Case No. 22-4045

UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

COLE MATNEY, et al., *Plaintiffs-Appellees*,

v.

BARRICK GOLD OF NORTH AMERICA, et al., *Defendants-Appellants*.

On Appeal from the United States District Court for the District of Utah,
The Hon. Tena Campbell presiding, Case No. 2:20-CV-00275-TC

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

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CORPORATE DISCLOSURE STATEMENT OF *AMICUS CURIAE*
FRAP RULE 26.1

Pursuant to Federal Rule of Appellate Procedure 26.1, *amicus* the Investment Company Institute states that it is a nonprofit organization, has no parent companies, and has not issued shares of stock.

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IDENTITY AND INTEREST OF *AMICUS*

The Investment Company Institute (ICI) is the leading association representing regulated investment funds. ICI's mission is to strengthen the foundation of the asset management industry for the ultimate benefit of the long-term individual investor. Its members include mutual funds, exchange-traded funds, closed-end funds, and unit investment trusts in the United States, as well as investment advisers to regulated investment funds and other professionally managed products. Its members manage total assets of $26.8 trillion in the United States, serving more than 100 million investors.

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 2022, an estimated 64.2 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 and Shareholder Sentiment, 2022*, 28 ICI Rsch. Perspective 9, at 10 (2022), https://www.ici.org/system/files/2022-10/per28-09.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 Appellants' proposed application of the Supreme Court's recent decision in *Hughes v. Northwestern University*, and the decisions of courts that effectively lower the pleading standards for excessive fee litigation in their jurisdictions. ICI is also able to explain how Appellants' 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 would 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 District Court's decision.

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All parties have consented to the filing of this amicus brief. No party's counsel authored this brief in whole or in part, and no party, party's counsel, or other person contributed money intended to fund the preparation or submission of this brief.

SUMMARY OF ARGUMENT

Defined contribution plans are crucial retirement savings vehicles for American workers, and the only way many employees access the investment markets. The adoption of incorrect pleading standards causes plan administrators/fiduciaries, in an attempt to avoid ERISA litigation, to defensively adopt bright-line rules that exclude many classes of investments from plan investment lineups, to the detriment of plan participants.

Appellants' focus on comparing plan funds' published expense ratios to supposed alternatives ignores applicable fee credits that reduce costs for investors. But ERISA requires fiduciaries to consider the all-in costs to investors, as well as other factors such as diversification and returns, when selecting plan investment menus. There are good reasons why fiduciaries might include actively managed funds and higher-cost share classes rather than limit plan options to index funds, "institutional" share classes, or CITs, even if these other options have lower published expense ratios. Appellants' allegations ignore 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 disregard the cost-sharing mechanisms of ostensibly higher-cost share classes that often make them a reasonable choice as a way to "defray[] reasonable expenses of administering the plan." 29 U.S.C. § 1104(a)(1)(A)(ii). As the Supreme Court

confirmed in *Hughes v. Northwestern University*, ERISA does not prescribe a bright-line rule, but affords fiduciaries significant discretion to not only select an appropriate mix of investment options for participants, but to structure the plan in a way that fairly and efficiently provides for payment of third-party services (such as recordkeeping fees).

Appellants' urged pleading standard would effectively limit options for plans and participants, to the detriment of employees whom Congress sought to benefit and protect. If Appellants can plead a breach of the duty of prudence by merely observing that a menu includes funds with share classes or actively managed funds that apparently carry higher fees than Appellants' proposed alternatives, plan fiduciaries will feel the need to exclude those funds or share classes just to reduce litigation risk. But so limiting the plan's investment menu ultimately disadvantages participants by stripping them of the investment choices they need to build a retirement portfolio that best reflects their individual circumstances, including risk tolerance, desire to manage their own portfolio, closeness to retirement, or any number of other factors.

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, Appellants' arguments, if adopted by courts, will ultimately harm the employees that Congress sought to benefit and protect.

