Keep It Simple Consulting

Summary of The Game

A Tic-Tac-Toe Analogy

The Game Summary

This paper analyzes the liability of Defined Contribution Plan Sponsors, Fiduciaries, and/or Trustees (PSFT). It provides an overview of the liability's legislative creation; it describes who benefits from PSFT liability; and, it highlights the legislative guidance allowing PSFT's to manage their liability. **Legislation allows the liability to be rather easily managed, however few PSFT's have taken full advantage of legislative guidance to mitigate PFST risk by properly delegating it.** At the conclusion of this paper the reader, with a good understanding of PFST risk, will see how easy it is to delegate PSFT liability.

The analysis is couched in terms of a game – a game that is as old as money. Like Tic-Tac-Toe, where losses are inconsequential. The game is played by companies skimming from Other People's Money (OPM) which in this case is under the control of a third party. This analysis focuses on a specific Game where OPM is the Defined Contribution Plan participants' assets. The third party is PSFT.

All games have rules, and the Rules of this Game change over time – the Rules are mostly legislated. This analysis briefly travels through some legislative history to describe the Rules. It starts with ERISA provisions, highlights The Revenue Act of 1978, then Colorado's 1995 adoption of the Prudent Investor Act, the Small Business Protection Act of 1996, the 2017 Fiduciary Rule, Regulation Best Interest, and ends with a suit currently before the Supreme Court – Hughes vs Northwestern. Be assured this trip through the rules is brief, as there have been tombs written on each of the above-mentioned topics.

With each change in Rules, it is apparent that the game changes. So, this paper points out Rule and respective Game changes. Then this paper gives an overview of the current players: Opponents and PSFT. To illustrate power of each player, this paper contrasts player incentives, penalties, etc.

The conclusion discusses the PSFT's next or last move. **Thus, accepting expert advice does not alone protect the PSFT, in fact as this paper demonstrates, quite the opposite. Utilizing the advice of an Advisor (sary) puts that liability squarely on the PSFT.** But first, it reminds the PSFT that legislation clearly states: If the PSFT retains a thief or corrupt vendor; they then become responsible for the theft or respective corruption.

This paper references other authors whose opinions support the Fiduciary Risk Mitigation thesis. Such Opinions are indented and shown in blue text so the reader can quickly identify them.

The Game

Companies skim from Other People's Money (OPM) under someone else's control. Companies see a lot of money in one place as an opportunity. They ascertain the funds are controlled by someone other than the owner. Further, if they conclude the controller, even with the best interests of the owner in mind, even with high ethics, does not have the same incentives as the company, then: Advantage Company! And, the game is on.

The Game as discussed in this paper:

Defined Contribution Retirement Plan assets are OPM

The PSFT control the Assets

Companies are PSFT Opponent(s)

The Players:

Advisor (sary)

Plan Sponsor

Tic-Tac-Toe an Analogy

Tic-Tac-Toe is a simple game most everyone has played. Most people play without thinking, like with their children. Often, many games are played in a series. The games have no consequences. No one tallies the wins, losses or draws.

In our Tic-Tac-Toe analogy, the PSFT and its Opponent(s) represent two players in the game of Mitigating Fiduciary Risk.

Obviously, the Game has Rules. The Opponents were instrumental in implementing legislation (the Rules) that favored them – The PFST is the target of that legislation.

Further, in this analogy, the Opponents are Tic-Tac-Toe Experts. The first rule, the Opponents always play first. Therefore, the PSFT plays second.

A computer model uses four player skill levels in Tic-Tac-Toe as follows:

- The **Novice** player makes random moves
- The **Intermediate** player blocks their opponent from winning
- The **Experienced** player knows that playing in certain first squares will lose the game
- The **Expert** player will never lose!

https://blog.ostermiller.org/tic-tac-toe-strategy/

It is this paper's perception that the PSFT should consider themselves a Novice; Maybe an Intermediate player at best.

The Rules: ERISA and the Revenue Act of 1978

Start with ERISA – The Employee Retirement Income Security Act and the soon thereafter passed Revenue Act of 1978. The Problem was Employee Retirement Defined Benefit Income Security. At the time, many employers were responsible for managing the Retirement Plan asset returns over the decades of an employees' employment and for the duration of their retirement. **The Plan Sponsor and Fiduciary were responsible for investing Defined Benefit Plan assets for an investment horizon of six or seven decades!**

The legislative solution for Protection was to focus regulations, compliance and penalties on the Retirement Plan Sponsor and Fiduciary (PSF). ERISA codified the Game Rules. It thereby made the Plan Sponsor and Plan Fiduciaries the target to attain participant "Income Security." PSF must make decisions, provide disclosures, obey plan documents, and act prudently. If PFS were noncompliant, they could be fined or prosecuted. However, if PSF wanted, the legislation offered means whereby they could minimize their risks by properly transferring some of the greatest liabilities to a qualified Fiduciary.

