No. 19-1401

In the Supreme Court of the United States

APRIL HUGHES, ET AL., PETITIONERS

v.

NORTHWESTERN UNIVERSITY, ET AL.

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

BRIEF OF INVESTMENT COMPANY INSTITUTE AS AMICUS CURIAE IN SUPPORT OF RESPONDENTS

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INTEREST OF AMICUS CURIAE[1]

The Investment Company Institute (ICI) is the leading association representing regulated funds globally, including mutual funds, exchange-traded funds, closed-end funds, and unit investment trusts in the United States. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. ICI's members

[1] Both parties have consented to the filing of this amicus curiae brief. No counsel for any party authored this brief in whole or in part, and no person or entity, other than amicus curiae or their counsel made a monetary contribution intended to fund the preparation or submission of this brief.

serve over 100 million United States shareholders and manage total assets of $32.4 trillion in the United States.

ICI serves as a source for statistical data on the fund industry and conducts public policy research on fund trends, shareholder characteristics, the industry's role in the United States and international financial markets, and the retirement market. For example, ICI publishes reports focusing on the overall United States retirement market, fund assets and flows, fees and expenses, and the behavior of defined contribution, or 403(b) and 401(k), retirement plan participants. ICI's research gives it the perspective and data to advocate for a sound legal framework for the benefit of funds and their investors.

The importance of mutual funds in helping average Americans achieve their retirement savings goals can hardly be overstated. In 2021, an estimated 55.4 million households owned mutual funds inside tax-deferred accounts such as 401(k) and other defined contribution plans, individual retirement accounts, and variable annuities. See ICI, *Ownership of Mutual Funds, Shareholder Sentiment, and Use of the Internet, 2021*, 27 ICI Rsch. Perspective 1, at 10 (2021), https://www.ici.org/system/files/2021-10/per27-11.pdf. Given the critical role that mutual funds play in retirement investing, ICI and its members have a strong interest in ensuring that the regulation of defined contribution plans effectively furthers Congress's purposes in establishing this important investment vehicle.

ICI's experience and expertise allow it to offer a real-world perspective on the impact of petitioners' proposed standard, and the decisions of courts that effectively lower the pleading standards for excessive fee litigation in their jurisdictions, as petitioners urge. ICI is also able to explain how petitioners' arguments are based on a misunderstanding of the realities and legal landscape of the retirement investment marketplace: their proposed standard would create incentives that run contrary to ERISA's principles for fiduciaries and plan sponsors, and harm plan participants and beneficiaries by limiting choice and access to investment options that will help them meet their savings goals. ICI submits this brief as amicus curiae to urge the Court to affirm the Seventh Circuit's decision below.

SUMMARY OF THE ARGUMENT

Defined contribution plans are currently one of the most important retirement savings vehicles for workers in the United States. For many employees, defined contribution plans may be the only way they gain access to the investment markets.

The increased threat of litigation that results from a lower pleading standard for excessive fee and related ERISA litigation is causing plan administrators/fiduciaries to adopt bright-line rules that exclude many classes of investments from defined contribution plan investment lineups, to the potential detriment of both plans and plan participants. Petitioners' pleading standard is premised on an overly simplistic and misleading view that "lowest-cost is per se preferable," which is without support in the investment fund context and is contrary to Department of Labor positions concerning ERISA.

Petitioners' theory focuses exclusively on cost—which they equate solely to lower investment fees or expense ratios—to the exclusion of other investment considerations. But ERISA requires fiduciaries to consider multiple objectives when selecting investment menus for a plan, including diversification and returns, and does not allow fiduciaries to focus only on one type of costs while ignoring others. There are good reasons why plan fiduciaries might choose to include actively managed funds and "retail" share classes rather than limit the plan options to index funds or "institutional" share classes, even if the index funds and institutional share classes of funds have lower expense ratios. In particular, petitioners' preferred bright line rule ignores the legitimate role of actively managed funds in ensuring that plan participants have the ability to structure retirement portfolios that meet their needs and goals, and disregards the cost-sharing mechanisms of retail share classes that often make them a reasonable choice for sponsors to include as a way to "defray[] reasonable expenses of administering the plan" for defined contribution plan participants. 29 U.S.C. 1104(a)(1)(A)(ii).

Likewise, there are sound reasons a plan fiduciary might include actively managed funds in its menu of investment options—just as many sophisticated investors do, whether for their own investments or as fiduciaries for defined benefit plans. ERISA does not prescribe a "one size fits all" approach, but affords significant discretion to plan fiduciaries not only to select an appropriate mix of investment options for plan participants, but to structure the plan in a way that fairly and efficiently provides for payment of third-party services (such as recordkeeping fees).

