

Publications

Fidelity Wins Dismissal from ERISA Claims Based on “Infrastructure” Fees

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Several highly publicized lawsuits were brought against the Fidelity organization in 2019 in connection with Fidelity’s receipt of “infrastructure fees” from mutual fund families and other investment providers made available on Fidelity’s “FundsNetwork” investment platform. Those lawsuits generally alleged that Fidelity was an ERISA fiduciary to client 401(k) plans in connection with the operation and administration of FundsNetwork, and had breached its fiduciary responsibilities by receiving infrastructure fees from investment managers. Last summer those cases were consolidated into a single putative class action in the U.S. District Court for the District of Massachusetts titled In re Fidelity ERISA Fee Litigation. On February 14, 2020, the District Court dismissed all claims against the Fidelity organization. We summarize the claims and the Court’s ruling, and offer some initial insights, below.

Our Reactions

The District Court’s ruling is favorable for plan recordkeepers and administrative providers. It represents another in a string of victories for recordkeepers that have successfully argued that the act of assembling a platform of investment options from which plan sponsors can select plan investments is not a fiduciary act.

The Court’s analysis and reasoning did not reach one of the key issues of interest to the regulated community – namely, whether Fidelity had properly disclosed the infrastructure fees in compliance with regulations issued under ERISA section 408(b)(2). That question is likely to remain an issue for some time to come.

Background

The litigation arose in connection with Fidelity’s FundsNetwork platform, which provides ERISA plans and other customers access to over ten thousand mutual funds and collective investment funds. The FundsNetwork is described by the plaintiffs as a

“supermarket” of fund investment options from which defined contribution clients may select the plan’s “menu” of investment alternatives. At the centerpiece of the lawsuit are payments that Fidelity negotiated to receive from mutual fund companies and collective fund sponsors in exchange for access to the Fidelity FundsNetwork. While Fidelity referred to these fees as “infrastructure fees,” necessary to facilitate communication, trading and recordkeeping between Fidelity and the fund companies, the plaintiffs instead characterize the fees as “secret payments,” a “pay to play” scheme and “kickbacks” that violate ERISA’s fiduciary rules.

Claims and Decision

The plaintiffs brought four distinct breach of fiduciary duty claims against the Fidelity defendants, including breach of fiduciary duty under ERISA section 404(a), fiduciary self-dealing prohibited transactions claims, breach of ERISA’s party-in-interest prohibited transaction rules and claims of co-fiduciary liability. In order to be successful on the breach of fiduciary duty claims, the plaintiffs would be required to show that Fidelity functioned as a fiduciary in connection with the FundsNetwork platform and when negotiating the infrastructure payments. Plaintiffs asserted several theories to support Fidelity’s fiduciary status, each of which was rejected by the District Court.

First, the plaintiffs argued that Fidelity was a fiduciary because its negotiation and retention of the infrastructure fees allowed Fidelity to “set” or “self-determine” the amount of compensation it received from plan customers. The plaintiffs theorized that by requiring mutual funds to pay the infrastructure fees after a plan entered a contract with Fidelity, Fidelity unilaterally increased its own compensation from plan customers, because the mutual funds passed the fees on to the plans through higher fund-level fees. The District Court held that Fidelity did not exercise unilateral discretion over its own compensation for two reasons. First, Fidelity had to negotiate the amount of any infrastructure fees with fund companies. Moreover, even where Fidelity was successful in securing infrastructure fee payments from mutual funds, the plaintiffs did not show that those costs were necessarily passed through to defined contribution plan customers. Because Fidelity could not unilaterally increase its compensation by negotiating the infrastructure fees, the Court determined that Fidelity had not acquired fiduciary status by affecting its compensation.

Second, the plaintiffs alleged that Fidelity was a fiduciary based on its use of so-called “omnibus accounts.” Fidelity establishes “omnibus accounts” in which the mutual fund shares are held on behalf of plan customers, and subdividing the omnibus accounts into “accumulation units” (in order to track the performance of each mutual fund). The plaintiffs argued that both the omnibus accounts and accumulation units qualified as ERISA “plan assets” and that Fidelity functioned as a fiduciary by “managing” those assets when administering the accounts. The Court rejected this claim of fiduciary status on the basis that Fidelity did not exercise discretion over the “omnibus accounts.” The Court reasoned that Fidelity simply followed the directions of plan sponsors and participants with respect to selected investments and did not exercise discretion to choose or redirect plan investments. The Court found it unnecessary to reach the “plan assets” status of omnibus accounts or accumulation units in order to conclude that Fidelity did not act as a fiduciary in connection with the omnibus accounts.

Third, the plaintiffs alleged that Fidelity was a fiduciary by reason of its control over the funds made available on the FundsNetwork and, by extension, the funds made available to plan customers. Here, the Court held that decisions by Fidelity to add or remove funds from its FundsNetwork platform did not transform the company into an investment fiduciary.—Citing to a number of recent decisions involving 401(k) platform providers, the Court ruled that control over a platform of investments from which sponsors can choose is non-fiduciary. (“Selecting the funds available on the FundsNetwork Platform does not, without more, transform Fidelity into a fiduciary.”) Next, the Court considered whether Fidelity exercised control over the plan customer’s lineup through exercising discretion to substitute or eliminate funds already on a customer’s lineup, as alleged by the plaintiffs. Here, the Court viewed Fidelity’s service agreements as determinative. The Court noted that the service agreements clearly disclaimed Fidelity’s responsibility for selecting or providing advice on the plan’s lineup, and permitted Fidelity to remove or substitute investment funds only after advance notice of the change. The Court held that Fidelity’s contractual right to revise its service offering with advance notice to the client plan did not give Fidelity sufficient control over the client plan’s lineup to make it a fiduciary.

Importantly, the plaintiffs had also argued that even if Fidelity was not liable as a fiduciary, it was nonetheless liable as a party in interest that had knowingly participated in a fiduciary breach. In this regard, the plaintiffs argued that Fidelity failed to properly disclose the payments as “indirect compensation” under the Department of Labor’s fee disclosure regulations under section 408(b)(2) of ERISA. The Court did not reach the issue of whether Fidelity’s alleged non-disclosure of the infrastructure fees violated ERISA’s section 408(b)(2) regulations. On this issue, the Court simply stated that Fidelity could not be held responsible for another fiduciary’s breach (i.e., by the plan sponsor’s having authorized the Fidelity service arrangement despite insufficient fee information) where no defendant had plausibly been alleged to have breached a fiduciary duty. In this regard, we note that the case was brought only against the Fidelity companies and did not name any plan sponsor as a defendant. In effect, the Court ruled that the failure name any

defendant plausibly alleged to have breached a fiduciary duty effectively barred the Court from finding that Fidelity was liable for knowingly participating in a fiduciary breach.