Please note: This is a transcription so there may be slight grammatical errors.

Jim:

Hello everyone and welcome to today's webinar, Fiduciary Training Part II: Litigation Trends and Takeaways. I would now like to introduce Dawn McPherson, Director of Retirement Plan Consulting at CAPTRUST.

Dawn McPherson:

Thank you. Hello everyone. Thanks to each of you for joining our discussion today. We are so excited to bring you the second installment of our quarterly fiduciary training series, and it is my pleasure to get to introduce you to our speakers. Matt Sharbaugh is a partner in Morgan Lewis's ERISA Litigation Group, resident in the Washington DC office.

Matt devotes a substantial portion of his practice to defending fiduciaries in a multitude of litigation matters, including many 401(k) and 403(b) excessive fees cases, and other claims of fiduciary breach under ERISA. Through his advocacy, Matt has helped to lead case teams to important and presidential victories in ERISA matters in federal district and appellate courts across the country. Fun fact, Matt was a former jazz trumpet player, so his improv and ad lib skills are on point.

Julie Stapel is a partner in the Employee Benefits Practice Group, resident in Morgan Lewis's Chicago office. Julie provides effective and practical solutions to clients complex ERISA issues. She proficiently steers plan sponsors and investment managers through ERISA's fiduciary and prohibited transaction rules, and negotiates virtually every type of investment related agreement with employee benefit plans. I also learned through our prep discussions that Julie was a contestant on Jeopardy. So, we might ask you to respond to any questions today in question form, Julie.

Finally, I'm pleased to introduce my colleague, Jim Strodel. Jim is a principal and financial advisor who has been with CAPTRUST since 2011. Jim is responsible for providing retirement plan advisory services to corporate fiduciaries, and Jim is highly motivated to create quality fiduciary processes that result in great outcomes for the plan committee, the company, and their employees. Jim is very into horse racing. So, Jim, it's a big week for you with the Kentucky Derby.

Matt, Julie, and Jim, thank you all for joining us today. Each of these three brings a unique perspective that will add tremendous value to the topics that we're going to discuss today. And hopefully, it will help you to expand your knowledge or reinforce your current knowledge and processes. So, with that, I'd like to hand things over to Julie. Please get us started.

Julie Stapel:

Thank you, Dawn. Thank you so much for having us. Matt and I are really pleased to be here to present to your clients and contacts on these issues that we spend a lot of time thinking about. I can take the next slide, Trudy.

So before we get into really the meat of the matter, I wanted to do a little bit of level setting just in case there's some in the audience who maybe are somewhat new to this field and just go over that ERISA is the federal statute, a federal law that governs private sector employee benefit plans. And more specifically for our purposes here today, private sector retirement plans.

One of the most notable things about ERISA is that it has very stringent and demanding fiduciary obligations that it imposes on anyone who has discretionary control or responsibility for the administration of a plan or the investment of plan assets. So, this would include things like choosing a

record keeper, negotiating fees with a record keeper, choosing the investment lineup. All of those things are fiduciary duties under ERISA.

Another notable thing about ERISA is that it gives participants and beneficiaries a right of action to sue fiduciaries for breach of fiduciary duty. And boy do they ever do that, particularly with the assistance of a large and ever-growing ERISA plaintiff's bar that organizes these claims into class actions, because pursuing them on a one-off basis would not be feasible or economic. So, we have this ecosystem of class actions and the plaintiff's lawyers who bring them for about the past 10 to 15 years with a particular uptick just in the past, I'd say two to three years. And that's what brings us to today's topic, and I'll take the next slide, Trudy.

So, what we're going to do is we're going to take two general concepts and themes in litigation. One is fee and expense. One is investment selection and monitoring. But please be aware that these two categories are by no means sort of hermetically sealed from one another, right? There's a lot of sort of interplay of these topics in any given lawsuit. And ultimately, in many ways, every ERISA breach of fiduciary duty case is a fee and expense case ultimately because it's about what the fiduciary spent in many instances.

So, we're going to talk about the landscape for those right now, but then we're going to try to kind of pin it back to the extent we can to concrete things that you can do as fiduciaries at your companies to mitigate the risk and best position yourself in the event of such litigation. Then at the end, time permitting, we want to talk about two of what we sort of see as emerging issues. So, these might be the issues that are the theme of litigation in the next 5, 10, 15 years, and that is cybersecurity and various issues surrounding the use of participant data in ERISA plans.

So, that's what we've got on tap. Let's not waste any more time, and I'm going to turn it over to my partner, Matt, to sort of give us the lay of the land on fee and expense litigation.

Matt Sharbaugh:

Great, thanks so much, Julie. As Julie said, happy to be here to talk about these issues. We spend a lot of our day thinking about these topics, and I know that's not necessarily true for everybody, so we're happy to sort of share some information with this group. And I'm going to cover the next few slides for the most part, but I look forward to having Jim and Julie certainly chime in to the extent that they have some points they want to share on the topics we're covering. So, I'll go ahead and take the next slide, please, Trudy.