ARGUMENT

I. THE *HUGHES* DECISION REAFFIRMED THE CENTRAL PRINCIPLE THAT "COURTS MUST GIVE DUE REGARD TO THE RANGE OF REASONABLE JUDGMENTS A FIDUCIARY MAY MAKE" IN CARRYING OUT HIS OR HER DUTIES

Appellants mistakenly assert that the Supreme Court's recent decision in *Hughes v. Northwestern University*, 142 S. Ct. 737 (2022), "represents a change in the controlling law" that the District Court failed to follow. Br. 26 (cleaned up). That contention rests on the faulty premise that *Hughes* "set forth" a new "pleading standard"—which Appellants assert repeatedly—but the Court neither articulated a pleading standard nor endorsed any particular set of allegations as being sufficient to state a claim for breach of fiduciary duty. *See id.* at 8, 24–28*; Hughes*, 142 S. Ct. at 741–42. Instead, the Court merely rejected the Seventh Circuit's categorical rule that foreclosed duty of prudence claims if the plan offered a variety of investment options. *Hughes*, 142 S. Ct. at 741–42. In rejecting that approach, the Court reasoned that such a categorical rule fails to ensure that plan fiduciaries "monitor investments and remove imprudent ones," as required by *Tibble v. Edison International*, 575 U.S. 523, 530 (2015). Because the Seventh Circuit's decision

had relied on the categorical rule, the Supreme Court vacated the judgment, but it did not hold that plaintiffs' complaint was adequate. Rather, the Supreme Court remanded so the Seventh Circuit could reevaluate plaintiffs' duty of prudence allegations in light of *Tibble* and under the pleading standard of *Ashcroft v. Iqbal*, 556 U.S. 662 (2009), and *Bell Atlantic Corporation v. Twombly*, 550 U.S. 544 (2007).

Critically, the Supreme Court rejected not only the defendant-friendly categorical rule the Seventh Circuit had adopted, but also other categorical rules, including the plaintiff-friendly categorical approach advocated by Appellants. The Court stressed that, "[b]ecause the content of the duty of prudence turns on the circumstances . . . prevailing at the time the fiduciary acts . . . , the appropriate inquiry will necessarily be context specific." *Hughes*, 142 S. Ct. at 742 (quoting *Fifth Third Bancorp v. Dudenhoeffer*, 573 U. S. 409, 425 (2014)) (internal citation and quotations marks omitted). The Court then reminded lower courts that "[a]t times, the circumstances facing an ERISA fiduciary will implicate difficult tradeoffs, and courts must give due regard to the range of reasonable judgments a fiduciary may make based on her experience and expertise." *Id*. Appellants' position that *Hughes* proffered a plaintiff-friendly bright-line "pleading standard" is simply incorrect.

Since *Hughes*, numerous circuit courts have recognized the inquiry's context-specific nature (as has traditionally applied under ERISA and as confirmed by *Hughes*) and held that plaintiffs do not plausibly state a claim for fiduciary breach merely by alleging that lower-cost or better-performing options were available. *See Smith v. CommonSpirit Health*, 37 F.4th 1160, 1164 (6th Cir. 2022) (noting that a court's assessment of fiduciary breach allegations "requires 'careful, context-sensitive scrutiny of a complaint's allegations' in order to 'divide the plausible sheep from the meritless goats.'" (quoting *Dudenhoeffer*, 573 at 425)); *Albert v. Oshkosh Corp.*, 47 F.4th 570, 577 (7th Cir. 2022); *Matousek v. Midamerican Energy Co.*, 51 F.4th 274, 278–83 (8th Cir. 2022). For alternative investments to show plan funds' "costs are too high, or returns are too low," plaintiffs "must provide a sound basis for comparison—a meaningful benchmark." *Davis v. Washington Univ. in St. Louis*, 960 F.3d 478, 484 (8th Cir. 2020). Indeed, "no court has said ERISA *requires* . . . 'every fiduciary to scour the market to find and offer the cheapest possible fund (which might of course, be plagued by other problems),'" *Oshkosh* 47 F.4th at 581 (quoting *Hecker v. Deere & Co*, 556 F.3d 575, 585 (7th Cir. 2009)), and *Hughes* did not "impose such a requirement," *id.* (citing *Hughes*, 142 S. Ct. at 742).

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

Appellants argue that including mutual fund share classes that allegedly had higher expense ratios than various alternative share classes or investments was inherently imprudent and, standing alone, allows their lawsuit to proceed. *See* Br. 32–38. Appellants' one-dimensional focus on expense-ratio comparisons between different share classes and investment vehicles is mistaken, misleading, and fails to recognize the critical decision-making role fiduciaries are charged with under ERISA in choosing plan investments. Appellants ignore a host of reasons why plan fiduciaries might rationally and beneficially include investment options other than the lowest-cost share class or vehicle.