ERISA purportedly benefited the plan participants. However, when viewing the ERISA Rules in the Game context, we posit the legislative benefactors were the PSF Opponents. Opponents could act as capitalists and reach for maximum profits while the legislation may be considered to offer them legal cover. An example of such legal cover lies in the ability of the Opponent to disclose their business practices, their sources of income, their conflicts of interest, etc. to the PSF. So, the Opponent discloses, the PSF acknowledges the disclosure, makes an informed decision and hires the Opponent. Upon retaining the Opponent, the Opponents' inappropriate business practices, sources of income, Conflicts of Interest, etc. are no longer the Opponent's legal problem; they are now the liability of the PSF. The PSF owns the now inappropriate decision which was not in the best interests of their participants.

If it is assumed the PSF is an Institutional Investor, the regulations become even more relaxed for the Opponent as an Institutional Investor is assumed to have the appropriate knowledge and skills upon which to make such sophisticated decisions. There may even be circumstances under which the Opponent need not disclose to the PSF, and as the Opponent can assume PSF has such knowledge and skill to make a prudent decision.

ERISA legislation focused on Defined Benefit Plans, so much of its thinking and terminology did not address Defined Contribution Plans. The Revenue Act of 1978, created under §401(k), Defined Contribution plans to become effective 1/1/1980.

1974 – ERISA (Employee Retirement Income Security Act)

Employee Retirement Income Security Act of 1974

- ERISA creates rules of conduct that those acting as a fiduciary must abide by.
- ERISA grants both plan participants and their beneficiaries certain rights.
- The law requires plan administrators to act in the best interests of plan participants and their beneficiaries and imposes fiduciary duties on those who manage or control employee benefit plans.

- ERISA also creates several enforcement mechanisms to ensure employers comply with its provisions.
- Under ERISA, a fiduciary is anyone who exercises discretionary authority or control over a plan's management or assets, including those who provide investment advice to the plan. Fiduciaries who do not follow the principles of conduct may be held responsible for restoring losses to the plan.
- In addition to keeping participants informed of their rights, ERISA also grants participants the right to sue for benefits and breaches of fiduciary duty.

ERISA is supposed to be a law of process, and not results. Stated differently, ERISA fiduciaries are not supposed to be liable for bad results if the process is diligent.

ERISA Created classes of Plan Sponsor Fiduciary Advisors

§3(16) Administrator

§3(21) Investment Advisor

(A) Except as otherwise provided in subparagraph (B), a person is a fiduciary with respect to a plan to the extent

(i) he exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets,

(ii) he renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so, or

(iii) he has any discretionary authority or discretionary responsibility in the administration of such plan.

Such term includes any person designated under section 1105(c)(1)(B) of this title.

(B) If any money or other property of an employee benefit plan is invested in securities issued by an investment company registered under the Investment Company Act of 1940 [15 U.S.C. 80a–1 et seq.], such investment shall not by itself cause such investment company or such investment company's investment adviser or principal underwriter to be deemed to be a fiduciary or a party in interest as those terms are defined in this subchapter, except insofar as such investment company or its investment adviser or principal underwriter acts in connection with an employee benefit plan covering employees of the investment company, the investment adviser, or its principal underwriter. Nothing contained in this subparagraph shall limit the duties imposed on such investment company, investment adviser, or principal underwriter by any other law.

§3(38) Investment Manager

(38) The term "investment manager" means any fiduciary (other than a trustee or named fiduciary, as defined in section 1102(a)(2) of this title)—

(A) who has the power to manage, acquire, or dispose of any asset of a plan;

(B) who

(i) is registered as an investment adviser under the Investment Advisers Act of 1940 [15 U.S.C. 80b–1 et seq.];

(ii) is not registered as an investment adviser under such Act by reason of paragraph (1) of section 203A(a) of such Act [15 U.S.C. 80b–3a(a)], is registered as an investment adviser under the laws of the State (referred to in such paragraph (1)) in which it maintains its principal office and place of business, and, at the time the fiduciary last filed the registration form most recently filed by the fiduciary with such State in order to maintain the fiduciary's registration under the laws of such State, also filed a copy of such form with the Secretary;

(iii) is a bank, as defined in that Act; or

(iv) is an insurance company qualified to perform services described in subparagraph (A) under the laws of more than one State; and

(C) has acknowledged in writing that he is a fiduciary with respect to the plan.

