date investments.

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Smaller Plans

- **Exela Enterprises [$154M/8,8682]: 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 in 2016 – has led to give court of appeals decisions and the Northwestern Supreme Court decision.
- University of Miami was sued in 2020; and the smaller University of Tampa plan [$139M/1,406] was sued in 2021.
- Over $130m in settlements: MIT ($18.1M); Emory ($16.75m); John Hopkins ($14m); University of Chicago ($6.5M); Brown University ($3.5m); Vanderbilt ($14.5M); Duke ($10.65m); Columbia ($13m).

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Excess Fee Cases against Multiemployer Plans

At Least Two Cases against Multiemployer Plans

- ***Ybarra v. Board of Trustees of Supplemental Income Trust Fund***, (C.D. Cal. Nov. 30, 2017) [27,178/$921.6m]: (1) excess investments fees – not lowest fee share class (Fidelity Advisor Freedom target-date funds .78-1.00% - replaced in 2016 with A-share JPMorgan SmartRetirement TD fund .81-.89% compared to .21% I share class; other active investments between .45-1.28%; (2) unreasonable recordkeeping fees: 2016 $431,499 direct + $4.4m indirect (.25-70% revenue sharing) = $161/per participant – should have been $40/participant or $1.1m total]
- Settled for approximately $9.5m – remainder of fiduciary policy after defense costs for motions to dismiss the original and amended complaint.

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Motion Picture Industry Pension Plan Excess Fee Case

- ***Klawonn v. Board of Directors for the Motion Picture Industry Pension Plans***, C.D. Calif [79,000-92,000/$3.7B-$5.1B] – note that this is a separate account plan – not self-directed.
- **Investment Underperformance:** "Among plans with over $1 billion in assets, the Plan ranked **173rd out of 175** on a 10-year basis."
- **"Astronomical Fees": "**fees are 1.18% per year – four to five times higher than the average plan of similar size -- $46m more per year in fees than participants in the average plan of this size."
- **NOTE:** the fees have been mispresented by plaintiffs and are actually 50% lower.

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Multiple Employer Plans

- While **multiemployer** plans have not been a focus of plaintiff firms to date, **multiple** employer plans have been targeted.
  - Pentegra – two lawsuits [now consolidated]
  - Trinet HR III, Inc.
  - Wood Group

Supreme Court Decision in Northwestern

January 2022

Why the Northwestern Case is Important?

- The Northwestern case presented the best opportunity to seek a uniform and rigorous standard of review for excessive fee pleadings.
- The problem with excessive fee cases is that they are based on **circumstantial evidence**.
  - ERISA is a law of process, but the cases are alleging that outcomes are imprudent.
  - No process is typically alleged – the complaints are inferring imprudence from allegedly inferior outcomes.
- The goal for plan sponsors in the Northwestern appeal was to seek a higher pleading standard for cases based on circumstantial evidence under the *Iqbal* and *Twombly* antitrust case law:
  - Allegations that are “merely consistent with antitrust violations, but just as much in line with unlawful behavior” fail to state a claim.
  - Must show that a prudent fiduciary in like circumstances would have acted differently = an alternative explanation based on competitive business strategy is consistent with prudent conduct.

Northwestern Allegations

Primary plan had $2.4B assets with 21,622 participants.

1) **Multiple recordkeepers**, whereas CalTech, Notre Dame, Loyola and Purdue had consolidated to one recordkeeper;
2) **Excessive recordkeeping fees**: $3.3/$4.1m = $153-213/participants, but allegedly should have been $35/per participant [with no benchmark provided];
3) **No RFP:** Failure to conduct competitive bidding for recordkeeping fees;
4) **Hundreds of investment options** – many duplicative [242 total; 32 fixed income; 48 large cap; and 15 mid cap].
5) Plan used **retail share classes** for 129 of the 242 investments ["materially identical" to available lower share classes].