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

ERISA's fundamental design affords 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 Op. 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 selecting and monitoring a variety of investment options for plan participants who vary widely in terms of sophistication, investment objectives, and risk tolerances. Under ERISA

fiduciary standards therefore, the "prudent" approach is to offer diverse investment options to minimize the risk of large losses unless it is clearly imprudent to do so. In incorporating a statutory safe harbor under ERISA Section 404(c), 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.[1]

Fiduciaries of participant-directed individual account plans—not the courts—are best positioned to evaluate the appropriate number, variety, and type of investment options for 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:*

[1] The Department of Labor (DOL) has indicated that even broader investment exposure (*i.e.*, to alternative assets) may be in compliance with ERISA's fiduciary duties. U.S. Dep't of Lab., Info. Letter (June 3, 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).

Creating Value for Stockholders 35 (1998), courts and the DOL historically have deferred to decisions made by a plan fiduciary so long as they followed a reasonable process in making that 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").

Appellants 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 published expense ratios or been "court-approved" by prior litigation. Such an outcome ignores other important factors a fiduciary should consider in selecting an investment menu beyond fees or expense ratios.

B. Appellants' Condemnation of Appellees' Selection of R5 Share Classes of Funds Instead of R6 Share Classes Ignores Well Established Recordkeeping Fee Practices.

Appellants' argument that it was imprudent for Appellees to include the R5 share classes of funds where ostensibly lower-cost R6 share classes were available, simply because the R5 share classes have (purportedly) higher expense ratios, overlooks (i) how the fees associated with plan recordkeeping are paid and thus the actual all-in cost for a given share class; and (ii) the broader context of how a fiduciary negotiates with investment companies and their recordkeeping affiliates

to make available a diverse menu of investment options and to provide other services necessary to the administration of the plan.

1. Appellants incorrectly focus on the published expense ratio and ignore the actual "all-in" expense for shareholders.

The total fees paid for investment in the share class of a fund are referred to as the "expense ratio" for that share class. Appellants incorrectly focus on the published expense ratio of the R5 share classes rather than the net amount borne by participants—the true expense ratio. Their position ignores the fact that plan fiduciaries may intentionally select share classes with higher published expense ratios because the fiduciaries will be able to obtain a credit through revenue sharing arrangements to cover certain plan administration costs, which is more favorable to participants on a net basis. According to a recent survey, among plans that utilize revenue sharing, 48.5 percent credit these amounts back to participant accounts periodically. Plan Sponsor Council of Am., *64th Annual Survey of Profit Sharing and 401(k) Plans* (2021).

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 plan's day-to-day operation, 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.

Plan sponsors often consider what are commonly referred to as "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.ici.org/system/files/attachments/rpt_14_dc_401k_fee_study.pdf. Because administrative fees must be covered regardless of the investment menu's makeup, a prudent plan fiduciary understands that the published expense ratio is not singularly determinative of whether a given investment option is the most economical—much less whether it is prudent overall. Instead, when evaluating different share classes of the same fund, a fiduciary looks to "context-specific" factors, including the true net expense ratio that will be borne by plan participants after netting credits available through revenue sharing. Whether labeled "R5," "R6," "institutional," "retail," or "retirement (R)," different share classes may,

among other things, provide the option of offsetting third-party administrative expenses through revenue sharing. *See* Plan Advisor, "Revenue Sharing Considerations: Fees and Fiduciary" (Apr. 4, 2022), https://www.planadviser.com/revenue-sharing-considerations-fees-fiduciary. But share classes with higher published expense ratios can generate more revenue sharing, which in turn can defray recordkeeping costs to the plan participants' benefit.

While details of plan sponsors' revenue sharing arrangements are not publicly available as a general matter, evidence demonstrates that retail share classes can be comparable to—and, indeed, in some cases net cheaper than—institutional share classes once the revenue sharing rebates are taken into account. For example, in support of their motion to dismiss, defendants in *Parmer v. Land O'Lakes, Incorporated* 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 Supp. of Defs.' Mot. to Dismiss at 5–7, *Parmer v. Land O'Lakes, Inc.*, No. 20-01253 (D. Minn. Oct. 9, 2020). There, plaintiffs complained that defendants selected the Investor share class of the T. Rowe Price 2005 fund (0.53 percent fee), instead of the I-Class shares of the same fund (0.41 percent fee). However, once the revenue sharing arrangement was

considered, the overall net fees were 0.03 percent lower in the Investor class. *See id.* at 6.