Revenue Act of 1978

§401(k) plans were established allowing employees to save tax deferred effective 1/1/1980

Defined Contribution Approach Inserted into Defined Benefit Dogma

Participant-directed defined contribution plans, most often 401(k)s, did not exist as mainstream retirement schemes when ERISA was created. That mismatch has resulted in billions of dollars in legal fees and settlements as participants sue to make their savings plans look more like old-fashioned pensions as defined by the statute. The beneficiaries: attorneys on both sides of these lawsuits and the mutual fund industry, which now holds $2 trillion in defined contribution assets, half of the total in these plans. The losers: retirees who pay higher fees and employers embroiled in lawsuits to support the industry built around ERISA's shortcomings.

ERISA Class-Action Suits Shape U.S. Retirement Future | Institutional Investor

The Rules

The Rules are laser focused on the PSF to comply with Fiduciary Standards with non-compliance penalties.

The Rules explicitly create safe harbor fiduciary definitions excluding Opponents who are investment companies or their investment advisors. See §3(21)B.

The Rules however acknowledge an Investment Manager Fiduciary to the plan where:

1. They have the power to manage, acquire or dispose of assets
2. They are Registered as an Investment Adviser, and
3. They acknowledge in writing they are a Fiduciary to the Plan.

The Game Changes

Once there are rules, the opponents focus on their tactics. Opponents have great incentives. On the other hand, the PSF now focus on their mandated obligations:

- act in the best interests of their participants,
- disclose,
- create paper trails,
- hire administrators, etc.

Fiduciaries must put participant first.

Fiduciaries must comply with Fiduciary Standards.

With new responsibilities and complexities, Fiduciaries hired advisors.

Advisors became Opponents: Adversaries or Advisor (sarys). They did not have fiduciary duties to the participants, in fact they could self-deal as long as the fiduciary was informed – the legislation effectively passed the malfeasance to the PSF unless the PSF explicitly transferred the liability and asked for the Opponent to accept such liability. The PSF retained the liability unless both transference and acceptance were properly executed.

Mutual Funds

1980’s Mutual funds capture the attention of American investors

Defined Contribution Plans become mainstream

Participants become responsible for their investment return.

Plan Sponsors were relieved of responsibility investment returns and chose to offer a range of investments to participants.

Investment Industry changes significantly

Record Keepers

Record Keepers play the game and seek control over OPM by using captive Funds

Fund Managers

Advisors

The Rules Change – Colorado implements The Prudent Investor Act and THE SMALL BUSINESS JOB PROTECTION ACT OF 1996

The Prudent Investor Act was adopted by Colorado. It is critical to note the definition of the Prudent Investor Rule states the "default rule" may be altered by the provisions of a trust. And, it clarifies: "A trustee is not liable to a beneficiary to the extent that the trustee acted in reasonable reliance on the provisions of the trust." Translation for PSFT, the trustee must look to the trust document for guidance first. Herein lies a potential risk mitigation bonanza or nightmare – what does the Trust document dictate?

When the Prudent Investor Act was adopted, the legislators' next step was to mandate Governmental Defined Contribution plans create trusts for participants' assets. Then, the Plan Sponsor / Fiduciary / Trustee (PSFT) were positioned with liability for conforming to the Duty of the Prudent Investor Rule, Loyalty, Investment Costs, and Compliance.

But, the legislators' provided the Trustee with a means by which to delegate these complex functions. With reasonable care, skill and caution a Trustee could properly delegate to an appropriate agent these functions and thereby remove the Trustee's respective liabilities to its beneficiaries.

1995 Colorado Adopts Prudent Investor Act

§ 15-1.1-101. Prudent investor rule

a) Except as otherwise provided in subsection (b) of this section, a trustee who invests and manages trust assets owes a duty to the beneficiaries of the trust to comply with the prudent investor rule set forth in this article.
b) The prudent investor rule, a default rule, may be expanded, restricted, eliminated, or otherwise altered by the provisions of a trust. A trustee is not liable to a beneficiary to the extent that the trustee acted in reasonable reliance on the provisions of the trust.

