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New Fidelity Fee Decision Addresses Several Important Issues For Plan Fiduciaries

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On March 27, 2020, the District of Massachusetts issued a decision finding that Fidelity breached its fiduciary duties to its own 401(k) Plan by failing to monitor investments and administrative expenses. Although the decision involved unique facts relating to the implementation of a settlement of a prior case brought against Fidelity, the court's 67-page opinion addresses several significant legal issues. These issues include a plan fiduciary's obligations with respect to self-directed brokerage accounts and the consideration of collective investment trusts and separate accounts as alternatives to mutual funds. The court also ruled that relief may be available against Fidelity even if Fidelity's breach caused no harm to the Plan and did not result in any profit to Fidelity.1 While the court's decision applies to a financial services company-sponsored plan that included its own proprietary mutual funds as investment options in the plan, we note that the court's analysis and conclusions will be of interest to all types of plan sponsors and fiduciaries.

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Background

In October 2014, Fidelity settled an earlier class action alleging breach of fiduciary duty. Under the terms of the settlement, Fidelity was required to: (i) provide a "Revenue Credit" to the Plan every year that "matches or exceeds the management fees and revenue generated by Fidelity pursuant to its role

[1] The decision was made on a "case stated" record, which is an alternative to a summary judgment motion. While the court found Fidelity liable for failure to monitor the Fidelity fund investments as well as administrative expenses, several issues remain for trial, including Fidelity's statute of limitations defense and issues related to causation and loss.

administering the various funds, which includes the cost of recordkeeping;" and (ii) have certain "designated investment alternatives" "undergo full fiduciary monitoring."

Fidelity was sued again in October 2018, with plaintiffs alleging that Fidelity breached its fiduciary duties by failing to monitor hundreds of Fidelity mutual funds offered to participants, failing to investigate alternatives to mutual funds (e.g., separate accounts and collective investment trusts), and failing to monitor recordkeeping expenses. Fidelity acknowledged that it "did not monitor these administrative costs, on the grounds that all administrative expenses paid to Fidelity would be credited back to the Plan" through the Revenue Credit and argued that the hundreds of Fidelity mutual funds offered in addition to the Plan's "designated investment alternatives" were "the equivalent of a self-directed brokerage account" and therefore need not be monitored.

Although the court concluded that Fidelity violated its duty of prudence by failing to monitor investments and administrative expenses, it held that Fidelity did not violate its duty of loyalty. Not only could plaintiffs not show that Fidelity acted with the "subjective motivation" to benefit itself at the expense of the Plan, but the court made clear that "[i]t is not enough for a plaintiff to identify a potential conflict of interest from the defendant's investments in its own proprietary funds." The court also rejected plaintiffs' argument that Fidelity engaged in a prohibited transaction, finding that the conditions of Prohibited Transaction Exemption 77-3 – which allows in-house plans of financial companies to invest in affiliated funds – were satisfied.

Self-Directed Brokerage Accounts

In addition to offering individual investment options to participants, many plans offer participants with the option to utilize a self-directed brokerage account (sometimes referred to as a "brokerage window"). Through the brokerage window, plan participants may select from potentially thousands of additional investment options. The court devoted seven pages of its opinion to the question of whether the "general duty under ERISA continuously to monitor investments and remove those that are imprudent" also applies to brokerage windows. But the court did not provide an answer. Instead, the court concluded that "there is significant lack of clarity regarding the duties a fiduciary owes with regard to the funds within a brokerage window," and held that a definitive resolution of the question was unnecessary because Fidelity's offering of hundreds of its own funds could not be treated as the "equivalent" of brokerage window (in part because only Fidelity's own proprietary funds were offered). Accordingly, the court concluded that Fidelity was responsible for monitoring each of those hundreds of funds.

The court's discussion is unlikely to add any clarity to the issue of a fiduciary's duties with respect to brokerage windows, and may further embolden similar challenges in other cases. Although the court noted that it was "perhaps unrealistic for a fiduciary to monitor . . . all" of the "hundreds or thousands of investments" available through a brokerage window, the court questioned whether holding there was no duty to monitor would be consistent with ERISA and DOL regulations. Yet, the court also noted that "[r]egulators have declined to weigh in on this question," and that DOL "withdrew" previous guidance on the subject.

GROOM INSIGHT: A brokerage window can provide important benefits to participants, and there is an argument that it may actually help reduce a plan's litigation risk. See Hecker v. Deere & Co., 556 F.3d 575, 586 (7th Cir. 2009) (rejecting excessive fee challenge and noting that the "2,500 other funds available through [the brokerage window]" helped demonstrate that the plan "offered a sufficient mix of investments for their participants"). This is particularly so where the brokerage window offers the full range of thousands of investment options offered by many leading platforms, and is not offered in lieu of other investments that are being monitored by plan fiduciaries. While the court expressed uncertainly regarding a fiduciary's duty to monitor a brokerage window, the court did not actually hold that monitoring is required and the Department of Labor, which is responsible for interpreting ERISA, has not to date identified a duty to monitor funds offered in self-directed brokerage window.

Alternatives to Mutual Funds

Most investment options in retirement plans are mutual funds, which generally hold a pool of investments and are subject to regulation and oversight by the Securities and Exchange Commission. An increasing number of lawsuits in recent years have alleged that plans should have used other pooled investment vehicles instead of mutual funds, such as separate accounts and collective investment trusts.

The court rejected this theory, holding that "that there is no fiduciary duty to investigate alternatives to mutual funds," including "[s]eparate accounts" and "collective trusts." Specifically, the court explained that "[t]hese non-mutual fund vehicles differ so much from mutual funds . . . in terms of their regulatory and transparency features that other courts have found it impossible to make an 'apples-to-oranges' comparison of the two."

GROOM INSIGHT: While this portion of the court's decision is a positive development for plan fiduciaries, we do not expect plaintiff's firms to stop challenging fiduciaries' failure to offer these potentially lower cost options.

Relief Under ERISA in the Absence of a “Net Loss” to the Plan or Profit to the Breaching Fiduciary

The court agreed with Fidelity that – with respect to recordkeeping expenses – there was “no net loss to the Plan” and Fidelity did not “receive[] gains or profits as a result of the breach” because “100% of the money collected for recordkeeping expenses was returned to the Plan.” But since the Revenue Credit provided to the Plan was allocated only to current Fidelity employees, former Fidelity employees who remained participants could have still been harmed. The court held that “[e]quitable relief is an available remedy for individuals even when the Plan as a whole has not suffered losses.”

GROOM INSIGHT: It is worth keeping in mind that some decisions that have disparate impacts on different groups of participants may have important legal consequences. Depending on the context, these may include not only the potential loss of otherwise available defenses to breach of fiduciary duty lawsuits, but may also implicate plan qualification requirements.