So, just sort of to lay the groundwork here, what is fee and expense litigation? Sometimes you hear these referred to as excessive fees cases. What does that mean exactly? It's really a pretty broad term that I think to Julie's point captures any sort of cost based litigation surrounding the administration of retirement plans. And that can be all sorts of costs really. It can be the costs associated with the investments that are offered to participants in the form of investment management fees. It can be administrative costs that are paid to the plan's service providers. Most commonly in this space, we see claims focused on record keeping fees and fees that are paid to the plan's record keeper. Mostly just because that tends to be the biggest bucket of administrative fees that plaintiffs can focus on.

And then other fees as well for, for instance, managed account services and things along those lines. These claims derive mostly from ERISA's duty of prudence. ERISA fiduciaries have a duty to act prudently like a fiduciary would do faced with similar circumstances. I'm paraphrasing the statute, but the key word is prudence, not perfection. And what ERISA focuses on when push comes to shove when these cases get litigated is really process.

And so, as we talk through these issues today, and particularly when we turn to some of the plan sponsor takeaways, we're really focused on process. What is it that the fiduciaries are doing? What are they talking about, and what intervals are they undertaking these considerations? And ultimately, one fiduciary may come to a different decision than another when it comes to a particular issue. But the key really, again, in litigation is what was the process? Did you have a process? Did you make a decision? And less so on what that decision ultimately might be.

So, as the slide here indicates, these cases have been prolific in recent years, I'd say, when they first emerged. They were really focused mostly on significantly large plans, plans with billions of dollars in assets. We've seen that shift over the past few years as we've had more plaintiffs firms enter this space and now smaller plans are being targeted by these lawsuits as well.

So, really, what that means is if you have some responsibility for a retirement plan. This is a space where you want to be paying attention and at least sort of being aware of what these potential issues are out there. I'll also say at the outset, the issues we're talking about today, by and large, apply both to 401(k) plans as well as 403(b) plans. I know we have folks in the audience who represent both of those constituencies, but we see litigation on these issues in both of those spaces and a lot of the things we talk about will be a through line between both.

I'll take the next slide please. Okay. So, before we turn to some of the specifics, I thought it's worth talking just for a minute about how these cases get litigated as a practical matter, and one of the most important battlegrounds that we have when we litigate these matters is that the motion to dismiss stage. So, for the non-litigators in the audience here, what does that mean? What is a motion to dismiss? In short, it's the first opportunity for a defendant to try to get a case thrown out as lacking merit.

The purpose of a motion to dismiss is to avoid costly discovery associated with these cases, to avoid business disruption associated with depositions of fiduciary committee members who in many cases tend to be relatively high level executives within the company, and to just get some certainty and get out of the case.

The challenge tends to be for defendants that it's a pretty tough standard at the motion to dismiss stage, because the court is asking, "Is the claim plausible?" Not is the claim successful, not who's going to win, not who's got the better argument. The question is, have plaintiffs pled enough facts to support a plausible claim? And defendants also are generally pretty limited in terms of the sorts of information and documents that they can introduce affirmatively at a motion to dismiss.

So, when we get these cases, we tend to think really carefully about what sorts of arguments can we properly introduce early on, what sorts of documents can we point the court to either to correct a misrepresentation that the plaintiffs have put into the complaint, or to add additional context that we think is helpful as courts analyze whether the fiduciaries have complied with their duties.

So, as we go through today and some of the takeaways, I think a lot of what we're going to be talking about is framed from a broader defense perspective. If you were to find yourself in one of these cases, what are the sorts of things you want to have thought about ahead of time so that you can point to those committee minutes or the work you've done with a plan consultant to help defend against these things?

But I think there's also some considerations that can be given to the sorts of documents you can use early on in a litigation to try to support a motion to dismiss, things like fee disclosures, things like plan-wide participant communications. Sometimes record keeping fee agreements are addended themselves that can help to level set and correct the record on these issues.

So, I'll take the next slide, please, Trudy. We'd be remiss if we talked about this space, and this is not going to be a case heavy presentation, just to be clear, but we'd be remiss if we didn't at least touch on the Northwestern University case that the Supreme Court decided last January. By way of quick background, Northwestern was one of many universities who was sued back in 2016 for an array of different claims involving excessive investment fees, record keeping fees, shared class claims, all of which we're going to talk about in a little more detail as a general matter.

The district court in the case dismissed the lawsuit on a motion to dismiss the Seventh Circuit, which is the court of appeals that reviewed the case, affirmed the dismissal. The Supreme Court took up the case following the Seventh Circuit's ruling. And I'll say from the ERISA litigation, I think there was a lot of anticipation from both sides of the aisle that we were finally going to get some clear guidance from the Supreme Court as to what the pleading standard was going to be in these cases.

Spoiler alert, that didn't really come to pass. So, in January 2022, we got a very narrow five-page ruling from the US Supreme Court, which is Supreme Court rulings go. It's something that could probably fit on a billboard. And the Supreme Court ultimately sent the case back to the Seventh Circuit with a very specific ruling.

It believed the Seventh Circuit had used a line of reasoning that effectively said, "Look, if you've got some prudent investments in your lineup, the fact that you might have some other prudent ones really shouldn't make a difference, because participants can choose whatever investments that they want." The Supreme Court said that sort of categorical rule isn't appropriate for ERISA, and so it sent the case back to the Seventh Circuit to reconsider the claims in light of that.

The court did instruct though, and this is something that's been litigated since that courts have to give due regard to the range of reasonable judgements a fiduciary may make based on her experience and expertise. So, courts are continuing to wrestle with what that language means and how it should be applied at the pleading stage, but I'll say from the ERISA litigation ...

