COMPLIANCE October 8, 2020

Salesforce Ruling Offers Key Lessons About Revenue Sharing, Fee Litigation

The dismissal ruling pushes back against overly broad claims suggesting that actively managed mutual funds and revenue sharing are inherently imprudent in qualified retirement plans.

By John Manganaro

A ruling recently issued by the U.S. District Court for the Northern District of California

plan advisers, for providing a couple of lessons.

Of note, the ruling grants a motion to dismiss in favor of the defense—which is a fairly uncommon outcome in the ongoing rush of Employee Retirement Income Security Act (ERISA) lawsuits. This is not the case because plaintiffs are having all the success in terms of the ultimate outcome of many of these lawsuits, but rather because the structure and inherent complexity of retirement plan lawsuits often makes federal district court judges reluctant to squash plaintiffs' claims at such an early stage.

Generally speaking, granting a motion to dismiss precludes more formal discovery and the generation of what often turns out to be mountains of potentially germane documentary evidence. This line of thinking was recently—and clearly—explained in a ruling filed in U.S. District Court for the Western District of Tennessee, Western Division, which denied a motion to dismiss an ERISA lawsuit against Autozone. As in the Salesforce lawsuit, the defendants in that ongoing case are accused of offering imprudently expensive and poorly performing actively managed mutual funds.

A Lesson About Active Management

between [actively managed funds] and low-cost Vanguard index funds invites the kind of factual analysis that is inappropriate at the pleading stage," the Tennessee district court ruling states. "This court declines to rule on the reasonableness of comparing actively managed funds to passively managed index funds on a motion to dismiss. While plaintiffs must allege more than inapt investment comparisons to make the necessary inference of imprudence to survive a 12(b)(6) motion, at the pleading stage, taking all factual allegations in plaintiffs' favor, the court finds the complaint sufficiently states a claim for breach of fiduciary duty based on AutoZone's selection and management of [the active] funds."

One ancillary effect of the reluctance of federal judges to dismiss such lawsuits prior to discovery is that many of the underlying issues of law have not been clarified, because so many plan sponsors simply choose to settle the cases rather than pay the legal fees associated with fighting them. From a purely economic point of view, this can make a lot of sense, as settlements generally range anywhere from a few million dollars to multiple tens of millions. These figures, especially on the lower end, are easily matched by the legal fees required to fight a complex ERISA lawsuit, even when a

Fiduciary liability insurance also plays a role here, as insurers may prefer to pay to settle claims early and on favorable terms, rather than enter a protracted lawsuit process that could result in sizable damages in addition to the legal fees.

Wagner Law Group Partner Tom Clarke, speaking at the recent PLANADVISER National Conference, summarized this state of affairs well, noting that the tremendous flow of ERISA lawsuits has accomplished surprisingly little from a legal theory point of view. He used the example of plan participant data, and whether lawsuits seeking to define whether participant data is a plan asset (and thus protected by ERISA) have done anything to answer that important question.

“So far, the participant data litigation hasn’t accomplished anything from a legal clarity point of view,” Clark said. “Although parties in some lawsuits have snuck the assumption that plan data is protected by ERISA into their settlement agreements, this does not mean it has been established as a matter of law. Just because something is included in a settlement doesn’t make participant information a plan asset.”

Returning to the Salesforce ruling, the California district court does not hesitate to summarily address the issue of active management’s use in retirement plans. The

generalized to state an actionable claim.

"Passively managed funds … ordinarily cannot serve as meaningful benchmarks for actively managed funds, because the two types of funds have different aims, different risks and different potential rewards that cater to different investors," the ruling states. "Actively and passively managed funds have, for example, different management approaches, and analysts continue to debate whether active or passive management is a better approach. Further, actively managed funds can offer investors the chance to earn superior returns, access specialized sectors or take advantage of alternative investment strategies, while also allowing rapid turnover both in the funds' holdings and the participants' investments. Passively managed funds typically disallow new investments for a month or more following any withdrawal."

In light of such differences, the ruling states, a plaintiff's bare allegations that passively managed funds were available as cheaper alternatives to the actively managed funds offered in the plan "do not suffice to demonstrate imprudence."

"In support of their asserted comparison, plaintiffs allege the passively managed funds have the same investment style or materially

managed funds offered in the plan," the ruling states. "Such conclusory allegations, however, are not sufficient to state a claim for relief."

A Lesson About Revenue Sharing

The Salesforce ruling also offers an important lesson about share classes. In their compliant, the plaintiffs argued that the use of nominally more expensive mutual fund share classes that use revenue sharing —i.e., rebate payments that help offset recordkeeping and administrative fees—is inherently imprudent.

Similar claims have been permitted to advance to discovery in many cases, which in turn means that many settlements have been reached in this area. Thus again, the courts have actually provided relatively little guidance in terms of the plaintiffs' original questions about the prudence of certain plan design decisions having to do with the provision of "retail" share classes and the use of revenue sharing. This is why the Salesforce ruling can be seen as instructive, though of course its impact may be limited outside the 9th U.S. Circuit.

The dismissal ruling explains that the court found compelling the defense's arguments that the plan engaged in revenue sharing in an appropriately considered, prudent and loyal manner.

the fees charged in connection with the JPMorgan SmartRetirement Institutional and Class R5 funds were used to pay for recordkeeping and other administrative services provided to the plan, an arrangement which frequently inures to the benefit of ERISA plans," the ruling states, citing a precedent set by a case known as *Terraza v. Safeway Inc.* "Known as 'revenue sharing,' this arrangement provides an obvious, alternative explanation for why the plan did not offer the lowest cost share class for those funds, and plaintiffs fail to allege any facts to support their conclusory allegation that the plan did not receive any services or benefits based on its use of more expensive share classes."