The pleading standard advocated by petitioners would effectively limit options for plans and plan participants. Fiduciaries of defined contribution plans have no ability to participate in upside gains of the plans' holdings, because all of the investments are held for the benefit of plan participants. Lawsuits such as petitioners' instant action present significant downside risk for those fiduciaries, however, because any liability will be borne by the fiduciaries and/or the plan sponsor. Simply put, if petitioners can plead a breach of a fiduciary's duty of prudence by merely observing that a plan's investment menu includes actively managed funds or retail share classes of funds, a plan fiduciary would have to exclude those funds or share classes to reduce litigation risk. But limiting the plan's investment menu ultimately disadvantages plan participants by stripping them of the investment choices they need to build a retirement portfolio that best reflects their individual circumstances, including their degree of risk aversion, desire to manage their own portfolio, closeness to retirement, or any number of other factors. Indeed, the threat of suit could even encourage plan sponsors simply to abandon their ERISA plans altogether.

These outcomes are inconsistent with Congress's goals in establishing ERISA fiduciary duties for defined contribution plans. Congress intended that plan sponsors and fiduciaries be able to establish arrangements for participants in which the participants select among a range of investment options reflecting their own investment objectives, risk tolerance, and time horizon. Whether in the form of higher per participant fees, fewer investment options, lower returns, or no ERISA plan at all, petitioners' proposed lowering of the standard for suing plan fiduciaries will ultimately harm the employees that Congress sought to benefit and protect.

ARGUMENT

I. IT IS CRITICAL THAT PLAN FIDUCIARIES MAINTAIN FLEXIBILITY TO SELECT A RANGE OF INVESTMENT OPTIONS, INCLUDING RETAIL SHARE CLASSES OF FUNDS AND ACTIVELY MANAGED FUNDS

Petitioners argue that respondents' inclusion of certain retail share classes and actively managed funds, rather than limiting the plans to institutional share classes or passively managed index funds, were imprudent decisions and, standing alone, should allow petitioners' excessive fee lawsuit to proceed. Petitioners focus solely on the investment fees or expense ratios associated with the particular share class or funds, but their reasoning is misleading and reductive. The critical decision-making inherent in choosing investments for 401(k) and 403(b) plans is much more complex than petitioners would ask this Court to conclude. Petitioners ignore a host of reasons why plan fiduciaries might rationally and beneficially include certain options—whether index or active funds or institutional or retail share classes—in the menu of investment options.

A. A Fiduciary Must Have Flexibility to Select a Variety of Investment Options Based on a Process that Considers a Wide Variety of Factors for an Individual Plan, Not Just Total Expense Ratio

The fundamental design of ERISA is to afford plan fiduciaries "broad discretion in defining investment strategies appropriate to their plans," rather than dictating plan options by government fiat. U.S. Dep't of Lab., Advisory Opinion 2006-08A (Oct. 3, 2006), https://www.dol.gov/agencies/ebsa/about-ebsa/our-activities/resource-center/advisory-opinions/2006-08a. Fiduciaries are tasked with carefully selecting and monitoring a variety of investment options for plan participants. Under ERISA fiduciary standards, the "prudent" approach is to offer diverse investment options in plans. In incorporating a statutory safe harbor under ERISA Section 404(c) into the fiduciary framework, Congress contemplated that plan fiduciaries would make available a "broad range of investment alternatives," to allow plan participants to affect targeted potential returns, select the degree of risk exposure and return potential of different investments within their account, and reduce overall account risk through diversification.[2]

[2] The Department of Labor has indicated that under certain circumstances, even broader investment exposure (*i.e.*, to alternative assets) would be in compliance with ERISA's fiduciary duties. U.S. Dep't of Lab., Information Letter 06-03-2020, https://www.dol.gov/agencies/ebsa/about-ebsa/our-activities/resource-center/information-letters/06-03-2020. Any "narrowing of the options available to employees * * * runs counter to a central purpose of ERISA." *Schwartz* v. *Newsweek, Inc.*, 827 F.2d 879, 883 (2d Cir. 1987).