Matt Sharbaugh:

... at the pleading stage, but I'll say from the ERISA litigation defense bar, we are optimistic about that language. We think it's helpful. We think it reflects the court's need to be mindful of the fact that there's no one right way to approach these issues from an ERISA fiduciary perspective, and there's a range of things that can be considered.

So we can go to the next slide, please. Just briefly, the case, as I said, went back to the Court of Appeals on the Seventh Circuit. The Seventh Circuit decided that case just at the very end of March, so about five, six weeks ago. And it revived two of the claims that were at issue. And again, an extensive discussion of this case is beyond the scope of this presentation. But the court sent back the record-keeping fee claim, and it's sent back the share class claim. Again, both categories of claims we're going to talk about later in the presentation today. And so those claims head back to the trial court potentially to be litigated through discovery.

So next slide, please. Thanks. All right, so let's talk about a few categories of fee and expense claims that we regularly see in the space. And this is by no means an exhaustive list, but we want it to sort of highlight the most common themes that we see across so many of these cases. So the first category is claims challenging individual investment fees. So what are those [inaudible]? Plaintiffs in these cases will look at the plan's investment menu, find a handful of investments in the menu that they think charge expense ratios that are too high. Most often, those are actively-managed investment options. And then plaintiffs will build a chart in the complaint where they say that the fiduciary should have replaced those high-cost investments with allegedly comparable ones that cost less. Oftentimes, the alternatives are passively-managed investments, which sort of, by their definition, tend to be less

expensive. And the plaintiff's core theory is, look, the failure to choose a less expensive investment itself was an imprudent decision.

I'll say for the most part, courts have been pretty skeptical of these claims that the motion to dismiss, and a lot of them get rejected as implausible at the pleading stage. For the most part, it's because plaintiffs in these cases, as I said, compare an actively-managed investment to a passively-managed investment, which sort of, by definition, explains why the fees are different. Or they'll compare different investment types, say a mutual fund to a collective investment trust. And courts say, "Look, that's not apples-to-apples, and there's reasons why one might cost more than the other. So that can't be enough to state a claim."

And I'll say more broadly, courts tend to recognize that at least where there are differences between investments, cost is not the only factor that a fiduciary need to, or really should, consider, right? Cost is one part of the analysis, but there might be reasons other than the fees that fiduciaries might choose to offer a particular investment. Maybe you have some passive investments on this side of the menu, you want to offer active investments for participants who are interested in those options. So I think this is one space where we've seen federal judges sort of recognize that there's room for discretion when it comes to fiduciary decision.

Julie Stapel:

Hey, Matt, before we leave this topic, one of the questions that came through that I thought might be good to address here is the distinction maybe between fees at the record-keeping level and then fees at the investment level. The person asking the question says that the company pays what I believe to be the record-keeping fees, and then asking about the distinction between that and the fees at the investment level. So those are two different levels of fees, typically paid in two different ways.

Matt Sharbaugh:

Yeah, they can be. I'll say the investment fees tend to be paid directly by participants through whatever their investment is in the form of a portion of the expense ratio. Record-keeping fees, I'll say in most plans, are ultimately paid by the participants, or at least with plan assets. And for that reason, participants can bring claims related to record-keeping fees as well, because they're ultimately paid by the plan or by the participants, even if, for instance, the company pays them, but then recoups them from the plan.

There are some plans who choose to pay administrative fees, including record keeping fees directly at the company level. So instead of using plan assets, they're paid with corporate assets. That's a different scenario and we've litigated that issue. And my position is if you're using corporate assets for record-keeping fees, that's not a fiduciary decision at that point, and so it shouldn't be subject to challenge under [inaudible].

Julie Stapel:

Jim, do you have any other thoughts on that, anything to add on that before we move on?

Jim:

Just to further emphasize the point that investment fees are borne by the plan participants. And Matt alluded to this I think on the previous slide, that share classes are... The expense associated with the fund and the plan often has different share classes, and they can be reduced as your plan grows. And so the importance of reducing to lower cost share classes is not lost on anyone.

Matt Sharbaugh:

Share class has been a hot topic and I think there's a slide on that to come, so we'll talk about that a little bit more, but that's definitely been a focus of these lawsuits in the past few years. So we can take the next slide, please.

Okay. So record-keeping fee claims. Every retirement plan has a record keeper, it's just a necessary function of retirement plan administration. And like most service providers, record keepers like to get paid for the work that they do. But this has become a area of significant litigation from the plaintiff's bar, by alleging that the record keeping fees should have been lower or more aggressively negotiated than they were. I think in part this has been driven just because the industry is sort of playing catch up a little bit, and we've seen more cost competition in this space among record keepers. So the fees that plans were paying 5, 8, 10 years ago, just as a general matter, are more than most plans are paying today. But certainly, it's been a focus of these cases.

So what do these claims look like? So plaintiffs in these cases will, number one, purport to calculate a plan's record-keeping fees, usually based on how it averages out on a per participant number. And they usually use form 5500 data to build those calculations. They often also use the 5500 data completely wrong. Their calculations are not based in reality. And as many of you probably know, form 5500s are not uniform from plan to plan, and they can look very different depending on how that information is input. But regardless, that tends to be the source material for these claims. So they'll calculate your plans fees at $75 or $80, or pick a number, per year, and then they'll go find other form 5500s of plans that paid half of that, right?