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The Supreme Court's Ruling

- The Supreme Court ruled that the Seventh Circuit erred in dismissing the complaint based on participants access to low-fee index funds – remanded case back. [Perspective: Northwestern plan offered only 7 index funds out of 242 investment options].
- In **rejecting the participant-choice defense**, the Court held that fiduciaries must remove any imprudent investment – cannot defend allegedly imprudent investment based on offering other prudent investments.
- **Bad facts make bad law:** Court held that the appellate court ignored claims that the investment options were too numerous, too expensive and underperforming.
- But Court did reaffirm that the *Iqbal* and *Twombly* pleading standard applies to ERISA cases and cited *Dudenhoeffer* "context specific" inquiry.
- **Key language:** "At times, the circumstances facing an ERISA fiduciary will implicate difficult tradeoffs, and courts must give due regard to the range of reasonable judgments a fiduciary may make based on her experience and expertise."

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The Impact of the Supreme Court Ruling

- Despite the requirement to conduct a "context specific" plausibility inquiry, every motion to dismiss following the Northwestern decision has been denied [prior ratio was 7 out of 10 survived a MTD].
- Courts continue to ignore the need for a heightened standard when lawsuits are based on circumstantial evidence.
- The risk of increased frequency of excessive fee lawsuits has been heightened.
- More risk that isolated investments will be targeted for claims of excessive fees or under-performance.
- The only way to reduce your fiduciary risk is to lower your plan recordkeeping and investment fees.

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DC Plan Benchmarks

What is available to benchmark plan fees?

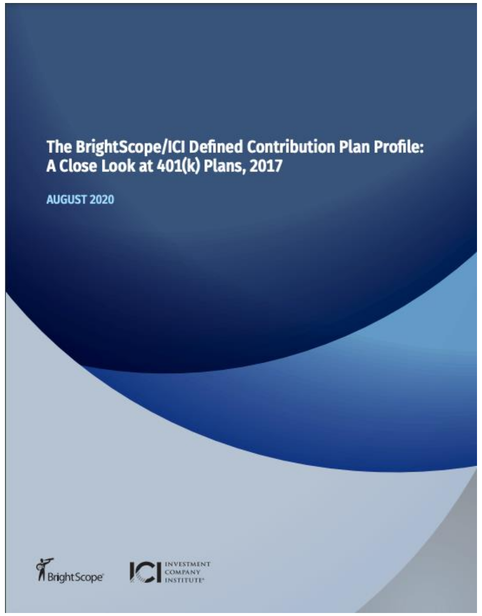
The search for a reliable and fair benchmark of plan fees

“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).

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 2021 entitled *The BrightScope/ICI Defined Contribution Plan Profile: A Close Look at 401(k) Plans, 2018.*
- The BrightScope/ICI Report is based on a sample of more than 60,000 private-sector plans – most with 100 participants or more in 2018.



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.