Fiduciaries of participant-directed individual account plans—not the courts—are best positioned to evaluate the appropriate number, variety, and type of investment options to offer on plan investment menus. Participants in one plan may differ dramatically from participants in another in terms of their proximity to retirement age, risk tolerance, sophistication and interest in managing their own investment portfolios, and any number of other characteristics may affect their ideal retirement investment menu. Consistent with the adage in fiduciary contexts that prudence is process, see Keith P. Ambachtsheer & D. Don Ezra, *Pension Fund Excellence: Creating Value for Stockholders* 35 (1998), courts and the Department of Labor historically have deferred to decisions made by a plan fiduciary so long as they followed a reasonable process in making that a given decision. See *e.g.*, *DiFelice* v. *U.S. Airways, Inc.*, 497 F.3d 410, 420 (4th Cir. 2007) (in deciding whether a plan fiduciary has acted prudently, a court must "ask whether the fiduciary engaged in a reasoned decisionmaking process").

Petitioners would subvert this well-articulated and widely understood regime and reduce the "process" to simply a consideration of which funds or share classes have the lowest expense ratios, or what funds or share classes have already been "court-approved" by prior litigation. Such an outcome ignores the importance of other factors a fiduciary should consider in selecting an investment menu beyond fees or expense ratios, as illustrated below.

B. Petitioners' Condemnation of Respondents' Selection of Retail Share Classes of Funds over Institutional Share Classes Ignores Well Established Recordkeeping Fee Practices

Petitioners' argument that it was imprudent for respondents to include certain retail share classes of funds where institutional classes were available, simply because the retail share classes have higher expense ratios, overlooks (i) how the fees associated with plan recordkeeping are paid; and (ii) the broader context of how a fiduciary negotiates with investment companies and their recordkeeping affiliates to make available to their plan participants a diverse menu of investment options and to provide other services necessary to the administration of the plan. Giving due consideration to both issues reveals the important reasons why these share classes should not be foreclosed as investment options.

1. *Petitioners Incorrectly Focus on Expense Ratio, Rather Than Actual "All-In" Expense*

The total fees paid for investment in the share class of a fund are referred to as the "expense ratio" for that share class. It is worth emphasizing that the fact that a share class is labeled "institutional" does not guarantee that it carries lower fees than retail share classes with similar investment compositions and objectives. For example, ICI calculates that as of 2020, nearly 40 percent of the institutional share classes of no-load equity mutual funds had expense ratios greater than the average expense ratio of comparable retail share classes.

Petitioners incorrectly focus on the sticker price of retail share classes rather than the net amount borne by participants. Their position ignores the fact that plan fiduciaries may intentionally select share classes with higher expense ratios because the fiduciaries will be able to obtain a revenue sharing arrangement more favorable to participants on a net basis to cover the various plan administration costs. According to a recent survey, among plans that have revenue sharing, 51.4 percent credit it back to participant accounts periodically. Plan Sponsor Council of Am., *63rd Annual Survey of Profit Sharing and 401(k) Plans: Reflecting 2019 Plan Experience* (2020).

The costs associated with defined contribution plans fall into two main categories: investment-related fees and administrative fees. The former includes advisory fees for investment management, which are generally paid as a percentage of the assets invested. The latter are charged for administrative services that are necessary for the day-to-day operation of the plan, such as recordkeeping, accounting, legal, and trustee services, as well as services that are provided directly to plan participants, such as educational seminars, access to customer service representatives, and the provision of benefits statements. In some cases, the expense ratio for a particular fund share class may include fees that are used to offset recordkeeping and other administrative costs of the plan offering that share class.

In addition, plan sponsors often consider revenue sharing arrangements in evaluating what share class should be made available to plan participants. "Revenue sharing" in the ERISA context refers to the practice of using a portion of the revenue generated by a mutual fund's investment fees to offset some or all of the costs of the administrative services provided by a service provider (generally the recordkeeper) that would otherwise be charged directly to the plans, plan sponsors, and/or plan participants. See Deloitte Consulting LLP, *Inside the Structure of Defined Contribution/401(k) Plan Fees, 2013: A study assessing the mechanics of the 'all-in' fee* 16 (2014), https://www.idc.org/system/files/attachments/rpt_14_dc_401k_fee_study.pdf. The Department of Labor has recognized that negotiating over revenue sharing is a fiduciary function that is inherently fact specific. U.S. Dep't of Lab., Advisory Opinion 2013-03A (July 3, 2013), https://www.dol.gov/agencies/ebsa/about-ebsa/our-activities/resource-center/advisory-opinions/2013-03a ("The plan fiduciaries must also act prudently and in the best interests of plan participants and beneficiaries in the negotiation of * * * revenue sharing * * * . Whether the actions of plan fiduciaries satisfy these general fiduciary standard requirements is an inherently factual question.").