§ 15-1.1-102. Standard of care – portfolio strategy – risk and return objectives

§ 15-1.1-103. Diversification

§ 15-1.1-104. Duties at inception of trusteeship

§ 15-1.1-105. Loyalty

§ 15-1.1-106. Impartiality

§ 15-1.1-107. Investment costs

§ 15-1.1-108. Reviewing compliance

§ 15-1.1-109. Delegation of investment and management functions

(a) A trustee may delegate investment and management functions that a prudent trustee of comparable skills could properly delegate under the circumstances. The trustee shall exercise reasonable care, skill, and caution in:

(1) Selecting an agent;

(2) Establishing the scope and terms of the delegation, consistent with the purposes and terms of the trust; and

(3) Periodically reviewing the agent's actions in order to monitor the agent's performance and compliance with the terms of the delegation.

(b) In performing a delegated function, an agent owes a duty to the trust to exercise reasonable care to comply with the terms of the delegation.

(c) A trustee who complies with the requirements of subsection (a) of this section is not liable to the beneficiaries or to the trust for the decisions or actions of the agent to whom the function was delegated.

(d) By accepting the delegation of a trust function from the trustee of a trust that is subject to the law of this State, an agent submits to the jurisdiction of the courts of this State.

THE SMALL BUSINESS JOB PROTECTION ACT OF 1996 (Colorado)

§457 plan assets set aside in trust

Plan Sponsors become Trustees

The Rules have now been set

The Rules are laser focused on the PSFT mandating they become a Prudent Investor.

As with ERISA, the focus appears to initially be on Defined Benefit Plans. Not until a couple of years later do the Defined Contribution Plans get folded in. And, similarly to ERISA, the DC "square" concepts are put into the DB "round" hole.

The Rules however acknowledge the Trust Provisions override the legislation and further, the Trustee may delegate through § 15-1.1-109 investment and management functions.

The Game Changes

The Prudent Investor Act and the SBJPA of 1996 pointed the finger at the SPFT with codified duties and penalties.

Excessive Fee Lawsuits become more prevalent. And notice, none have defendants from the Investment Industry, Consultants, the Mutual Funds or Record Keepers. They are all just Advisor (sarys) to the PSFT and apparently carry no liability for charging excessive fees.

Excessive Fee Lawsuits of Plan Sponsors by Participants

Plan Sponsors / Fiduciaries or Trustees are Defendants

Plan Sponsors / Fiduciaries **choose / allowed** excessive fees

Excessive Fee Lawsuit statistics Recap

In considering the opponents, it may be of interest to look at the lawsuits' claims first:

Beneficiaries claimed against the PSFT for a myriad of reasons – here are 15 of the top reasons for the 51 Excessive Fee class of lawsuits filed in 2016. The number in parentheses is the number of complaints out of the 51 lawsuits. The yellow highlighted claims would have applied to the Investment Manager (IM), not the PSFT:

(1) Failure to Monitor Investments (35) IM
(2) Failure to Monitor Fiduciaries (34)
(3) Knowing Breach of Trust (34)
(4) Self-Dealing (28) IM
(5) Failure to Monitor Record Keepers (26)
(6) Active v Passive (26) IM
(7) Use Lower-Cost Share Classes (23) IM
(8) Imprudent Prop. Funds (22) IM
(9) Failure to Solicit Record Keeper Bids (18)
(10) Failure to Consider Other Investments (17) IM
(11) Float Interest (14)
(12) Too Many Options (13) IM
(13) Failure to Disclose (11)
(14) Multiple Record Keepers (11)
(15) Imprudent Target Date Funds (8) IM
(16) Other (18)

Source 111821webinar_slides.pdf from presentation "Whatever Happened to the class of 2016: Lessons learned from the ERISA excessive fee complaints filed in '16. Blaine Aikin and Duane Thompson. Adapted by KISC with highlights and Investment Manager commentary.

Note, it is our understanding that none of the suits top claims name an Advisor as defendant – they are in the pleadings, but not as a defendant.

Further note, eight of the fifteen boilerplate claims are claims that could be considered to be Investment Manager functions.

Advisor - Investment Industry, Consultants, Mutual Funds, Recordkeepers are not Defendants

In fact, the legislation almost protects Advisor

Mutual funds are protected based on part B of §3(21) which exempts them from being a fiduciary to the plan that retains them.

The Rules Change? 2017 Fiduciary Rule; 2019 Regulation Best Interest; Hughes v. Northwestern

It appears Legislators recognize past legislation has not brought the intended protection to participant income from Opponent skimming. So, Legislators try again, almost fifty years after ERISA – this time they may have designed a good solution. The DOL proposed the 2017 Fiduciary Rule. It would have mandated Retirement Plan Providers (Opponents) accept a fiduciary standard similar to that of the PSFT. Is this the first time that constraints are aimed at the Opponents?