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

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

NEPC 2021 Defined Contribution Plan Trends and Fee Survey

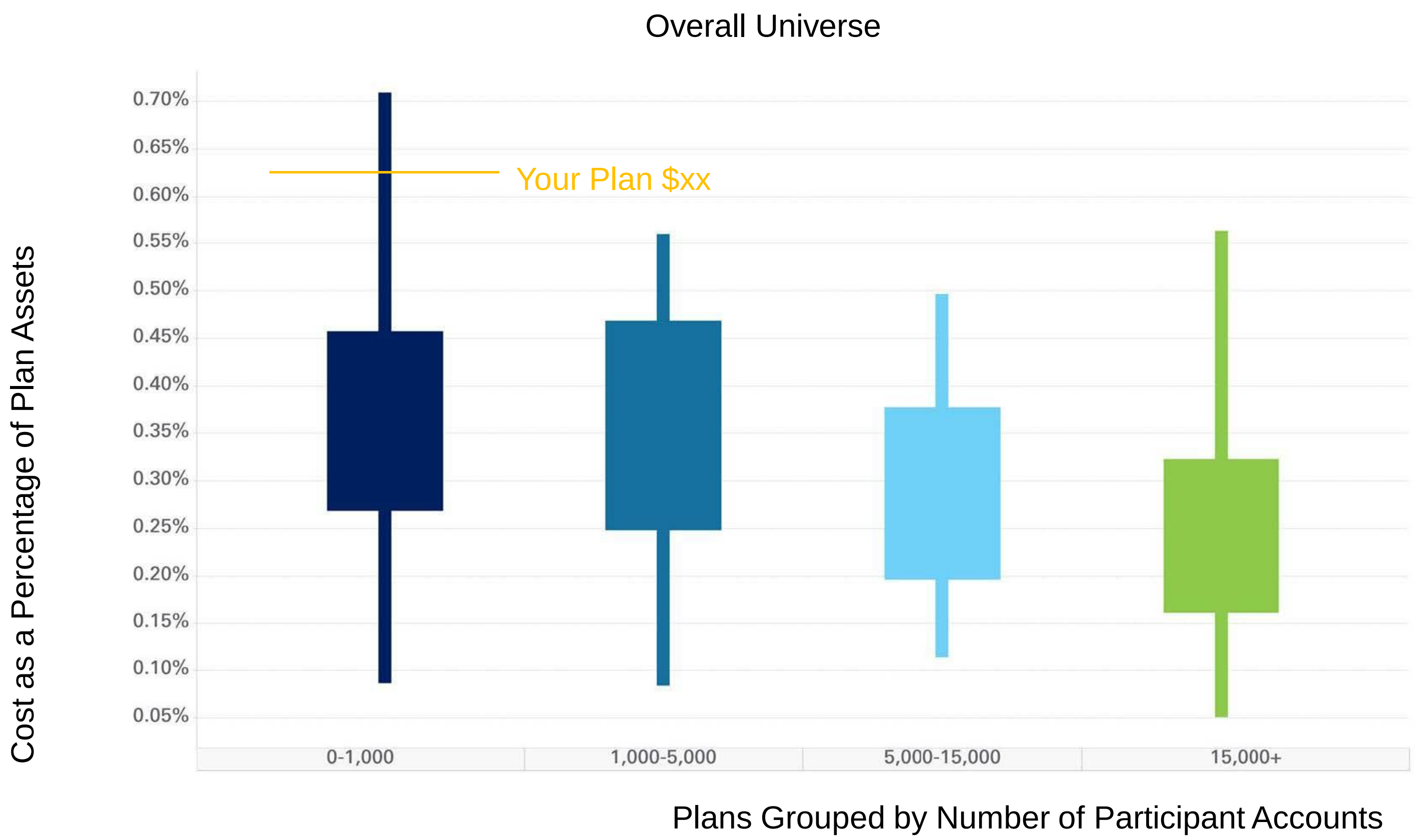
- The second national survey of defined contribution plans is published for the last fifteen years by NEPC. The *NEPC Defined Contribution Plan Trends and Fee Survey*, uses a much smaller sample of 137 defined contribution plans with $230 billion in aggregate assets and 1.6 million participants.
- The average plan in the NEPC survey is $1.7 billion in assets and 12,200 participants; and the median plan is $728m in assets and 5,400 participants.
- Note the <u>small sample size</u> despite its disproportionate influence in excessive fee cases.

2021 Recordkeeping, Trust, Custody Fee Review: Benchmarking Base Fees

- Each box plot provides a visual display of record keeping, trust and custody costs by plan size, according to NEPC's 2021 Defined Contribution Plan & Fee Survey which includes 137 defined contribution and deferred compensation plans.
- Fees were gathered from participating plans' service providers and recast in a uniform format. The data represents broadly what plans pay and not how they pay.
- The box of the plot is a rectangle which encloses half of the sample, with an end at each quartile. The whiskers extend to the upper and lower observations excluding outliers.

