Managing Fiduciary Risk in the Current Environment of Plan Fee and Investment Litigation

What are "Excessive Fee" Claims?

Under the Employee Retirement Income Security Act of 1974 ("ERISA"), people with discretionary authority over a plan's administration or investments have a fiduciary duty to act carefully (i.e., the "duty of prudence"), and to act solely in the interests of plan participants and for the exclusive purpose of providing benefits to them (i.e., the "duty of loyalty").

In the context of 401(k) and 403(b) plans, a stream of class actions have been filed alleging that plan fiduciaries breached these duties by retaining recordkeepers that charge too much and retain investment options that are too expensive and that underperform their benchmarks. These class actions are commonly referred to as "Excessive Fee" litigation. These Excessive Fee suits have proliferated in recent years, with hundreds of lawsuits filed against employers in every industry across the country.

Generally speaking, these cases tend to fall into three categories of alleged breaches of fiduciary duty under ERISA:

Paying excessive recordkeeping fees	Paying excessive investment management fees	Using underperforming investment options
• Paying fees based on an assets-under-management model instead of a per-capita model • Allowing recordkeepers to retain revenue sharing generated by plan funds • Failing to address and monitor float income generated by the plan	• Failing to offer lower-cost share classes • Offering funds that use revenue sharing • Failing to use collective investment trusts ("CITs") • Using actively-managed funds instead of "index" funds • Using target-date funds that are overly expensive relative to their value • Using expensive or redundant managed accounts/investment advice programs	• Offering funds that underperform their benchmarks • Using the wrong benchmark to measure performance • Relying on the investment advice of professionals who have real or perceived conflicts of interest

The truth is that fiduciaries of well-managed plans get sued over fees. While there's no foolproof way to avoid it, using a good fiduciary process, qualified legal counsel and a reputable, experienced Fiduciary Liability insurer are key components in managing this risk.

Mitigating the Risk of Litigation – Focusing on Plan Processes

Strong plan processes can deter or defeat Excessive Fee litigation, and robust discussions among fiduciaries and plan providers (recordkeepers, investment managers, etc.) can strengthen those processes. Below are some questions that may serve as catalysts for these discussions. As always, please see your attorney or plan professionals for guidance.

Understanding and negotiating recordkeeping fees:

- ✓ How much is the recordkeeper paid (including both direct fees and revenue sharing)?[1]
- ✓ How is the recordkeeper's fee calculated (e.g. assets under management, per capita, etc.)?
- ✓ Were any reductions, rebates or credits requested or negotiated, and if so, what are they? If there are any rebates, who receives them and how are they used?
- ✓ What is the total recordkeeping fee when considered on a per-capita basis?
- ✓ What services does the recordkeeper provide for the fee charged, and are the fiduciaries and participants satisfied with the quality of these services?
- ✓ Have the fiduciaries and recordkeeper discussed the recordkeeper's right to use participant data for non-plan purposes? If so, are there any restrictions or compensation associated with it?
- ✓ Are RFPs or RFIs periodically conducted, and if so, when was the last one done?
- ✓ Are recordkeeping fees benchmarked, and if so, what is done to ensure that the benchmark is appropriate and reasonable (e.g. looks at a sufficient number of comparable plans with comparable (unbundled) services)?
- ✓ Does a qualified, independent consultant assist with evaluating recordkeeping fees, and if so, what do they do?[2]

Reviewing investment performance and investment fees:

- ✓ Does the plan have an investment manager? If so, are they a 3(21) or a 3(38) manager?
- ✓ Do the fiduciaries and providers have regular, periodic meetings to review and benchmark investment fees and performance?
- ✓ Is there a process for watch-listing and removing underperforming funds? If so, what is it and is it consistently followed?
- ✓ How many investment choices are offered and has consideration been given to whether the offerings are too numerous or too few?
- ✓ Does the plan provide a diversified array of investment choices (or does the plan offer investment choices that are very similar)?
- ✓ Are different investments styles (e.g., actively-managed vs. index funds) considered?
- ✓ Are investment expenses considered, including:
  - If less expensive alternatives to mutual funds are available, have they been considered?
  - If less expensive mutual fund share classes are available, could the plan be eligible (or request an exception to eligibility) to use them?
  - If the investments generate revenue sharing, how much, what is done with it, and are any rebates available?
- ✓ Do the plan's investments align with the plan's investment policy statement?

Documenting fiduciary actions:

- ✓ Are meeting minutes, including decisions and underlying rationale, documented and maintained?
- ✓ Are the plan documents, including committee charters and investment policy statements, up to date?
- ✓ How comprehensive are the fee disclosures that participants receive? Do they address any revenue sharing, rebates or credits?

Conducting periodic fiduciary training:

- ✓ What, if any, kind of training is provided to "on-board" new fiduciaries?
- ✓ What, if any, continuing education opportunities are offered to fiduciaries?

[1] If recordkeeping fees are bundled with other plan fees, how much of that bundled fee is attributable to recordkeeping?
[2] Independent consultants generally do not receive any referral fees, commissions or other compensation from, nor are they affiliated with, the provider of the service or product they review.

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10/2023