Because administrative fees must be covered regardless of the makeup of the investment menu, a prudent plan fiduciary understands that the expense ratio (on which petitioners focus in isolation) is not singularly determinative of whether a given investment option is prudent. Instead, when evaluating different share classes of the same fund, a fiduciary looks to the overall expense that will be borne by plan participants. Both institutional share classes and retail share classes may provide the option of covering third-party administrative expenses through revenue sharing. Mercer LLC, *Defined contribution plan fee practices: revenue sharing considerations* (2020), https://www.mercer.us/content

/dam/mercer/attachments/north-america/us/us-2020-dc-revenue-sharing-considerations.pdf. But investment options with higher expense ratios—such as retail share classes of some funds—can generate more revenue sharing, which in turn can help defray the recordkeeping costs for the plan.

While details of plan sponsors' revenue sharing arrangements are not publicly available as a general matter, there is evidence showing that retail share classes can be comparable to—and, indeed, in some cases are net cheaper than—institutional share classes once the revenue sharing rebates that can be credited back to the plan are taken into account. For example, in support of their Motion to Dismiss, defendants in *Parmer* v. *Land O'Lakes, Inc.* demonstrated that they secured lower fees by retaining "Investor" (retail) share classes rather than "I-Class" (institutional) shares in each of fifteen different funds. See Reply in Support of Defendants' Motion to Dismiss at 5-7, No. 20-cv-01253 (D. Minn. Oct. 9, 2020), ECF No. 45. There, plaintiffs complained that defendants selected the Investor share class of the T. Rowe Price (TRP) 2005 fund, with a fee of 0.53 percent, instead of the I-Class shares of the same fund, with a fee of 0.41 percent. However, once the revenue sharing arrangement utilized by the Investor share class was factored in, the plan fiduciaries were able to secure overall fees that were 0.03 percent lower in the retail share class on a net basis. See *id.* at 6.

A prudent fiduciary must have the flexibility to engage in a plan-specific analysis scrutinizing fees in light of the particular circumstances of the individual plan and "all-in" expense that will be borne by participants.[3] There is no standard methodology for capturing the impact of revenue sharing since the amount and way it is used varies across plans and recordkeepers. Mercer, *supra*. Notably, while petitioners—like numerous other plaintiffs in excessive fee lawsuits—take issue with respondents' use of revenue sharing, still other plaintiffs in other fiduciary breach complaints filed in recent years have in effect alleged that it is imprudent *not* to select funds utilizing revenue sharing when those funds yield the lowest net investment expense. See, *e.g.*, Compl. ¶¶ 154, 170-185, *Reichert* v. *Juniper Networks, Inc.*, No. 21-cv-06213 (N.D. Cal. Aug. 11, 2021), ECF. No. 1; Am. Compl. ¶¶ 136-167, *Bangalore* v. *Froedtert Health, Inc.*, No. 20-cv-00893 (E.D. Wis. Sept. 10, 2020), ECF No. 19 ¶¶; Am. Compl. ¶¶ 130-168, *Albert* v. *Oshkosh Corp.*, 20-cv-00901 (E.D. Wis. Aug. 31, 2020), ECF No. 20. It cannot be, of course, that it is a breach of fiduciary duty both to include and to exclude retail share classes from a plan menu. But the fact that some plaintiffs saw the value of those share classes and others did not strongly suggests that the reasonableness of their inclusion is a matter of judgment, based on the specific circumstances of the particular plan.

Larger plan sponsors might be willing and able to absorb administrative costs for their participants in the

[3] Although it arose in a different context, this Court recognized the importance of affording deference to fiduciaries' process in *Jones* v. *Harris Assocs. L.P.*, noting that "[w]here a board's process for negotiating and reviewing investment-adviser compensation is robust, a reviewing court should afford commensurate deference to the outcome of the bargaining process." 559 U.S. 335, 351 (2010).

absence of the opportunities for revenue sharing, but this practice can be even more important for smaller plan sponsors, which may otherwise find the administrative costs of managing a plan prohibitive. In the absence of revenue sharing, sponsors and fiduciaries of small plans may be compelled to select a potentially higher per-participant fee or decide not to offer a plan at all.[4] In fact, plans are increasingly charging recordkeeping fees directly to plan participants. See Deloitte, *2019 Defined Contribution Benchmarking Survey Report*, https://www2.deloitte.com/content/dam/Deloitte/us/Documents/human-capital/us-2019-defined-contribution-benchmarking.pdf.