But, the 2017 Fiduciary Rule was not implemented. However, its ideas are exceptional and probably should be implemented by the PSFT through contract.

2017 Fiduciary Rule

In 2017, the U.S. DOL proposed what is known as the fiduciary rule. It would have required all financial professionals who work with retirement plans or provide retirement planning advice—advisors, broker-dealers, and insurance agents—be legally bound by the fiduciary standard, meaning they would be required to put their clients' interests first. Below is part of a summary of the Fiduciary Rule authored by upcounsel prior to the delay of its implementation. The perspective is in general, but for our purpose, think of PSFT as the client or individuals; Opponents as the financial advisors, planners or brokers; and commissions as compensation.

Definition of a Fiduciary

The DOL's meaning of a fiduciary requires that financial advisors provide advice that is in the client's best interests, and to ensure that clients' interests are put ahead of their own. This definition provides that advisors cannot hide any potential conflicts of interest, and also indicates that any dues and commissions be disclosed fully to the client. The fiduciary definition also includes those advisors who are making a simple recommendation and not actually providing specific advice. "Fiduciary" is a higher standard than "suitability" standard, which was formerly obligatory of financial advisors. Suitability merely meant that if the specific type of investment being recommended to the client met his or her needs, then the recommendation was suitable. Therefore, it gave financial advisors' leeway to persuade clients' into believing that a specific investment was right for them, even if it wasn't. With the term "fiduciary" however, financial professionals have a responsibility to put the best interests of the client ahead of their own as opposed to obtaining "suitable" investments for the client.

Financial advisors who plan to work on commission would be required to provide their clients with a disclosure contract known as the Best Interest Contract Exemption (BICE) if a potential conflict of interest exists, i.e. if the financial advisor receives an additional commission for selling a particular product. In addition, all money that the financial advisor will receive must be disclosed to the client; this means including specific numbers and percentages.

Reaction to the Rule

It is obvious that rule changes were well overdue, considering ERISA rules hadn't been changed for 40-years since its inception. In fact, many groups are in favor of this new rule. And of course all individuals who wish to use the assistance of a financial advisor are also in favor of this rule since it will protect them fully. This new rule will ultimately increase clarity for those wishing to invest and prevent financial advisors' from receiving such high commissions. More specifically, a 2015 report by the White House Council of Economic Advisors identified that prejudiced advice depleted a total of $17 billion on an annual basis from retirement accounts.

To no surprise, many planners and brokers have opposed the new rule. Such professionals would prefer a lower suitability standard than the higher fiduciary standard because the higher standard will provide for reduced commission and added expenses for adhering to compliance requirements. In fact, the stricter standard could increase costs for the financial services industry to roughly $2.4 billion a year.

Many financial professionals believe that the increased standard would eliminate commissions altogether for them. If receiving significantly reduced commissions, they would be forced to shift certain fees onto clients, which would prevent any middle or lower-market investor clients. In fact, 3 separate legal proceedings have already been filed opposing the rule. One of the lawsuits was filed in the U.S. District Court for the Northern District of Texas in June 2016. The suit was initiated by the Securities Industry, the U.S. Chamber of Commerce, and Financial Markets Association, and the Financial Services Roundtable, and indicates that the Obama administration didn't have the permission to take action in endorsing the rule.

Other critics to the rule actually believe that the rule will cause additional fraud on the part of financial advisors. They specifically state that the rule will require significant paperwork, which is an easy way to hide a scam and later indicate that the customer signed the paperwork.

DOL Fiduciary Rule: Everything You Need to Know (upcounsel.com)

The Fiduciary Rule was not implemented.

Consider the Securities Industry filed suit to delay. Further consider, in March of 2017 the world's two largest asset managers, Vanguard and Blackrock, called for a more significant delay.

Originally, the DOL regulated the quality of financial advice surrounding retirement under ERISA. Enacted in 1974, ERISA had never been revised to reflect changes in retirement savings trends, particularly the shift from defined benefit plans to defined contribution plans, and the huge growth in IRAs.

On March 15, 2018—The Fifth Circuit Court of Appeals, based in New Orleans, vacated the fiduciary rule in a 2-to-1 decision, saying it constituted "unreasonableness," and that the DOL's implementation of the rule constitutes "an arbitrary and capricious exercise of administrative power."