Using the same methodology, they'll build a pretty little chart and put some graphs into a complaint, and allege that because your fees were twice or three times as much as a group of other plans, that shows that you didn't have a good process for record-keeping fees, and so the fiduciaries must have been imprudent. These claims I'll say have been prolific. I'll say courts I think are increasingly skeptical about them and are taking a closer look at them at the motion-to-dismiss stage. And there's sort of some key issues that emerge when courts go through this analysis. Number one, again, cost alone is not the only consideration. And when it comes to record keeping fees, plaintiffs like to say, record-keeping services are a commodity. They're just widgets and they're fungible, and you can plug one record keeper in for another, and as long as they charge less, that's better.

That's a pretty myopic view of what record keepers do. And I'll say, from my perspective, we spend a lot of time arguing against that proposition because different record keepers can provide different services, different plans might need different types of services within the broad bucket of record keeping. And so just looking at the price tag at the end of the day really is not enough to evaluate whether a decision was imprudent or unreasonable. Plaintiffs also, as I said, use form 5500 data in misleading ways, whether purposefully or inadvertently. But because of that, their comparisons oftentimes are not apples to apples. When they're saying your plan paid twice as much as some other plan. Oftentimes, if you peel back that onion a little bit, that just doesn't tend to be the case.

There's a lot of focus in these complaints about the absence of competitive bidding or a failure to put the record keeping services out for bidding or an RFP. Usually, it's a conclusory assertion. It's not grounded in fact. They'll just say it. And because of that, courts tend to hook into it. It sounds kind of processy, and so that sometimes has been enough to get some of these claims over the line. But there certainly is a focus on market testing and bidding these issues.

And then the other thing we see in some of the more recent cases is a multiple record-keeper scenario. Some plans have not just one record keeper, but two. And plaintiffs to focus on those because their contention is, look, by failing to consolidate those providers to a single record keeper, you gave up some bargaining leverage and you could have got a better rate if you'd consolidated. Now look, there's

oftentimes really good reasons that plans have more than one record keeper. I'll say particularly in the university context, where we saw a lot of these cases in the mid 2010s, there's historical reasons that that's the case. So it's certainly not a dead bang winner sort of argument, but again, it's something that plaintiffs will use in these complaints to try to get themselves past the motion-to-dismiss.

All right, so Trudy, can we go to the next slide, please? Okay. The last category of plan that we wanted to flag for the group here today, as Jim already mentioned, relates to share class selections for certain investments in a plan. So what is a share class? Many investments are offered in different share classes that have different fees associated with them. Oftentimes, they're driven by the total assets that a plan has invested within an investment option. And the expense ratios, the fees for these share classes can differ. Oftentimes, a higher cost share class tends to throw off more revenue sharing. A portion of those higher fees go to pay for some other plan service that would have to be made up elsewhere, most often rent.

So usually, the higher cost of the share class, there's a chunk of that that gets peeled off and spent on record-keeping fees, and so that tends to be sort of the practical explanation. But plaintiffs are very focused on these sorts of claims because for the reasons we talked about earlier as to why some of the individual investment fee challenges can be difficult, differences between investments, different strategies, different asset holdings. The comparator for these claims is kind of baked right into it. Because what plaintiffs will say is, "Look, these investments are identical except that one cost is less than the other, so why would a prudent fiduciary choose the higher cost share class?"

And given the kind of simplicity with which plaintiffs can portray these claims, courts have been more receptive to allowing share class claims to proceed past the motion to dismiss. I'll say that in doing that, the courts almost always recognize that there could be reasonable and prudent explanations for why a fiduciary would choose a higher cost share class. But then they pivot and say, "But those are questions for discovery, and we can't decide those on a motion-to-dismiss."

Again, we spend a lot of time pushing back on that notion on behalf of clients who have used higher cost share classes for the very purpose of revenue sharing and keeping record-keeping fees down in another aspect of plan, but that's certainly how court have been approaching these issues.

Julie Stapel:

Jim, I know you mentioned you get a lot of share class questions. Anything you want to add before we leave this topic?

Jim:

This is a little detailed, but as share classes proliferate, there's an emerging issue where new share classes on a gross basis can be more expensive than the ones that a plan owns. But then through what Matt was talking about, revenue sharing, have increased revenue share that make it net cheaper than the share class that's in the plan today. And it's a complicated decision to make. That would be to increase the gross expense ratio, which it's a headline number for a plan participant, only to reduce it through revenue sharing. Oftentimes participants don't get that second piece, that actually the net cost is cheaper. So it's a thorny issue for a committee.

Matt Sharbaugh:

Yeah, there've been a few cases that have tested that proposition, sort of the opposite of the theory we've been talking about. And keying off of what you just said, Jim, which is to say, not offering the share class with the top line higher number was imprudent because when you factor in the revenue sharing and all the machinations that go into that, the bottom line number participants pay is less. And

there've been a few cases that have pressed that claim. I know at least the Seventh Circuit has rejected it as not plausible, but it's certainly something that's out there. So I guess in terms of a takeaway-

Matt Sharbaugh:

... something that's out there. So I guess in terms of a takeaway on this, I think to the extent that your plan uses revenue sharing to pay for record keeping fees, and this is an issue that you're thinking about, the key's going to be sort of documenting the rationale for the decision, thinking through the issues and showing that you've done so. From my perspective, I don't think there's one right way to do this. I think reasonable fiduciaries can approach it either way. The key is just sort of reflecting that you've thought about these issues and you made decision based on a determined record because you're trying to achieve a certain objective. [inaudible].