Consistent with *Parmer* and the evidence referenced above, the District Court record here establishes that the JPMorgan R5 share classes selected by Appellees and offered by the plan in fact cost *less* than Appellants' proposed R6 share classes. Specifically, the plan's publicly filed 5500 Forms show that the JPMorgan R5 share classes receive a 15 basis point revenue credit which the Master Trust Agreement attributes to the plan's revenue sharing arrangement. Supp. App. Vol. I at 128; Vol. II at 314–17. When that credit is properly netted against the R5 share class's published expense ratio, the plan participants' all-in cost is lower than the R6 share class's in every case.

These examples illustrate precisely why 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. There is no standard methodology for capturing revenue sharing's impact since the amount and way it is used vary across plans and recordkeepers. *See* Fred Reish, *The Equitable Allocation of Revenue Sharing to Participants*, Am. Soc'y. of Pension Prof'ls & Actuaries (last visited Nov. 6, 2022), https://www.asppa.org/sites/asppa.org/files/The-Equitable-Allocation-of-Rev-Sharing%20%281%29.pdf. Notably, while Appellants—like numerous other

plaintiffs in excessive fee lawsuits—ignore the effects of revenue sharing for purposes of their complaint, plaintiffs in other fiduciary breach complaints have recently alleged in effect that it is imprudent *not* to select funds utilizing revenue sharing when doing so would yield the lowest net investment expense. *See*, *e.g.*, Compl. ¶¶ 154, 170–185, *Reichert v. Juniper Networks, Inc.*, No. 21-06213 (N.D. Cal. Aug. 11, 2021); Am. Compl. ¶¶ 136–167, *Bangalore* v. *Froedtert Health, Inc.*, No. 20-00893 (E.D. Wis. Sept. 10, 2020); Am. Compl. ¶¶ 130–168, *Albert* v. *Oshkosh Corp.*, 20-00901 (E.D. Wis. Aug. 31, 2020). The fact that some plaintiffs acknowledge the value of share classes providing revenue sharing, while other plaintiffs categorically deny the prudence of including them, strongly suggests that, contrary to either categorical position, 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 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. Absent 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.[2] In

[2] The latter scenario would be wholly inconsistent with Congressional efforts in recent years to promote retirement savings by American workers. *See*, *e.g.*, H.R. 2954, 117th Cong. (2022) (the "Securing a Strong Retirement Act of 2022")

fact, plans are increasingly charging recordkeeping fees directly to plan participants. *See* Deloitte Consulting LLP, *2019 Defined Contribution Benchmarking Survey Report*, at 20, https://www2.deloitte.com/content/dam/Deloitte/us/Documents/human-capital/us-2019-defined-contribution-benchmarking.pdf.

In response to the 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, down from 50 percent in 2015. *See id.* 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 percent. *See id*. at 20, Ex. 7.2. As these figures indicate, a pleading standard that dissuades plan fiduciaries from selecting an otherwise acceptable method for covering plan administrative expenses will likely

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(requiring employers with new defined contribution retirement plans to automatically enroll newly hired employees, upon becoming eligible, and providing various tax credits to small businesses to encourage them to offer a retirement savings plan to their workers); and S. 2370, 116th Cong. (2019) (the "Automatic IRA Act of 2019") (sought to "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").

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 plan fiduciaries make investment decisions for the exclusive purposes of providing benefits to participants and defraying reasonable plan expenses, and that administrative decisions be made by each plan's fiduciaries individually, based on their particular circumstances. 29 U.S.C. § 1104(a)(1).