Everything You Need to Know About the DOL Fiduciary Rule (investopedia.com)

While this paper does not have the political understanding to assess why the Fiduciary Rule was not implemented. It is fact that it was not. However, a PSFT could implemented through contract the Rules intentions. A PSFT could require its Investment Manager function be fulfilled by a registered company with licensed agents. The PSFT could contract to properly transfer Trusteeship (or Fiduciary obligations) to the company and require the company accept such obligation as a named Trustee (or Fiduciary) in writing.

2019 Regulation BI (Best Interest)

Regulation Best Interest (BI) is a 2019 Securities and Exchange Commission (SEC) rule that requires broker-dealers to only recommend financial products to their customers that are in their customers' best interests, and to clearly identify any potential conflicts of interest and financial incentives the broker-dealer may have for the sale of those products.

It is related to the U.S. Department of Labor's fiduciary rule which was not implemented. However, its scope is limited and although may have been an attempt to satisfy the need proposed by the Fiduciary Rule, does not really apply to the Opponents in our Game.

Hughes v. Northwestern (at the Supreme Court now)

Excessive Fees to the Supreme Court

Excessive Fees are a part of the Game. ERISA was meant to restrain the PSFT through the DOL. This case, being supported by the DOL as representative of PSFT behavior, to the Supreme Court, so they can clarify fiduciary responsibilities appears to the author as another attack on the PSFT and in support of the Opponents. Below is a excerpt from a paper authored by Daniel Aronowitz at Euclid. The Bold text is our editing.

> The Supreme Court accepted the *Hughes v. Northwestern* excessive fee case for review after the Department of Labor ("DOL") filed an amicus brief advocating that the case presented an opportunity for the Court to rule on "the question of what ERISA requires of plan fiduciaries to control expenses"
>
> The Northwestern case provides the first opportunity for clarity and judicial fairness. But with these high stakes, plan sponsors should be wary of the prospects of the Northwestern case. The reason is that the Northwestern plan's recordkeeping and investment arrangement is, at best, problematic, and **bad facts often make bad law. . . the plan has all of the troubling attributes that have attracted excessive fee litigation: multiple recordkeepers, alleged recordkeeping costs of $150-200+ per participant with significant asset-based and uncapped revenue sharing, hundreds of investments, and most of its investments in higher fee share classes.** This is not the set of facts that plan sponsors would select for Supreme Court review, particularly if it will control the pleading standard for 401k and other defined contributions plans — most of which are better structured and have much lower fee profiles. In fact, the Northwestern plan is so anomalous to how most large defined contribution plans are currently structured, if fairly construed, **the case should have no precedential value for most 401k plans.**

Northwestern even argued in opposing class certification that the case was no longer relevant, because it had radically changed its plan in 2016 to streamline investment options and lower fees. **But, unfortunately, DOL and the Supreme Court disagreed.** Nevertheless, we believe the best strategy before the Supreme Court is for plan sponsors to be upfront that the Northwestern facts are suboptimal, yet that should not alter the need for a rigorous and predictable pleading standard for excessive fee cases.

Pleading Standard for Excessive Fee Lawsuits by Daniel Aronowitz, Euclid Specialy Managers

Does this case indicate the Opponents with friends in high places are after the PSFTs?

The Department of Labor ("DOL") filed an amicus brief advocating the case presented an opportunity for the Court to rule on "the question of what ERISA requires of plan fiduciaries to control expenses"

1. active versus passive investing; (IM)
2. that recordkeeping is a commodity in which vendors compete on price;
3. the merits of revenue sharing; (IM)
4. the need for RFPs for recordkeeping services;
5. plan fiduciaries were required to conduct an independent assessment of every fund with revenue sharing; (IM)
6. the risk of closed architecture plans; (IM)
7. the investment structure of plans in which TIAA is the recordkeeper; (IM)
8. and multiple recordkeepers.

Pleading Standard for Excessive Fee Lawsuits by Daniel Aronowitz, Euclid Specialy Managers

The Players

We have already described the PSFT as a player.

We refer to opponents. So now let's put faces on the opponents. There is a long list of opponents – we categorize them into two camps: The PSFTs first Opponent or "Adversary", is their Advisor or Advisor (sary). In general, Advisor (sary) are all vendors who contract with the PSFT. While not all abuse their client relationships, all should be treated with suspicion and the decision to retain them should be reviewed with the 2017 Fiduciary Rule as underlying principle.