Julie Stapel:

That was almost a perfectly crafted segue to the next slide, Matt. You're so good. So the next two slides, we're going to kind of like I said, give you that takeaway, pin it back to what your committee and your fiduciaries might think about. I'm going to really mostly skip this slide. Matt kind of covered this a little bit. What are the specific or what's the fiduciary duties that are implicated here? He mentioned the duty of prudence, which we'll cover in a second. The other one is called the duty of loyalty, which is basically an anti conflict of interest rule that requires fiduciaries to act solely in the interest of participants and beneficiaries. So this means not in the plan sponsor's interest, not in a record keeper's interest. You have to do what's best for participants and beneficiaries. Of course, what's best for them is a wide spectrum as we just talked about, but that's one of the two duties at issue in these cases.

The next one, and I'll take the next slide, Trudy, is the duty of prudence. Matt said he was paraphrasing. Of course, I do know such thing when it comes to the duty of prudence. I've just slapped it right here on the slide for you. I'm generally opposed to just excerpting ERISA on a slide, but I do think this is a good one to put on there because what it really shows is there's so many words in here, so many different ways of describing that duty of prudence, and I really think they all kind of mean something, right? There's no wasted language in this provision. And a couple of the key points I think to take away from it are it refers to what a prudent ... It says man. I say person. What a prudent person acting in a light capacity and familiar with such matters would use.

So, what that gets that as sometimes referred to as a prudent expert. In other words, it's not enough to just mean well and do your best and try hard. A fiduciary needs to do more than that and bring in an expertise when they don't have it if that expertise is necessary to effectively make plan decisions. The other point, as Matt indicated, is it really is quite process driven. A fiduciary won't be looked to to guarantee an outcome, but could be looked to be able to demonstrate that there was a process. And I've sort of over the years kind of called this good fiduciary housekeeping, hence the silly magazine cover from 1962. Just keep your affairs in order. And a big part of that is documentation, as Matt indicated, because the best process in the world isn't going to do you a lot of good if you can't demonstrate what it was when challenged. So, documentation is a key part of the duty of prudence as well. Jim, I'm sure you have some thoughts on these topics. What else?

Jim:

And you said it, but the exclusive benefit rule is critically important; that when a committee gathers, you've got executives, leadership, that everybody does need to put aside their organizational objectives and goals and reframe that they're there for the best interest of plan participants. I try and start every committee meeting with just a reminder of that.

Julie Stapel:

Yes. The overly hackneyed two hats, right? It's very cliché in a risk expression. I say a fiduciary may wear two hats. This is in a lot of court cases. And what that means is that the same human can be both an executive or officer of the company and can also be a plan fiduciary because companies don't have the capacity or the bandwidth to have one set of people who are officers and one set of people who are just fiduciaries. So, that dual role is built into even the very largest plans we work with. You know, the people who are the fiduciaries have other corporate rules and functions. And so keeping that distinction is really key.

We'll take the next one, Trudy. And so just again, to tie this back to what specifically fee and expense, as Matt said, the lack of RFPs have given some plaintiffs some traction in some of these cases. RFPs are big and expensive and difficult and suck up resources, so it's not something you're just going to be doing all the time. So I think the key thing is yes, RFP at appropriate intervals, but in between RFPs, continue that sort of dialogue, that process of talking about fees and thinking about fees, and using your advisors and your consultants as part of that is essential. And in my opinion, one of the biggest value ads that consultants can do is to sort of help you with that interim level of fee review.

Matt Sharbaugh:

Yeah, and I'll just add here ... I mean, just asking some basic questions. If you have responsibility for a retirement plan, do you know how the record keeping fees are paid? Do you know who your record keepers? Does the company pay the record keeping fees? Do the participants pay the record keeping fees? How much are the record keeping fees on average per person? When is the last time that you bid out those services and potentially looked at new providers? If you haven't done that, when is the last time that you've benchmarked those fees against the market to determine where you fall within the range? These are all the sorts of questions that God forbid you find yourself in a deposition chair in one of these litigations that you may find yourself being asked. And so getting ahead of these issues, thinking about them, making sure that you're sort of regularly paying attention to these issues, I think is really important.

There's a point out here about participant fee disclosures and the importance of this. One thing I see, and this ties back to the motion to dismiss piece, is to the extent that your plan pays record keeping on a flat dollar per participant basis, do your participant disclosures say what that number is? It's helpful if they do because then when plaintiffs come in and try to make up a number that's twice as big as what you actually pay, that's a document you can use on a motion to dismiss to try to get yourselves out of the lawsuit on the front end. So these are some of the things to think about, but again, sort of good fiduciary housekeeping, just paying attention to these issues, talking about these issues, asking the right questions really goes a long way to setting yourself up for success if you find yourselves facing one of these cases.