2. Restricting plans to offering only shares in certain classes could unnecessarily limit investment options.

Drawing a bright line rule about selecting share classes with lower published expense ratios over other share classes could narrow investment options in other ways. For a given fund that offers both retail and institutional share classes, for example, 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/how-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). *Id.* By contrast, most retail mutual funds require a minimum initial investment of between $500 to $5,000, and there are some with no minimums. *See* Cory Mitchell, *Minimum Investment: What Is a Minimum*

Investment, Investopedia (June 22, 2022), https://www.investopedia.com/terms/m/minimum_investment.asp. As the JPMorgan Funds Prospectus reveals, there is no minimum investment requirement for the R5 share classes, while investors seeking to establish an account in the R6 share classes must meet a $5,000,000 to $15,000,000 minimum investment requirement depending on the type of account. Supp. App. Vol. II at 475.

If fiduciaries can only select higher-minimum balance share classes over lower-minimum balance share classes, then they could be compelled to limit the designated investment options—effectively funneling participants' retirement assets into fewer funds to meet the institutional share class's investment minimum. To meet investment minimums, plan fiduciaries would also likely cease offering less popular types of funds—such as those targeting specific market sectors. 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, would be unable to do so. Such narrowing of investment options and limiting of 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 a particular share class, such as institutional. Having a rule that focuses on

categories of share classes (such as institutional versus retail), as opposed to what is best for plan participants based on all factors, 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 2019 (the most recent year analyzed) 55.8 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, 2019*, at 7 (Sept. 2022), https://www.ici.org/system/files/2022-09/22_ppr_dcplan_profile_401k.pdf.

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

In arguing that Appellees failed to adequately consider lower-cost, better-performing alternative investments, Appellants focus in particular on passively managed index funds, Br. 41–46, but Appellants ignore the entirely legitimate reasons a fiduciary might prudently include other types of funds in a plan's offerings. Appellants' theory implies that plan fiduciaries should be deemed to have acted imprudently simply by selecting an actively managed fund when a lower-cost index fund was available in the same asset class. If that position were adopted, alternative investments, actively and semi-actively managed investments, emerging market funds, 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—all of which typically have higher expense ratios than index funds given the greater managerial effort required—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 DOL has recently confirmed that alternative investments may be offered by defined contribution plan fiduciaries. *See* U.S. Dep't of Lab., Info. Letter (June 3, 2020), https://www.dol.gov/agencies/ebsa/about-ebsa/our-activities/resource-center/information-letters/06-03-2020; U.S. Dep't of Lab., Supplement Statement on Private Equity in Defined Contribution Plan Designated Investment Alternatives (Dec. 21, 2021), https://www.dol.gov/agencies/ebsa/about-ebsa/our-activities/resource-center/information-letters/06-03-2020-supplemental-statement. And for good reason.

Actively managed mutual funds help 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. When comparing investment options, fiduciaries consider net investment performance—total returns minus fees and expenses—rather than cost alone. ICI's research reveals that the ten largest actively managed funds' three-, five-, and ten-year annualized net returns (after fees and expenses) were nearly identical to those of the ten largest index funds at

the same intervals. In fact, the actively managed funds' average net returns (after fees and expenses) 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/. Internal ICI analysis indicates that these results hold using data updated through September 2022. Second, 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. *Id*. Given that the active funds' net returns can match or exceed index funds', there is simply no basis for categorically labeling active funds as imprudent. Such a presumptive approach is not merely overly simplistic, it is fundamentally misguided.[3]

[3] Appellants claim that the ostensibly lower-cost alternative funds with the "same investment style" as the plan funds should have been offered because they "also had better performances than the Plan's funds in their 3 and 5 year average returns as of June 2020." Br. 14. But plaintiffs in ERISA fiduciary breach suits should not be permitted to cherry pick the time frame used to assess performance of investments in a given portfolio. For example, the SEC Office of Investor Education and Advocacy Investor Bulletin: How to Read a Prospectus encourages investors to "[p]ay close attention to the fund's 5- and 10-year returns. If the fund's returns were stellar in the past year but unimpressive in the past five or 10

Finally, including actively managed options in a plan lineup assures participants greater choice and flexibility in designing a portfolio that suits their investment profile, needs, and risk tolerance. Certain investment categories, such as emerging markets and small-cap growth stocks, have few index mutual funds available on the market. If litigation risk effectively excludes actively managed funds from retirement plan lineups, it may be difficult for participants to gain exposure to these beneficial asset classes in their retirement savings. Certain options are by their nature 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, as the *Hughes* opinion observed, on the particular circumstances. But, as fee-related litigation in the defined contribution plan space has proliferated over the last decade, some fiduciaries have, as a defensive measure, 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*, Ctr. for

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years (or over the life of the fund, if shorter), it is possible that the past year's outperformance will not last." SEC, "Investor Bulletin: How to Read a Mutual Fund Shareholder Report," at 4, https://www.sec.gov/files/ib_readmfreport.pdf.