The Advisor (sary) include the Plan Record Keeper, the Plan Advisor or Consultant, Mutual Funds, any Broker/Dealers, the Investment Manager, the Target Date Funds, and the Custodian. Each Advisor (sary) may treat the PSFT as an Institutional Investor and assume the PSFT has the sophistication, expertise, knowledge, and resources to make informed decisions. The Advisor (sary) need not fully disclose its conflicts of interests, its organizational structure, or its sources of compensation. It is up to the PSFT to conduct its due diligence when making fiduciary decisions.

To summarize, if Advisor (sary) are contracted with the Plan and are not a properly delegated Fiduciary / Trustee with written acceptance of such delegation, they should be considered an opponent.

In addition to the Advisor (sary), PSFTs have New Opponents (NO). NO are the opportunists who undertake boilerplate Excessive Fee litigation. They are enabled by Advisor (sary) who have taken advantage of PSFT decisions to accept Advisor (sary) "Excessive Fees."

NO work with disgruntled employee participants. Their Modus Operandi is to put together a plausible nest of claims with the purpose to survive a motion to dismiss. Upon surviving, they enter the discovery phase. At which point they have won the opening gambit and then proceed to bleed the PSFT into settlement, possibly without the need for facts under a threshold motion for dismissal.

> Over 350 excessive fee lawsuits have been filed in the last five years, with well over one billion in settlements and several hundred million in payouts to Schlichter Bogard and Denton, Capozzi Adler and other law firms. During this entire time period, the Department of Labor has been largely silent, allowing plaintiff law firms to terrorize plan sponsors without providing clear guidance as to what ERISA fiduciary law actually expects regarding plan fees. And without a clear pleading standard to evaluate whether cases have merit, plan fiduciaries and their insurers have been forced to spend millions to defend these cases, as federal courts hash out unequal and inconsistent justice in high-stakes litigation.
>
> The key issue is what standard or hurdle plaintiffs must satisfy in order to withstand a motion to dismiss. The pleading standard is critical, because if the case proceeds to expensive discovery, which is more burdensome to the defense . . . plaintiffs gain the upper-hand to drive a settlement based on a high damages model . . . Given that most cases currently survive a motion to dismiss — only one-quarter are dismissed

at the pleading stage — plaintiffs have been able to leverage substantial settlements against plan sponsors.

https://www.euclidspecialty.com/wp-content/uploads/2021/08/Euclid-Specialty-The-Pleading-Standard-for-Excessive-Fee-Lawsuits_August-2021.pdf

For both Advisor (sary) and NO we contrast their superiority in incentives, funding, access to legal advice, influence on legislation and in writing legislation. In all situations the PSFT are out gunned.

The Opponents (Advisor (sary) and New Opponents) have a history of lucrative dealings fueled by the following perspectives:

Player *Perspective*	*PSFT*	*Advisor (sary)*	*New Opponents*
Focus	***Compliance***	***Profits***	***Profits***
Complex Organizational Structures	***No***	***Maybe***	***No***
Complex Compensation (Revenue Sharing, Implicit Fees, etc)	***No***	***Maybe***	***No***
Conflicts of Interest Acceptable	***No***	***Maybe***	***Maybe***
Fiduciary	***Yes***	***No***	***No***
Full time endeavor	***No***	***Yes***	***Yes***
Financial Resources	***Minimal***	***Unlimited***	***Unlimited***
An established industry	***No***	***Yes***	***Yes***
Financial incentives	***Minimal***	***Substantial***	***Substantial***
Legal Resources	***Minimal***	***Substantial***	***Substantial***
Lobbyists	***No***	***Yes***	***Yes***
Potential Penalties	***Yes***	***No***	***No***
Potential Liabilities	***Substantial***	***Minimal***	***Minimal***

The table above intends to illustrate the level of advantage Opponents have over the PSFT. In essence it is industries against an individual or committee. Industries have the history, money, talent, and incentives to keep the status quo where they skim OPM. Truly, Goliath against David.

Plan Sponsors / Fiduciaries Trustees

Plan Sponsor provides a benefit as a Human Resource incentive.

Fiduciaries / Trustee conduct their Fiduciary / Trustee duties as a sub-part of their full time position

PSFTs are Deemed “Institutional Investors”

> **“What Is an Institutional Investor?**
>
> An institutional investor is a company or organization that invests money on behalf of other people. Mutual funds, pensions, and insurance companies are examples. Institutional investors often buy and sell substantial blocks of stocks, bonds, or other securities and, for that reason, are considered to be the whales on Wall Street.
>
> The group is also viewed as more sophisticated than the average retail investor and, in some instances, they are subject to less restrictive regulations.”
>
> Institutional Investor (investopedia.com)

Which means, Opponents may assume Institutional Investors understand the motives, mechanics and driving forces of the Advisor (sary).