Jim:

Yeah, I'll just emphasize to Julie's point about RFPs are complex. They take a lot of time. A fee benchmark is not nearly as complex. Your committee, your consultant should be readily prepared to provide an annual fee benchmark or maybe every two years. We've been told through clients that have been through litigation that the existence of regular fee benchmarks are incredibly valuable defense documents.

Matt Sharbaugh:

Yeah. There was a case that just came out last week. It was a summary judgment case, but that's one of the things the court looked at exactly, was there was a regular process that the fiduciaries used every few years, at least a benchmark. And then I think they also did an RFP at some point in the relevant period. But even if they're into that process, you didn't get the lowest cost fee as compared to some other plan, the fact that you took those steps and went through the right process pieces really goes a long way towards defending against these claims.

Jim:

And another one more final piece on share classes is you should be ... It's a good practice to review all your plan investments for the opportunity to reduce share classes. So it would be good to have on record an annual review of the share classes you use comparing against alternative share classes.

Matt Sharbaugh:

All right, great. Trudy, we can take the next slide, I think. And the next slide after that. All right, so the other sort of bucket we wanted to talk about a little bit today, let me see.

Julie Stapel:

I think we went in the wrong direction, Trudy.

Matt Sharbaugh:

Might have gone back. There we go.

Julie Stapel:

[inaudible].

Matt Sharbaugh:

Relates to investment selection and monitoring. And so these are the claims that really are not driven by fees, but instead by things like investment performance or just the suitability of investments more general. And to Julie's point at the top of the presentation, these claims don't always come in silos. Oftentimes this theory will sort of work in harmony with the fee theory and sometimes plaintiffs attack investment choices on both grounds. But we wanted to spend at least a little bit of time covering this bucket as well. So again, how do these claims sort of present themselves? Plaintiffs again will find a group of investments within your plan that have usually sustained periods of alleged underperformance against some potential benchmark or alternative investment. It by definition is going to be based on a lookback of investment returns. So these tend to be sort of hindsight driven claims for the most part, although plaintiffs will do their best to argue that that's not the case.

But effectively, here are six investments that underperformed over a period of time. These investments, which are meaningful benchmarks, did better. And so the fact that your investments underperform must have must mean that you didn't have good process for monitoring those investments. And this sort of claim also derives generally from the duty of prudence. Fiduciaries have a responsibility and a defined contribution plan to not only select prudent investments in the first place, but to regularly monitor those investments on a going forward basis and potentially remove investments if they become imprudent at some point.

So these claims, as I said, really turn on sort of a hindsight analysis, although plaintiffs will say, "Look, this was data available to the fiduciaries in real time in 2018, so it's not hindsight based." But I think

courts are a little skeptical of these sorts claims because they do just have a sort of sense of hindsightedness to them. And ERISA is about making decisions in the moment, not second guessing things after the fact. These claims likewise tend to turn pretty considerably on whether plaintiff's reporting to appropriate comparators or benchmarks. Are there differences in the investments that they're reporting forward that would explain the performance differences, for instance? Those sorts of things.

These claims I think are a little more challenging to defend where you've got an investment in your plan with a limited track record. You know, it's a new investment in the marketplace, or it's an investment that not very many other retirement plans offer. That's not to say fiduciaries can never choose to put those sorts of investments in plan, but if you do, I think it's something you want to think about and make sure you've sort of documented in a way that will be helpful going forward because it's not the same sort of investment with the broader track [inaudible] things. And then oftentimes these cases focus on sort of proprietary funds, or maybe you have a record keeper for a plan who also has some of its investments in the plan. And so there becomes sort of an error of disloyalty or a conflict of interest that overlays this a little bit, which plaintiffs will try to use to get a court's attention on these issues.

Can we take the next slide, please? And I'll say a place we've really seen these claims develop in the past few years has focused on target date funds, which many plans now use in their investment lineup and which many plans use as the sort of default investment for participants who don't make an affirmative selection about [inaudible] their funds. So these have become targets in part because of that dynamic, and also because they tend to just have the largest share of assets collectively within a plan. So, different target date products have been targets here, pun intended or not intended, potentially, target date funds being targets. But the Fidelity Freedom Funds, just to take an example, there was a wave of cases filed against the Fidelity Freedom Funds alleging that they were expensive and underperforming and risky, all sort of packaging together all the sorts of things we've been talking about so far today.

A lot of courts allowed those claims to proceed past the motion to dismiss, and they've gone into discovery and gotten various stages of litigation. There was a case last year that came out of the Sixth Circuit, which we've cited here, which shut down one of these theories. And I'll say was one of the cases, I think, that is part of the shifting tide a little bit. The pendulum swing is maybe a better analogy back a little bit in favor of fiduciaries in these cases. But the Sixth Circuit picked up on a lot of the issues we've been talking about about the problems with these claims, the hindsight driven nature of them, the fact that you can't just focus on cost alone, all those other issues as well.

So again, this is just one example. I don't mean to pick on the Fidelity Freedom Funds, but there was a wave of cases out there that were focused on those investments. Others have been targeted too. Some plans use custom target date funds. Those have been targeted in some cases as well. So really, this is the claim that can apply to any sorts of target date funds that are out there, and these are issues that you want to be thinking about if you have responsibility for a plan. Next slide, please.