Ret. Rsch., at 5 (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/). In other words, allowing complaints that are based on erroneous categorical premises about purportedly "good" and "bad" funds to survive the pleading stage has real-world consequences that can limit plan participants' investment options.

D. A Categorical Rule Requiring Sponsors to Identify and Select CITs Over Mutual Funds Would Be Inappropriate.

Appellants assert that it was imprudent to include mutual funds in the plan rather than collective investment trusts ("CITs") with similar investment objectives, because CITs offered lower expense ratios and were otherwise identical to the selected mutual funds. The assumed premise of this argument—that mutual funds and CITs are interchangeable investment products available to plan sponsors, varying only in cost—is simply incorrect, and there is no basis for a court to credit the assertion that CITs are presumptively more prudent investment options simply because they may have a lower published expense ratio than an allegedly similar mutual fund.

For starters, there are far more mutual funds offered in the marketplace than CITs, and many mutual funds do not have equivalent CITs offered by their sponsors. Thus, plan fiduciaries will frequently have no choice between a mutual

fund and a comparable CIT when selecting a plan menu option featuring desired investment style and asset class exposure.

Even where roughly analogous CIT and mutual funds are available in a desired investment style and asset class, there may frequently be practical barriers to the plan including the CIT as an option. For example, many CITs feature high minimum investment thresholds that would be out of reach for any but the very largest plans. By contrast, mutual funds—and especially the "R" share classes geared towards retirement plans—do not present this barrier to entry.

Moreover, when a plan might be able to select between equivalent mutual funds and CITs, while also meeting CIT minimum investment thresholds, numerous valid considerations could lead a prudent fiduciary to select a mutual fund over a CIT—even if the CIT featured a lower published expense ratio. For one, CITs typically do not offer revenue sharing. As discussed above, the offset of administrative costs available via mutual fund revenue sharing arrangements might result in the mutual fund option having a lower net expense ratio than the CIT option. Indeed, as the record below establishes, once the applicable revenue share credits are applied to the published expense ratio of the mutual funds, the mutual funds offered here have a *lower all-in cost* than the JPM and Fidelity CITs proposed by Appellants. *See* Appellees' Br. 27–29.

Separately, given the huge number of mutual funds offered in the market, and the mutual fund-specific disclosure requirements under the Investment Company Act of 1940 and SEC rules (which do not apply to CITs), much more market comparison data is readily available for mutual funds than for CITs (including rankings and ratings published by third-party service providers like Morningstar). Plan fiduciaries may prefer to offer investment options that they can more easily research.

Further, mutual funds can offer greater flexibility for individual plan participants in some situations. CITs may only be held in qualified retirement plans, whereas mutual fund shares can also be held by individuals in other types of accounts. It is common practice for employees to "roll over" their retirement plan investments into Individual Retirement Accounts (IRAs), especially when switching employers. ICI, *The Role of IRAs in US Households' Saving for Retirement, 2021*, 28 ICI Rsch. Perspective 1, at 1 (2022), https://www.ici.org/system/files/2022-01/per28-01.pdf ("57 percent of traditional IRA–owning households indicated that their IRAs contained rollovers from employer-sponsored retirement plans."). If a plan participant seeks to "roll over" investments held in their 401(k) plan to an IRA, any CIT holdings must be liquidated (to the potential detriment of the participant), whereas mutual fund holdings under certain circumstances may simply be transferred into the IRA without being liquidated.

This participant flexibility may be seen by plan fiduciaries as an additional benefit to offering mutual funds rather than equivalent CITs.

III. APPELLANTS' BENCHMARKING ALLEGATIONS ARE UNFOUNDED AND HAVE IN ANY EVENT BEEN DEEMED INSUFFICIENT AT THE PLEADING STAGE BY OTHER COURTS

In an attempt to support their allegations, Appellants purport to benchmark the fees of plan funds against the fees of two different sets of supposed comparator funds, asserting that both comparator sets have median fees lower than the relevant plan funds. But neither proposed set provides an apt comparator, as they are comprised of broad sets of funds in loosely similar asset classes but representing widely ranging management styles.