The Move

PSFT recognize they have the responsibility and resulting liability to protect the best interests of their participants. Further, for every decision they make they must take full responsibility (the buck stops with the PSFT). To the extent they retain an Advisor (sary) that does not accept fiduciary responsibilities, the responsibility for the Advisor (sary) actions (or PSFT decisions based on Advisory (sary) guidance) lies directly on the PSFT. Only if the PSFT discharges a Fiduciary responsibility properly, do they transfer that responsibility. The legislation clearly outlines how PSFTs can legally and effectively accomplish their risk mitigation.

Recap

If PSFT retains a thief, it becomes responsible for the theft.

Best Protection for PSFT from thieves is to properly retain a Fiduciary / Trustee.

Tic-Tac-Toe Analogy – Summary

We introduced the Tic-Tac-Toe Fiduciary Risk Mitigation analogy when we described the Game. We asked the PFST's analogous skill level in the Game as compared to the Expert Opponent: Novice, Intermediate, Experienced, or Expert.

We stated the Opponents have successfully structured the rules, and as it applies to our Fiduciary Risk Mitigation analogy, they are Experts and they move first.

Now, with the context of the previous section where the Players are introduced, we again ask what is the PFST analogous Tic-Tac-Toe skill Level? In light of the Expertise against which the PSFT is pitted, we assume the PSFT is a Novice or Intermediate player at best. In this context, here are computer calculated win/loss statistics.

PSFT	Novice	Intermediate	Experienced	Expert
Advisor (sary) EXPERT	**1 wins: 97.8%**	**1 wins: 76.6%**	1 wins: 27.1%	1 wins: 0.00%
	2 wins: 0.00%	**2 wins: 0.00%**	**2 wins: 0.00%**	**2 wins: 0.00%**
	Ties: 2.20%	Ties: 23.4%	Ties: 72.9%	Ties: 100.00%

https://blog.ostermiller.org/tic-tac-toe-strategy/

These statistics are very interesting! There are two players.

For each PSFT skill level of Novice, Intermediate, Experienced and Expert the computer calculated chance of winning against the Expert Advisor (sary) are illustrated. The top row of each column is the chance the Advisor (sary) wins. The second row in each column is the chance the PSFT wins and the last row is the chance of a "Cat's" game or a tie. **These computer simulation results illustrate any skill level of PSFT can NOT win!** All their skill does is determine the likelihood of a Tie! An Intermediate skill level PSFT never wins and loses 76.6% of the time!

If it has not been clear up to this point, our Fiduciary Risk mitigation analogy suggests that a PSFT who does not properly delegate their Investment Manager responsibilities to a qualified Fiduciary / Trustee will always lose. However, if properly delegated to the Investment Manager Fiduciary / Trustee they will always tie.

Winning Strategy

Recognize Plan Advisors may be playing the game as the Fiduciary / Trustee's **adversary**. As such, they are often protected by the Fiduciary /Trustee's decision to choose them with all of their faults.

Use the Fiduciary Rule approach – Retain and Appoint Fiduciaries / Trustees

Only retain Fiduciary Advisors who make Expert moves themselves and then assist you in making complementary Expert moves.

Take advantage of Legislation

§3(38) Investment Manager

§15-1.1-109. Delegation of investment and management functions

2017 Fiduciary Rule

Winning the Game

Action	Fiduciary Advocate	Advisor (sary)
Acts in Best Interest of Participants	✓	
Acts in their own best interest		✓
Eliminates Conflicts of Interest	✓	
Discloses all Compensation	✓	
Discloses All Business Practices	✓	
Is a Named Fiduciary	✓	
Supports the Golden Rule	✓	
Supports the Silver Rule	✓	

PSFT, as shown in the previous section, cannot win the Fiduciary Risk Mitigation Game. Their best outcome is a consistent tie. The only means by which the PSFT can guarantee Fiduciary Risk Mitigation is by properly delegating the Investment Management function to a Fiduciary Advocate.

Golden Rule: Do unto others as you would have them do unto you.

Silver Rule: Do not do unto others as you would not have them do unto you.

Our Conclusion, PSFT should request proposals to Mitigate their Fiduciary Risk. The RFP purpose might read as follows:

The PSFT intends to exercise reasonable care, skill and caution to appropriately select a qualified Investment Manager Trustee Agent and delegate investment and management functions for the herein described scope and terms.