Jim:

Even the low cost index funds, Matt, in the last year, the BlackRock funds have been under attack, so even passively managed, which is where a lot of plan sponsors went.

Matt Sharbaugh:

Exactly right. And again, speaking of sort of perfect segues, Jim, we wanted to touch on that as well. So, the BlackRock funds have become one of the most recent targets. There were a-

Matt Sharbaugh:

... have become one of the most recent targets. There were 11 lawsuits filed across large plan sponsors across the country last summer, challenging the BlackRock LifePath target-date funds. To Jim's point, these are low cost passively managed index funds. They are the second or third most popular target-date fund in the market today. The plaintiff's theory in this case was exceptionally narrow. It was effectively, "Here are three or four other target-date suites that perform better than the BlackRock funds over a three or four or five year period of time." And based on that fact, the loan courts usually find that there was prudence here in fiduciary decision making.

As the slide says, there may be some cause for guarded optimism here. Of the 11 of those cases, three of them so far have been dismissed with prejudice at the motion to dismiss stage. So those courts have recognized that performance alone is not the appropriate yardstick for fiduciary management. There are still half a dozen or so kicking around in courts around the country, so we're certainly watching this space. But to Jim's point, it just goes to show you you could have the lowest cost target-date suite out there that's performing by all accounts pretty well against the market and still find yourself potentially facing one of these claims. So those are issues you want to be thinking about.

And some considerations that have been important in the BlackRock cases, different target-date funds have different glide paths for instance. Without getting too into the weeds, there's a glide path that runs through retirement. There's one that runs to retirement. Fiduciaries can decide one or the other may be better for their particular participant population. But to the extent we're talking about housekeeping and memorializing decision making and those sorts of things, that's something that you want to be thinking about potentially and making a record of in your committee minutes and other materials. And same when it comes to active strategies versus passive strategies. There's different options in the market. Different fiduciaries could decide that one or the other is better. But again, just reflecting that this was a part of your decision making process as to why you chose this particular target-date suite can go a long way to helping you defend against these claims if you find yourself in a lawsuit.

Okay, the next slide please.

Julie Stapel:

Yeah, and actually before I take this slide over, Matt, I just want to note that it was one of those BlackRock complaints, and I think they were all pretty much the same, actually had the audacity to say that it seemed that all the fiduciaries cared about was having a low cost, which of course when you're on the defense side, it's infuriating. It's like, "Oh, I wonder why they did that." Only 10 years of terrorizing lawsuits about not having a low enough fee and now the complaint is, " Oh, all you cared about was the fee." So in my more cynical moments, it does sort of feel like there's just always going to be a theory about how a fiduciary did something wrong.

And that's why I'm sort of an advocate of... I'm glad you're all here and listening to this. It's good and it's important. But also you just need to do what's best for the plan. You can't live paralyzed by litigation because we simply can't predict what they're going to do next. And if you try to outsmart them and say, "Well, okay, they're after BlackRock. We'll get rid of BlackRock," then the target that you just picked might be the next one. So I think it's a good reminder to say, "Just kind of steer your ship as a fiduciary and you can't let yourself just be battered all around by this because it's too irrational, I guess."

So that takes us to this kind of plan sponsor takeaway. Really it's all the process points we've already talked about. I just want to put in one pitch from a fiduciary process perspective about target-date funds. And that is they're different than your other funds, right? They're more complicated. The analogy I like to use is there's stuff going on under the hood. You got to look or your advisors have to help you look so that you understand how it's working, what are the layers of fees, what are the component funds. And then also it's more difficult to assess performance, right? Because the successful

performance is going to be, "Did you get people to where they needed to be sort of in terms of their retirement readiness?" So I think there's some additional complications there. And because they are often such a large part of a plan, I think they're worth that extra bit of diligence. Jim, anything else on that?

Jim:

I think that in 2014, the DOL published tips for fiduciaries for monitoring target-date funds or default options.

Julie Stapel:

We did.

Jim:

We deeply believe in following those. Those are a core of how we help our clients get through the default evaluation, target-date evaluation. And then one point for some of our largest clients, were having the target-date managers come in and explain to the committee, even though we've already done it once every year or two, what they own, why they own it, how it's constructed, the glide path that Matt talked about, so that they're hearing directly from their investment manager on their default funds in their actual committee meetings.

Julie Stapel:

Those are great suggestions. Very, very smart. Okay. So we find ourselves with nine minutes and two emerging topics. So we'll do a little bit of a rapid fire around here. I can take the next slide, Trudy.

Let's talk about this one. We can let plan data go or I'll just give you a little teaser on that, but I'm sure it's not going to be a surprise to anyone that cybersecurity is a major concern in all walks of life. Retirement plans are no different. The Department of Labor have meant to look up exactly when this was, but I think it's going on a year and a half now, if not more. It came out for the first time in its history with specific guidance about cybersecurity considerations for plans. Other regulatory agencies like the SEC for example had had cybersecurity guidance for a while, but this was the first time the DOL sort of dipped its toe in the water on this topic. So it really did kind of refocus some energy and some attention on this.

At the same time, probably not coincidentally, we've been seeing cybersecurity questions come up in Department of Labor audits and examinations. I'm sure there's some of you in the audience who have had the pleasure of one of those sometime in the last few years where a Department of Labor examiner comes in with a very lengthy list of questions. In the last few years, those questions have started to include cybersecurity questions, which we think is reflective of a new focus on that front at the Department of Labor. Litigation wise, it hasn't quite found its footing of what I think it's going to look like in terms of litigation. I can take the next slide, Trudy.

