GROOM LAW GROUP

Publications

Second Proposed Class Action Lawsuit Targets Fidelity's Mutual Fund Platform Fees

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A second lawsuit has been filed against Fidelity regarding its widely-reported practice of charging infrastructure fees to mutual fund complexes that seek to have their funds included in Fidelity's FundsNetwork platform. The new complaint was filed by participants in the Rock Holdings & Associated Companies 401(k) Savings Plan, the Cadence Health Matched Savings Plan, and the Blue Shield of California Tax Deferred Salary Investment Plan. *Summers v. FMR, LLC, et. al.*, No. 1:19-cv-10501 (D. Mass filed March 18, 2019).

The complaint comes in the wake of reported inquiries into Fidelity's platform fee practices by the Department of Labor and Massachusetts state authorities, as well as a substantially similar proposed class action lawsuit filed in the same district less than a month ago. *See Wong v. FMR, LLC, et. al.*, No. 1:19-cv-10335 (D. Mass filed February 21, 2019).

Summary of Allegations

Like the first lawsuit, the new complaint asserts fiduciary breach and prohibited transaction claims against Fidelity. The new lawsuit includes allegations that Fidelity sought to limit disclosure of the fees by participating fund companies.

Notable allegations include the following –

- Fidelity breached fiduciary duties to ERISA plan clients "by charging mutual fund and other investment companies a substantial fee as a condition for their investment vehicles being offered on Fidelity's fund platform," and that such fees constituted "illegal and undisclosed pay-to-play fee[s]" and kickbacks.
- Fidelity "instructed participating mutual funds not to disclose the Fee to any third party, including plan sponsors, plan beneficiaries, and the public," and "warned mutual funds in written materials that any fund refusing to pay the Fee would 'be subject to a very limited relationship.'"
- Fidelity charged an excessive fee based on "each such mutual fund's industrywide assets, as opposed to its assets held by Fidelity customers," which demonstrated that the platform fees had "no meaningful relationship to any 'infrastructure" maintenance by Fidelity, and hence constitutes excessive compensation" even if the fees were disclosed.

- Fidelity engaged in self-dealing because its assessment of the platform fees was partly motivated by its desire to "offset losses it has sustained from investors flocking to lower-cost index funds" that were not offered by Fidelity.
- Fidelity's platform fee "constitutes an ERISA marketing and distribution fee that is subject to statutory disclosure requirements," and Fidelity therefore breached its disclosure obligations by failing to disclose the fee as indirect compensation.

Observations and Outlook

Recordkeepers like Fidelity are typically not fiduciaries under ERISA. Both the *Wong* and *Summers* complaints use creative theories to assert that Fidelity was functioning in a fiduciary capacity when negotiating for and agreeing to accept the payments of the infrastructure fees. In this regard, the lawsuits allege that Fidelity acted as a fiduciary to its ERISA plan clients by exercising fiduciary authority and control over the expenses ultimately borne by the plans through their fund holdings.

In addition, the *Summers* suit appears to allege that the Fidelity fund platform may itself be a plan asset, and that by limiting funds' access to the platform based upon their willingness to pay, Fidelity was exercising fiduciary authority. The establishment and maintenance of a fund investment platform by a plan recordkeeper, in and of itself, has generally been regarded as non-fiduciary business activity. In light of this longstanding understanding, how the courts receive this theory in the full context of the plaintiffs' allegations will be critically important to the recordkeeping and service provider community.

Separately, the lawsuits raise questions as to whether Fidelity met its disclosure obligations as a "covered service provider" to its ERISA plan clients within the meaning of the Department of Labor's fee disclosure regulations. That issue appears to turn on the question of whether or not Fidelity received infrastructure fees "in connection" with its provision of recordkeeping services to plans.

The *Wong* and *Summers* class action lawsuits, along with the reported investigations by the Department of Labor and Massachusetts state regulators, have focused significant attention on service provider compensation. Looking ahead, we expect that there may be additional scrutiny, including inquiries by securities regulators, as to the propriety of the payments by fund companies outside of a Rule 12b-1 plan, as well as the propriety of agreements between recordkeepers and fund complexes prohibiting the disclosure of certain payments.

In addition, it is likely that this renewed focus on service provider compensation and the adequacy of fee disclosures will soon shift to questions about plan sponsors and their responsibility for understanding the full scope of service provider fees.

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