Source: NEPC 2021 Defined Contribution Plan & Fee Survey

2021 Investment Fee Review: Benchmarking Asset-Weighted Expense Ratios

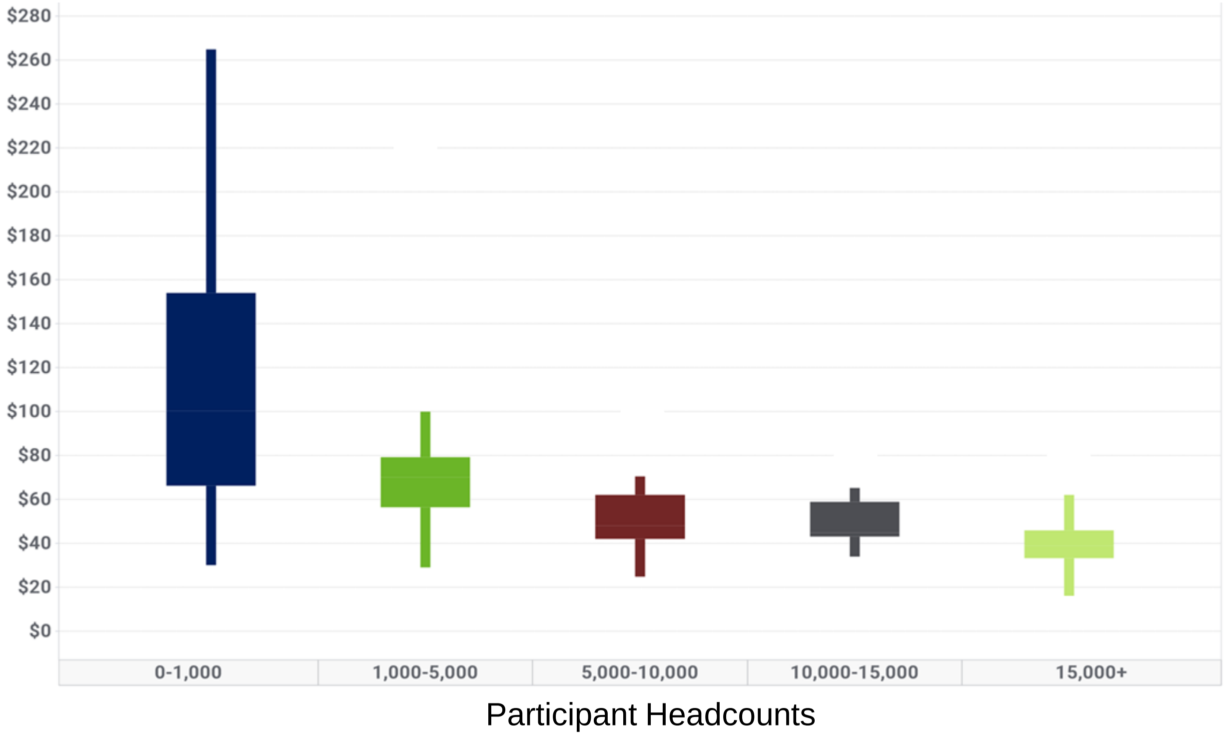


- Each box plot provides a visual display of asset-weighted expense ratios by plan size, according to NEPC's 2021 Defined Contribution Plan & Fee Survey which includes 137 defined contribution and deferred compensation plans.
- Investment options, asset balances and expense ratios were gathered from participating plans, with NEPC calculating the asset-weighted expense ratio.
- The box of the plot is a rectangle which encloses half of the sample, with an end at each quartile. The whiskers extend to the upper and lower observations excluding outliers.

Source: NEPC 2021 Defined Contribution Plan & Fee Survey

2020 Total Fees As a Percentage of Plan Assets

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



- 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

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 NEPC, AON Hewitt, Captrust and Fiducient have their own benchmarking.
- **Fiduciary Benchmarks** is a common subscription service to benchmark your plan.
- **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