So far the litigation has been more in the nature of sort of individual participants who are the victim of a cybersecurity crime. Last year there was one filed in the Southern District of New York, a pretty garden variety sort of fraud. Somebody posed as the participant, embezzled $750,000 from the participant's 401(k) account. The participant sued both his or her employer and the record keeper, saying that they did not have sufficient processes to keep this from happening. Both the plan sponsor and the record keeper moved to get themselves dismissed from the lawsuit and that did not succeed. They are still in the lawsuit, and this lawsuit is working its way through the courts. So it's not hard to imagine if there

was a mass cybersecurity event that caused loss of plan assets. It is not hard to imagine that that would be crafted or could be crafted into a claim about breach of fiduciary duty. I'll take the next slide.

Let's skip this one. We'll go to the next one. The part of what the Department of Labor put out in its guidance were tips for planned fiduciaries when hiring service providers. This is I think a really helpful list or a way to think about it. If you've not had conversations with your record keeper about cybersecurity, it might be good to put on your kind of compliance agenda for the coming year. And one of the things I think is really important to understand is that in the Department of Labor's view, and this hasn't been tested yet in courts, but in the Department of Labor's view, it is a fiduciary responsibility to make sure that the plan's assets are safe, appropriately safeguarded against cybersecurity attacks. They view it as a fiduciary duty.

Therefore, remember what I said about needing to be a prudent expert? To the extent you are, if you have a fiduciary committee for example, you might want to consider having your company's own IT be involved in these decisions because you as a fiduciary committee may not have be equipped or have the tools to... So you can go ask your record keeper, and I know this from experience. Because for better or for worse, Morgan Lewis put me on the fiduciary committee of our own plans. I guess they figured if I talk as much about it, I should do it. When you meet with your record keeper, they have a very well planned set of things that they tell you. And to someone like me who doesn't really know that, it was essential that we had one of our IT people in to kind of translate it for us. So I offer that for your consideration. I do think the Department of Labor is going to continue to view it as a fiduciary duty. So I think you're well served to think about what kind of experts you need to deploy on that.

And Trudy, we'll take the next slide. And the next one please. I just want to leave you with this because I love this story. So this is the picture on the left-hand side, you will see Prince William, the immediate heir to the throne in England. This was when he was in the Air Force and the press sent to do a feel good photo app about how this prince was in the Air Force. When they had that press come in, they had their password taped to that column there. It was a major issue once it got published. The whole security system of the Royal Air Force had to shut down while they change the password. This is just a reminder that the best cybersecurity is not going to help you if your end users are careless. So it's a good reminder for people to have good password hygiene, take care of it, don't leave it taped to a monitor. So I'll just leave you with that on cybersecurity.

Jim:

I'd just like to add one point, Julie, if I could on cyber, and this is about fiduciary insurance that plan sponsors get. Fiduciary insurers have gotten more sophisticated and we've seen where they're extracting cyber from their actual fiduciary policies. So whoever is risk at your organization involved with fiduciary insurance policies, it's really important to look at how they handle cyber in the fiduciary as it relates to the retirement plan.

Julie Stapel:

Yeah. And the flip side of that coin, Jim, is how does your cyber cover your plan?

Jim:

Exactly. Exactly.

Julie Stapel:

Because you can have a coverage kind of gap there. That's a very emerging issue in insurance right now as well.

Dawn McPherson:

Matt, Julie, Jim, this has been fantastic. I can't believe how helpful and useful it is to hear the various perspectives from the work you do each day, litigator perspective, and then counsel and consultant for directly with plan sponsors. I know we are two minutes till stop time, but maybe we could ask one question that's come in. And I want to say before I turn it over to Matt, Julia or Jim to answer this one question, we have had several questions come in the chat. We've been able to answer a handful of them. If we haven't answered your question, rest assured we will follow up with you after this webinar.

So the one question I thought I'd throw your way because we're talking about litigation skyrocketing, and there were a couple questions that came in around this, who's really driving it and the idea that it's hard for these sponsors to believe that employees are actually driving a lot of this. So can we take just 60 seconds to comment on that?

Matt Sharbaugh:

Yeah, I'll give you the defense litigator's jaundice view of this, which I think is actually a real one. But I mean, look, plan participants generally are not driving these cases because for the most part, your participants don't know what the record keeping fees look like or what they're even invested in for the most part. These are lawyer driven cases for the most part. They tend to generate based on solicitations of your participants. Lawyers will look for big plans or plans with particular attributes based on 5,500 data, and then they'll start soliciting participants from that plan. So as someone who administers a plan, what's the first indication you might be a target of one of these cases? Usually, it is a request from a participant for information related to the plan. ERISA provides a statutory mechanism whereby your participants consent a written request and ask for plan related documents. If you receive one of those, it's probably a good idea to get your in-house counsel or an ERISA litigator involved early because usually that is the first step to a potential lawsuit coming down the pike.

Dawn McPherson:

Thank you, Matt. Thanks to each of you for being here today, our speakers and our attendees. We hope you'll join us for next quarter's fiduciary training webinar.

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