In response to a survey conducted by Deloitte in 2019, only 33 percent of plan sponsor respondents reported that all of their 401(k)/403(b) plans' recordkeeping and administrative fees were paid through investment revenue, *i.e.*, via revenue sharing arrangements,

[4] The latter scenario would be wholly inconsistent with Congressional and regulatory efforts in recent years to promote retirement savings by American workers. See, *e.g.*, H.R. 5376, 117th Cong. (2021) (the "Build Back Better Act," which was approved by the House Ways and Means Committee on September 15, 2021 and would require businesses with five or more employees to automatically enroll their employees in IRAs or 401(k)-type plans); S. 2370, 116th Cong. (2019) (the "Automatic IRA Act of 2019," which would "amend the Internal Revenue Code of 1986 to expand personal saving and retirement savings coverage by enabling employees not covered by qualifying retirement plans to save for retirement through automatic IRA arrangements[]"); and H.R. 2913, 111th Cong. (2009) (the "Encouraging Americans to Save Act," which would "amend the Internal Revenue Code of 1986 to provide matching payments for retirement savings contributions by certain individuals").

down from 50 percent in 2015. See *2019 Defined Contribution*, *supra* at 20, Ex. 7.1. In the same period, the percentage of sponsors reporting that the fees charged by their plans' recordkeeper were paid directly by the sponsor dropped from 36 percent to 25 percent, and the percentage of sponsors reporting that fees were allocated to participants on a pro rata basis according to their account balances nearly doubled from 15 to 29. See *id.* at 20, Ex. 7.2. As these figures indicate, a pleading standard, like that proposed by petitioners, that dissuades plan fiduciaries from selecting an otherwise acceptable method for covering plan administrative expenses will likely result in higher fees charged directly to participants, which may discourage their participation in the plan. At the very least, such a standard is inconsistent with Congress's design that such administrative decisions be made by plans individually, based on their particular circumstances.

2. *Restricting Plans to Offering Only Institutional Shares Could Limit Investment Options*

Drawing a bright line rule about selecting institutional share classes over retail share classes could narrow investment options in other ways that petitioners also fail to acknowledge.

For a given fund that offers both retail and institutional share classes, the fund would normally require a much larger minimum investment size for a defined contribution plan to gain access to the institutional share class. See Karen Wallace, *How to Access Funds With High Minimum Investments*, Morningstar (Aug. 30, 2017), https://www.morningstar.com/articles/823640/ho w-to-access-funds-with-high-minimum-investments. Each fund defines its own share classes, but some third-party data providers define institutional share classes as those having a minimum-balance requirement of up to $1,000,000 or more (on a plan-wide basis). *Ibid.* By contrast, a retail share class is generally defined as a share class that has a low minimum initial balance requirement (*e.g.*, $2,500). See Sean Collins, *The IMF on Asset Management: Sorting the Retail and Institutional Investor "Herds,"* ICI (June 4, 2015), https://www.ici.org/viewpoints/view_15_imf_gfsr_05. Accordingly, by choosing institutional classes over lower minimum balance retail classes, fiduciaries could be compelled to limit the number of designated investment options to effectively funnel a sufficient portion of participants' retirement assets into a smaller number of funds so that they meet the minimum investment size for the institutional share class.

In order to ensure that minimum investment levels will be met, plan fiduciaries would likely cease offering certain types of funds that are less popular—such as those targeting specific sectors of the market. And as a result, participants who may have been fully apprised of and willing to bear a higher expense ratio in a particular fund or share class in order to access specific market sectors, such as to implement a diversification strategy, will be unable to do so. The tendency of petitioners' proposed pleading standard to narrow investment options and limit participants' ability to diversify their accounts runs contrary to ERISA's goals. 29 U.S.C. 1104(a)(1)(C).

Further, in some cases, only plans of a certain asset size will qualify for the institutional share class. A plan sponsor has to be able to make decisions based on what is available for them. Having a rule that focuses on institutional versus retail, as opposed to what is best for plan participants, is unworkable for smaller plans which simply may not have enough total assets to qualify for them. For example, BrightScope/ICI research indicates that as of 2018 (the most recent year analyzed) 58.5 percent of 401(k) plans had assets of less than $1 million. ICI, *The BrightScope/ICI Defined Contribution Plan Profile: A Close Look at 401(k) Plans, 2018*, at 7 (July 2021), https://www.ici.org/system/files/2021-07/21_ppr_dcplan_profil e_401k.pdf.