First, Appellants invoke data from a report published by ICI and BrightScope, a financial information company. *See* Supp. App. Vol. II at 551 (the "ICI Study"). Appellants argue that "several funds during the Class Period were more expensive than comparable funds," App. Vol. I at 114, and offer a chart comparing the expense ratios of various funds to the supposed "ICI Median" expense ratio for funds in the "same category," *id.* at 114–15. Using the ICI Study (of which *amicus* was a joint author) in this manner is improper. Nowhere does the ICI Study state or imply that the broad investment style categories referenced in the study (*e.g.*, "Domestic Equity," "Non-target date balanced," "Int'l Equity," "Money Market," *see id.*) are proper benchmarking measures or that funds within a

style category should all have similar fees. To the contrary, ICI expressly cautioned that the expense ratios applicable to funds within any "investment category" may vary based on, for example, whether they are actively or passively managed and the extent to which they invest in small-cap, mid-cap, or emerging market stocks. *See* Supp. App. Vol. II at 609. As discussed above, fund style characteristics as divergent as, for example, active management versus passive indexing, make for different investment products, value propositions for investors, and cost structures. Thus, "it is important to examine different points in the distribution of expenses to understand the range of mutual fund expenses paid in 401(k) plans." *Id.* Generally alleging that the funds are "comparable" and using such broad investment style categories as a benchmark is nothing but an unproductive apples-to-fruit salad comparison.

Appellants' other purported benchmark comparator is a similarly divergent set of 16 passively or actively managed funds that Appellants appear to have hand-picked without basis other than their ostensibly lower expense ratios. *See* App. Vol. I at 126–28. Appellants assert, *without more*, that the 16 alternative funds have the "same investment style," *id.* at 126 n.13, despite often facially different investment strategies employed by the plan funds as compared to the proposed alternative funds. *See id.* at 126–28 (comparing, *e.g.*, diversified international fund

to growth international fund and opportunity institutional fund to small cap value fund).

Recognizing the need for apt comparators, other courts, including the Eighth Circuit, have consistently held that alleging that funds with lower fees have the "same investment style" or "materially similar characteristics" as plan funds does not state a claim for relief. *Anderson v. Intel Corp. Inv. Pol'y Comm.*, 579 F. Supp. 3d 1133, 1152 (N.D. Cal. 2022) (quoting *Davis v. Salesforce.com, Inc.*, 2020 WL 5893405, at *4 (N.D. Cal. Oct. 5, 2020)); *Matousek*, 51 F.4th at 281 (Plaintiffs' "peer-group performance comparisons" fall short of a "meaningful benchmark" because "the composition of the peer groups remains a mystery"). For example, the district court in *Anderson* recognized the need to identify suitable and meaningful benchmarks to survive a motion to dismiss. The court held that plaintiffs' amended complaint failed to "provide factual allegations explaining why their chosen benchmarks are 'meaningful' benchmarks that have similar aims, risks, and rewards as the Intel target date funds." *Anderson*, 579 F. Supp. 3d at 1150. Rather than describing why the target date funds at issue had similar aims, risks, and rewards as the comparators they chose, plaintiffs alleged only their conclusion that these comparators were "common." *Id*. The plaintiffs merely identified goals and features that were common to *all* target date funds; they did not detail the investment strategies, glidepaths, and fees of any specific target date funds with the

same target date as the plan's target date funds. *Id*. As a result, the district court held that plaintiffs' allegations failed to identify meaningful benchmarks and were insufficient therefore to state a claim for relief. *Id*. at 1152.

This stands to reason. Without well-pled allegations about meaningful benchmarks, a court cannot evaluate whether an allegation of a violation of the duty of prudence is plausible. "After all, . . . the key to stating a plausible excessive-fees claim is to make a like-for-like comparison." *Matousek*, 51 F.4th at 279 (citing *Davis*, 960 F.3d at 485). Appellants' generic allegations that the plan funds are "comparable" to the ICI Study funds or of the "same investment style" as the 16 alternative funds fall well short of plausibly alleging a true "like-for-like comparison."

CONCLUSION

For the foregoing reasons, the judgment of the District Court for the District of Utah should be affirmed.

Respectfully submitted,

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