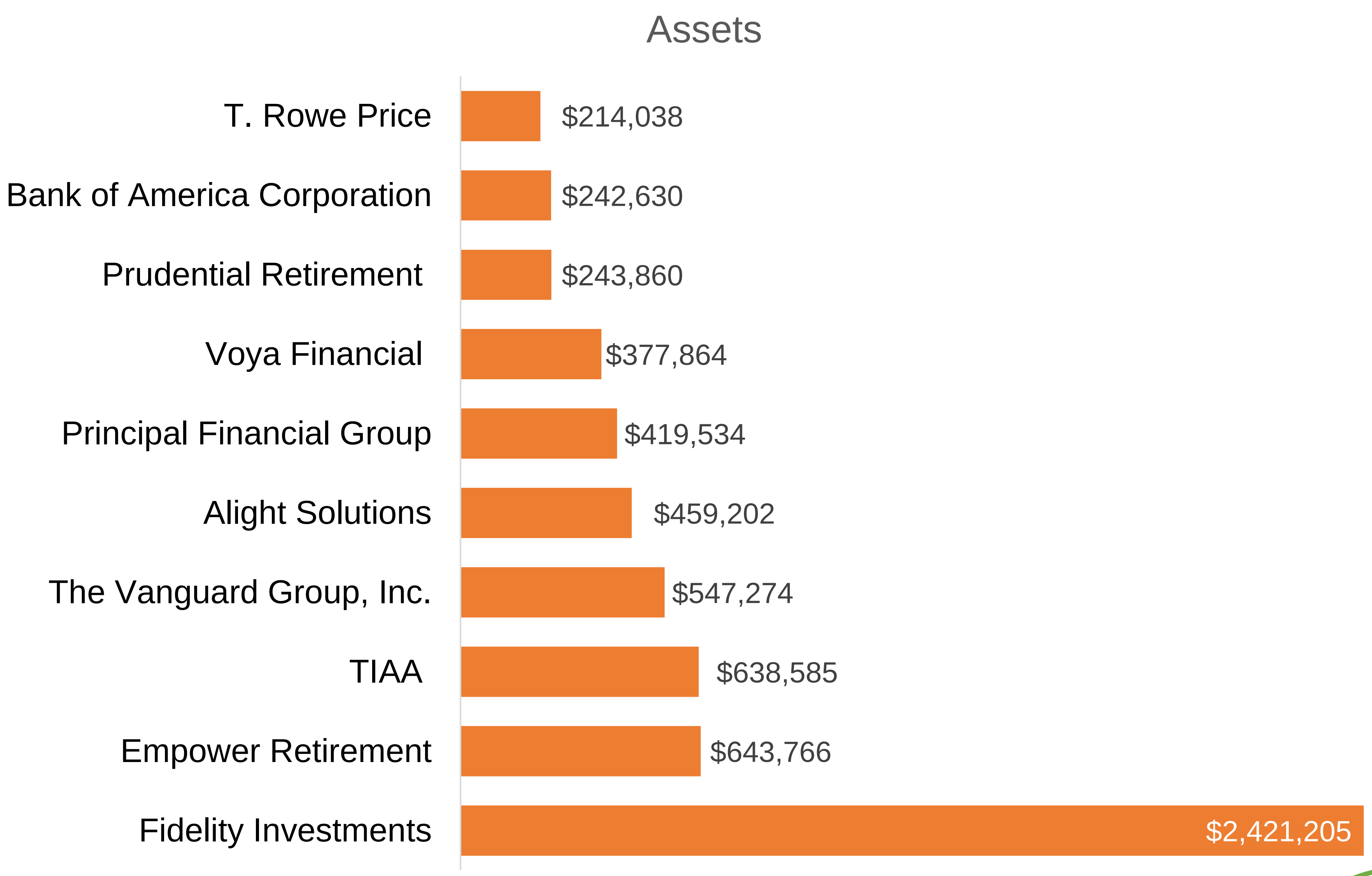
What Benchmarks are Used in Excessive Fee Cases?

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

Recordkeeping Fees

How Plaintiffs Allege Plan Administrative Fees Are Too High

Top Recordkeepers



Source: 2020 Best in Class DC Providers - PLANSPONSOR

CLAIMS: Recordkeeping Fees are Too High

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
- Revenue Sharing is uncapped and increases indirect
- Failure to conduct RFPs for lower RK fees

Recordkeeping fees are too high – using 401k Averages Book

Nvidia Corporation

[$1.0B assets/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, <u>the Plan</u>, with between a half-billion and a billion dollars in assets and over 7,000 participants throughout the Class Period, <u>should have had a direct recordkeeping costs below $5 average, which it clearly did not</u>."

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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 direct recordkeeping fee as Capozzi asserts: BUT they leave out the indirect $160 cost 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.

$14 Fidelity Recordkeeping Fee Testimony

- 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*.