C. By Offering Both Index (Passive) and Active Funds, Plans Can Hedge Risk and Enhance Investment Choice for Plan Participants

Petitioners' approach would also effectively require fiduciaries to select index (*i.e.*, "passive") funds to the exclusion of other types of funds, which is similarly misguided as an application of ERISA's "prudence" standard. Under such a regime, alternative investments, actively and semi-actively managed investments, emerging markets, and small- and mid-cap funds could well be excluded from defined contribution plan investment menus out of concern about litigation. Yet these investment vehicles are the same strategies that have been prudently utilized in defined benefit pension plans and non-retirement brokerage accounts, as well as in private equity, to diversify or hedge against risk for years, and the Department of Labor has recently confirmed that alternative investments may be offered by defined contribution plan fiduciaries. See U.S. Dep't of Lab., Information Letter 06-03-2020, https://www.dol.gov/agencies/ebsa/about-ebsa/our-activities/resource-center/information-letters/06-03-2020. And for good reason.

Actively managed mutual funds play a legitimate role in helping plan fiduciaries assemble a broad and diverse menu of investment options consistent with their duties under ERISA. First, it is not safe to assume that index funds are the better investment merely because they may be the lower-cost option. As noted above, when considering otherwise comparable investment options, fiduciaries consider net investment performance—total returns minus fees and expenses—rather than cost alone. According to ICI's analysis, the three-, five-, and ten-year annualized net returns of the ten largest actively managed funds as of July 2021 (after fees and expenses) were nearly identical to those of the ten largest index funds at the same intervals. In fact, the average net returns (after fees and expenses) of the actively managed funds generally were slightly higher than their index fund comparators. See David Abbey, *Actively Managed Funds Are Appropriate Options for 401(k) Plans*, CFA Inst. (Sept. 29, 2021), https://blogs.cfainstitute.org/investor/2021/09/29/actively-managed-funds-are-appropriate-options-for-401k-plans/. The point is not that active funds are necessarily preferable to index funds, but that because the net returns of the former can match or exceed those of the latter, there is simply no basis for categorically labeling active funds as imprudent. Such a presumptive approach to assessing the prudence of a plan's investment menu is not only overly simplistic but misguided in application.

Moreover, actively managed funds can provide a mechanism for protecting against volatility in investment returns. ICI's comparison of the ten largest actively managed funds against the ten largest index funds shows that actively managed funds have experienced slightly less variability in their monthly returns over three-, five-, and ten-year periods. Abbey, *supra*. This stands to reason because as more stocks are held by passive investors, active fund managers have more opportunities to find and purchase mispriced stocks. *Ibid.*

Finally, the inclusion of actively managed options in a plan lineup assures participants greater choice and flexibility to design a portfolio that suits their investment profile, needs, and risk tolerance. Certain categories of investments, such as emerging markets and small-cap growth stocks, have few index mutual funds from which investors might choose. If actively managed funds are effectively excluded from retirement plan lineups due to litigation risk, it may be difficult for participants to gain exposure to these beneficial asset classes in their retirement savings. Certain options are by their nature particularly well-suited to active management. For example, international funds can benefit from active management to help navigate default, country, and exchange rate risks.

None of the above is to suggest that active funds are necessarily preferable to index funds. Each has its advantages, and which option is appropriate depends on the particular circumstances. But, as fee-related litigation in the defined contribution plan space has proliferated over the last decade, some fiduciaries have reportedly developed a bias against active management that perpetuates a negative pattern of rewarding the inclusion of allegedly "safe" funds. See George S. Mellman & Geoffrey T. Sanzenbacher, *401(k) Lawsuits: What are the Causes and Consequences* 5, Ctr. for Ret. Rsch. (2018), https://crr.bc.edu/wp-content/uploads/2018/04/IB_18-8 .pdf (citing David McCann, *Passive Aggression*, CFO Mag. (June 22, 2016), https://www.cfo.com/retirement-plans/2016/06/passive-investment-aggression/).

II. PETITIONERS' PROPOSED PLEADING STANDARD EXPANDS THIS COURT'S PLAUSIBILITY FRAMEWORK AND HARMS PLAN PARTICIPANTS

Petitioners advocate for a regime in which excessive fee litigation can proceed based on little more than allegations that a fiduciary selected a retail share class over institutional classes, or actively managed funds over passive index funds. This approach is not only at odds with established law governing the federal pleading standard, but also would heighten litigation risk for fiduciaries, which may ultimately constrain fiduciary choice to the participants' detriment and increase costs for plan participants.