Comparing its ruling in this matter with other cases, the California district court says this particular matter is "readily distinguishable" as a case in which preliminary dismissal is appropriate.

"First, in a number of those cases, the plaintiffs therein had alleged numerous acts of wrongdoing, which, when viewed collectively, were found sufficient to state a claim," the dismissal ruling explains. "In others, there is no indication that the defendant therein submitted for the court's consideration the same type of evidence regarding revenue sharing as defendants have submitted here. To the extent the cases on which plaintiffs rely have held

> a claim for imprudence, this court is not persuaded by the reasoning therein. … Accordingly, plaintiffs fail to state an imprudence claim predicated on a comparison of share classes."

It is important to note that the Salesforce litigation plaintiffs have been granted leave to amend the flaws in their complaint, with a new filing deadline of October 23. For this reason, it is possible that the Salesforce case could be revived, but either way the lessons will still stand with respect to what it takes for plaintiffs to survive a motion to dismiss in this context.

Tagged: active management, ERISA, Fees, retirement plan litigation, revenue sharing

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CLIENT SERVICE October 8, 2020

15th Anniversary of RPAY: Pensionmark

Given the firm's forward-thinking attitude, not all that much has changed since Pensionmark was recognized as the 2013 PLANSPONSOR Multi-Office Adviser Team of the Year, apart from the size of the firm.

By Lee Barney

Since Pensionmark Financial Group won the PLANSPONSOR Multi-Office Adviser Team of the Year award in 2013, the practice's focus has largely remained the same, says Troy Hammond, founder and CEO.

"What I mean is that we have always tried to be at the forefront of many trends," Hammond says. "We started a call center in 1991 as a move towards a focus on

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Troy Hammond

participant outcomes and holistic financial wellness. I wish I had trademarked that, given how the industry has developed. Taking care of participants has been in our DNA. What is also important to us is how we deliver our service."

Another theme continued since 2013 is that Pensionmark remains an "aggregator" firm, meaning the firm is interested in bringing other independent advisers into its brand.

Hammond says that making Pensionmark an aggregator stemmed from his background in technology. It occurred to him that by leveraging collective resources, Pensionmark advisers could together serve sponsors and participants more efficiently.

"I said to myself, 'There is a better way to do this.' By building the infrastructure and scaling technology, we have been able to deliver better service to clients at a better

says.

Hammond notes that he joined Pensionmark in 1990. Between that year and 2008, Pensionmark operated as a single advisory firm with a wealth management division on the side. But in the years leading up to 2008, Hammond started exploring the possibility of becoming an aggregator by speaking to advisers about the firm's scalable infrastructure and how, by tapping into this, other advisory practices could be free to seek additional business. The reception was so strong, Hammond says, that Pensionmark started its aggregation model in 2008.

Looking back at how this has enabled the firm to grow, Hammond says the numbers are "breathtaking." In 1990, for example, Pensionmark served a mere five plans and onboarded five additional plans that year. By 2008, the practice had 100 clients. Today, Pensionmark serves 3,600 plans from 71 offices across the country. 401(k) plans remain the core business in each of these offices, but the Pensionmark network of advisers includes many specialists in such areas as cash balance plans and nonqualified plans, Hammond notes.

In terms of assets under advisement (AUA), in 1992, Pensionmark first crossed over the $1 million mark.

Hammond says.

Even this year, with the world facing the coronavirus pandemic and so many businesses being locked down, Hammond notes, Pensionmark attracted five new offices in the second quarter. Hammond believes that more advisory practices realize the value of joining an aggregator with so many resources, and the pandemic is just accelerating that trend.

“Today, we have efficiencies in every area,” Hammond says. “For example, we have a whole team of people handling investments, and within that, quantitative and qualitative specialists and people who specialize in vendor management. While our core DNA has not changed, our sub-specialization has.”

As far as Pensionmark’s relationship with strategic partners is concerned, Hammond says, one thing that really sets his firm apart from other aggregators is that it takes no soft dollars from other service providers. Rather, Hammond says, because his practice has nearly $50 billion in AUA, Pensionmark operates from a position of great strength to be able to negotiate better prices from investment managers, recordkeepers and third-party administrators (TPAs) for its clients.

“We offer something many other advisers

and can have much better conversations with them than smaller companies can. As a result, we can bring in a target-date fund or a recordkeeper in five basis points lower. Leveraging those relationships not only to get better prices, but better services, is a big part of what we do."

As to how the industry has evolved since 2013, when Pensionmark won the PLANSPONSOR award, Hammond says there has been consolidation in all areas of the business—be it among asset management firms, recordkeepers or advisers.

Hammond believes the fee compression that has affected all of the players in the retirement plan industry has prompted companies to look for additional ways to generate revenue, and that this has only made fee compression worse.

"Everyone doing everything is a little much, and this also creates confusion for plan sponsors," he warns.

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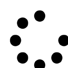

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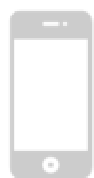
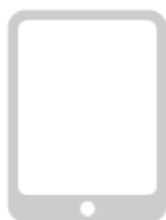

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