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Comparison to Lawsuit against Fidelity's own plan

- ***Williams v. Centene Corporation***, E.D. Mo (2/22/22): Capozzi alleges in paragraph 89: "Let's start with what Fidelity itself would pay if it were in Defendants' shoes. In a recent lawsuit where Fidelity's multi-billion plan with over 58,000 participants was sued, the "parties [] stipulated that if Fidelity were a third party negotiating this fee structure at arms-length, the value of services would range from $14-21 per person per year over the class period, and that recordkeeping services provided by Fidelity to this Plan are not more valuable than those received by other plans of over $1,000,000,000 in assets where Fidelity is the recordkeeper." *Moitoso et al. v FMR, et al*, 451 F.Supp.3d 189, 214 (D.Mass 2020).

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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].
- **BUT NOTE:** the Form 5500 revenue for a recordkeeping includes transaction costs and other non-recordkeeping revenue and may not include revenue sharing – misleading because 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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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.

Capozzi Chart of “Comparable” Plans

Comparable Plans’ R&A Fees paid in 2019					
Plan Name	**Number of Participants**	**Assets Under Management**	**Total R&A Costs**	**R&A Costs on a Per Participant Basis***	**Recordkeeper**
Publicis Benefits Connection 401K Plan	48,353	$2,167,524,236	$995,358	$21	Fidelity
Deseret 401(k) Plan	34,938	$4,264,113,298	$773,763	$22	Great-West
The Dow Chemical Company Employees’ Savings Plan	37,868	$10,913,979,302	$932,742	$25	Fidelity
The Savings and Investment Plan [WPP Group]	35,927	$3,346,932,005	$977,116	$27	Vanguard
The Rite Aid 401(k) Plan	31,330	$2,668,142,111	$930,019	$30	Alight Financial

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Chart from *Williams v. Centene Corporation*, E.D. Mo (2/22/22):

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)

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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."

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 – **Question**: 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%]

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 investments and/or active investments will be above the ICI all-in 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.
- February 2022: $13.75m settlement approved.

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Milliman Case – Alleged Imprudence of Three Investments

- ***Mattson v. Milliman, Inc.***, 01/13/2022 [W.D. WA] [$1.7b/4,500]
- Challenge to three target-risk funds in the plan with only $250m invested and only 300 participants invested – alleging underperformance compared to aggressive growth purported benchmarks.
- The Unified Trust Wealth Preservation Strategy Target Growth Fund; Unified Trust Wealth Preservation Strategy Target Moderate Fund; and Unified Trust Wealth Preservation Strategy Target Conservative Fund.
- Milliman investment advisor affiliate Milliman Financial Risk Management LLC is a sub-advisor to the Unified Funds.

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 70^{th} to 97^{th} percentile of their peer funds [compound performance 2016-21: -5.89%/-.085% annual compared to Fidelity and -15.57%/-2.18% TRP].