A. Petitioners' Pleading Standard Disregards *Iqbal*

As an initial matter, petitioners' permissive pleading standard is at odds with this Court's two-pronged approach for evaluating whether a complaint satisfies Fed. R. Civ. P. 8's pleading requirement: First, the court must "identify[] the allegations in the complaint that are not entitled to the assumption of truth." *Ashcroft* v. *Iqbal*, 556 U.S. 662, 680 (2009). That is, the court must separate pleadings of fact from pleadings of conclusion. Next, the court must evaluate the factual assertions to determine whether "they plausibly suggest an entitlement to relief" or they allow "the court to draw the reasonable inference that the defendant is liable." *Id.* at 678, 681. Facts that are "merely consistent with" a defendant's liability are not enough and "stop[] short of the line between possibility and plausibility." *Id.* at 678.

Petitioners propose that by alleging a single fact—either that a fiduciary has selected a retail share class over an institutional class, or has selected an actively managed fund over a passive index fund—they can satisfy this standard, survive a motion to dismiss, and proceed to discovery. Not so. As discussed above, there are good reasons why a plan fiduciary would include active funds and retail share classes in a plan—reasons that are consistent with their fiduciary duty to select prudent investment options. As such, the simple fact of selection of those options over others, without more, cannot "plausibly suggest" a fiduciary breach. Based on these facts alone, the court is not able to draw a "reasonable inference" that a fiduciary is liable because, again, selection of these investment options may be in the interest of plan participants either to provide revenue sharing opportunities, enhance investment choice, account for the unique needs of the plan participants, or reduce "all-in" costs.

B. Petitioners' Permissive Pleading Standard Harms Plan Participants

Petitioners' permissive pleading standard allows excessive fee litigation to proceed more easily to discovery, and because plan sponsors bear the costs of excessive-fee litigation, it exposes fiduciaries and sponsors to increased litigation risk and costs.

1. *Enhanced Litigation Risk Leads Fiduciaries to Eliminate Important Investment Options for Plan Participants, Leading Plan Participants to Access Fewer Diverse and More Tax Disadvantaged Investment Opportunities*

Petitioners' pleading standard overly incentivizes fiduciaries to select or not select a particular investment option to avoid litigation risk and costs, rather than evaluating that option on equal footing with other prudent choices. If this Court holds that petitioners are correct that the inclusion of retail share classes of funds or investment options with higher fees alone is sufficient to state a viable claim for breach of a fiduciary's duty of prudence, then fiduciaries will have to act more conservatively, limiting investment options in plans, to fulfill those duties. This regime would not be in the best interests of plan participants or the retirement system.

As fiduciaries face an increased risk of liability and litigation costs for including a particular type of investment (*e.g.*, sector funds that offer higher returns but are more costly to manage and thus have higher fees, actively managed funds, or retail share classes of funds), they will likely default to removing those investment types from the plan investment menu—even if those options would offer more revenue sharing opportunities (see supra), provide higher returns for plan participants, or offer plan participants more expansive access to financial markets.

Indeed, as lawsuits like the case at bar have proliferated, the number and variety of investment options offered in defined contribution plans have constricted, with investment line-ups being streamlined, thus reducing investment fund choice. See Cerulli Assocs., *Litigation in Defined Contribution Retirement Plans* (2021), https://cdn.ymaws.com/dciia.org/resource/resmgr/resource_library/Cerulli_Whitepaper-Litigatio.pdf; see also Fidelity Invs., *Building Financial Futures: Trends and Insights of Those Savings for Retirement Across America* (2021), https://sponsor.fidelity.com/bin-public/06_PSW_Website/documents/Building_Financial_Futures.pdf.

Offering a robust menu of investment options that has been curated by fiduciaries and tailored to the needs specific to the plan's participants is intrinsic to ERISA's fundamental purpose: to protect the interests of employee benefit plan participants and their beneficiaries by ensuring that those in charge of such plans act in the participants' and beneficiaries' best interests. A fiduciary-curated menu of plan investments permits plan participants to choose investment options from a menu that has been assembled for them, based on the circumstances of the participants in a given plan, such as employees' current ages, projected retirement ages, risk tolerances, investment sophistications, asset accumulation/preservation disposition, and other factors. The slate of investment options from plan to plan should vary to provide access to investment opportunities that the fiduciary tailors to the plan participants and their investment needs and sophistication level, and may include retail share classes, actively managed investments, target date funds, small cap funds, emerging markets funds, ESG funds, and alternative asset classes. The particular menu should vary but in all instances should include a diverse set of options appropriate for that plan's participants. The petitioners' proposed pleading standard would effectively replace this complex and tailored fiduciary function with a presumptive one-size-fits-all investment selection process.

Having the ability to provide an array of investment options, whether through passive index funds, actively managed funds, or retail or institutional share classes of funds—if prudently selected—within a defined contribution plan menu helps ensure that plan participants have the ability to structure retirement portfolios that meet their needs and goals. Sophisticated investors, to be sure, may isolate investment opportunities outside of their retirement accounts, but millions of Americans have their primary or sole retirement savings portfolio housed in a 401(k) or 403(b) plan.

Plans instead may offer to participants seeking to pursue different investment opportunities a self-directed brokerage (SDB) window option, which offer plan participants the ability to invest in funds or stocks of their own choosing through a brokerage platform. But they also put the onus on the plan participant to select from the myriad investments available through such platforms, perhaps necessitating a reasonable degree of sophistication by the plan participant. Although the Department of Labor has stated that fiduciaries of plans with brokerage windows are still bound by ERISA Section 404(a)'s statutory duties of prudence and loyalty including taking into account the nature and quality of services provided "in connection with" the brokerage window, see U.S. Dep't of Lab., Field Assistance Bulletin 2012-02R, Q&A 39 (July 30, 2012), https://www.dol.gov/agencies/ebsa/employers-and-advisers/guidance/field-assistance-bulletins/2012-02r, fiduciaries are generally understood not to be responsible for monitoring the investment activities within the brokerage window, and stakeholders have pushed for greater clarity in this area, see Written Statement of Chantel Sheaks, Vice President, Retirement Policy, U.S. Chamber of Commerce Before the 2021 Advisory Council on Employee Welfare and Pension Benefit Plans Meeting on "Understanding Brokerage Windows in Self-Directed Retirement Plans" (June 24, 2021), https://www.dol.gov/sites/dolgov/files/EBSA/about-ebsa/about-us/erisa-advisory-council/sheaks-06242021.pdf.

Therefore, SDB accounts are not a perfect substitute for offering a full slate of investment options that have been prudently selected by a plan fiduciary, which serves as an important filter in the evaluation and selection process.

2. *Enhanced Litigation Risk Leads to Higher Insurance Premiums to the Detriment of Plan Participants*

Alternatively, fiduciaries and sponsors may look to purchase additional fiduciary liability insurance coverage to defray at least some litigation costs and risk of liability, but the premiums associated with this insurance become yet another incremental expense of maintaining a plan to the detriment of the various stakeholders involved. Premiums, for example, were up by about 35 percent in 2020 as compared to 2019; coverage limits have been much lower than they used to be, meaning that plan sponsors must buy as many as five policies from different insurers in order to have the full level of coverage they once did; and the retention fees they must pay have skyrocketed. See Emile Hallez, *Fiduciary insurance costs soar amid new 401(k) litigation*, Inv. News (Oct. 21, 2020), https://www.investmentnews.com fiduciary-insurance-costs-401k-litigation-198407.

Retentions, which represent the amount of money an insured must pay out-of-pocket before insurance coverage kicks in (similar to a deductible) can now sometimes reach as high as $10 to $15 million, when in the past retentions of $0 were fairly common. See Jacklyn Wille, *Spike in 401(k) Lawsuits Scrambles Fiduciary Insurance Market*, BL News (Oct. 18, 2021), https://news.bloomberglaw.com/employee-benefits/spike-in-401k-la wsuits-scrambles-fiduciary-insurance-market. As such, ironically, excessive fee litigation—even with its hyper focus on fees and expense ratios—ultimately leads to *increased* costs associated with offering a plan for plan sponsors and employers—an effect that may ultimately trickle down to plan participants.

* * *

As such, should the Court embrace the pleading standard advocated by petitioners, this wave of litigation and attendant effects would only intensify. Excessive fee litigation constrains fiduciaries and has a cascading effect on the design of defined contribution plans. Namely, it can mean fewer investment choices for plan participants—potentially driving plan participants to less-protected avenues for market access—as well as higher insurance premium costs, all ultimately to the detriment of plan participants.

CONCLUSION

For the foregoing reasons, the judgment of the court of appeals should be affirmed.

Respectfully submitted.

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