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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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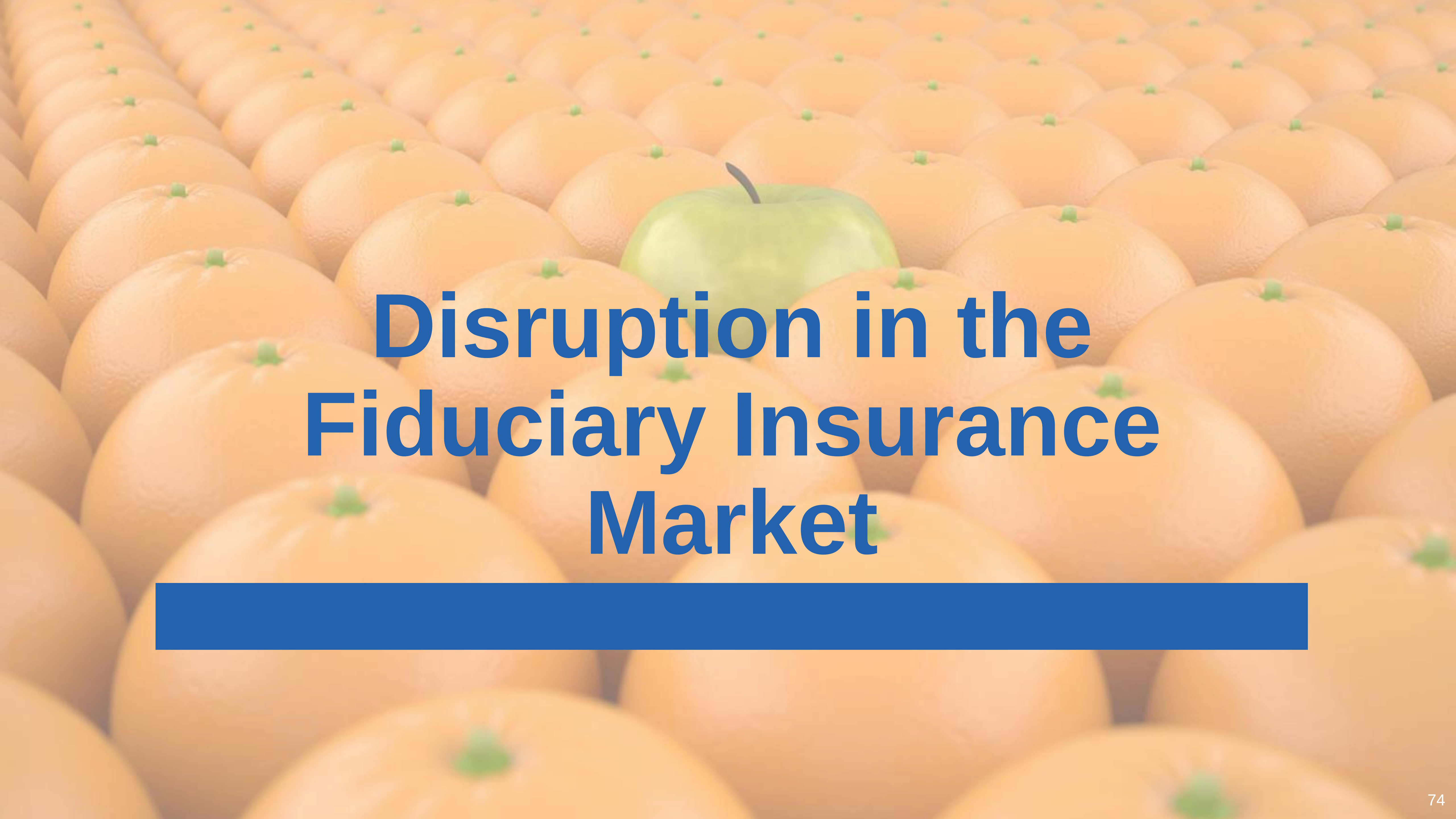

Disruption in the Fiduciary Insurance Market

Disruption in Fiduciary Insurance Market

- The frequency [350+] and loss severity [nearly $3B paid] of excessive fee cases since 2016 has led to significant changes in the fiduciary insurance market:
  1. Fiduciary carriers are reducing limits – harder to secure adequate limits
  2. Increasing policy retentions for excessive fee claims
  3. Higher premiums
  4. Increased fiduciary underwriting requirements

Increased Underwriting Requirements

- Plan sponsors will need to provide additional plan fee and investment information to secure coverage at renewal
- Supplemental application questions regarding recordkeeping and investment fees, fiduciary process, and whether the plan has received an excessive fee inquiry
- Will need to provide form 5500, plan financials, and most recent fee disclosures from the plan recordkeeper [rule 408b2 plan and 404a5 participant fee disclosures]

Lessons from Excess Fee Cases

Consider New Plan Provisions

- Require exhaustion of plan's claims procedures before a lawsuit can be filed
- Plan statute of limitation periods
- Mandatory arbitration clauses
- Class action waivers
- Venue provisions
- Consider 3(38) discretionary advisor

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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How to Become a Better Fiduciary Liability Insurance Risk

- **Pay the recordkeeping out of corporate assets** – eliminate the issue by paying all plan administration fees.
- **Conduct frequent RFPs and ensure low, per-participant RK fee:** 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.
- **Lowest Share Class - 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.
- **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.

Euclid Excessive Fee Resources

- 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 – Amicus Brief in Hughes v. Northwestern; Bad Facts Make Bad Law – Lessons From the Northwestern Decision; Webinar replay: **euclidspecialty.com/news-announcements/**

Thank You

Questions?

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