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What We Can Learn from the Anthem Settlement

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The recent settlement of the Anthem class action lawsuit (Bell v. ATH Holding Company, LLC) reflects some trends in 401(k) litigation: the focus on share classes, arguments to support inclusion of non-mutual fund investments in defined contribution plans and developments in monitoring service providers.

The suit against Anthem and its fiduciary plan committee alleged that, among other issues, they selected overly expensive share classes (considering what was available to a multi-billion dollar plan). The case was recently settled for $23,650,000 and for certain nonmonetary conditions. In this piece, we review and comment on the nonmonetary conditions.

The Complaint

The complaint contains allegations about the investments and recordkeeping costs, but the more striking allegations regard the investments:

- All but two of the plan’s investment alternatives were in Vanguard mutual funds. Though Vanguard funds have often been cited by plaintiffs as exemplifying low-priced investments, in this case the plaintiffs alleged that the committee should have selected even less expensive share classes. Two examples: the plan was using a Vanguard Institutional Index Fund with a 4-basis-point fee, but a 2 bps share class was allegedly available; and the plan offered the Vanguard Extended Market Index Fund, which charged 24 bps, while there was a 6 bps share class allegedly available.

- The plaintiffs didn’t stop there. They alleged that collective trusts and separately managed accounts were available that were even cheaper ... and that those less expensive but virtually identical investments should have been used.

In other words, as in other similar cases, the plaintiffs here argued that the plan committee had to seek the lowest-cost share classes available to the plan regardless of other relevant factors. They also argued that the committee needed to investigate whether the plan had access to reasonably similar collective trusts or separately managed accounts that would have been cheaper still. The message plaintiffs are sending to plan committees and their advisors is that—in the plaintiffs’ view—the lowest cost rules, and, in pursuit of this, the investment search obligation has evolved beyond mutual funds.

The Settlement

While the monetary settlement was quite large, there were also several “Nonmonetary Terms”:

- The committee must engage an independent investment consultant who is experienced with investment options in defined contribution plans. The consultant must review and make recommendations about the plan’s investment lineup, including whether to include a stable value option.

- The committee must meet and review the investment consultant’s recommendations and decide whether and to what extent to implement them.

- The committee must consider, with the assistance of the investment consultant, among other things, (1) the lowest-cost share class mutual funds available to the Plan; (2) the availability of revenue-sharing rebates; and (3) the availability of collective trusts and/or separately managed accounts that have risks and features similar to those of a mutual fund.

- After the committee’s consideration of the recommendations, it must provide the plaintiffs’ class-action attorneys with a written summary of the recommendations and the committee’s decisions. (This means that the plaintiffs’ attorneys will oversee the implementation of the settlement agreement for a three-year period, which is unusual in 401(k) plan litigation.)

- The committee must also issue an RFP for record keeping services for the plan. The responses from the record keepers must include a fee proposal “based on a total fixed fee and on a per-participant basis.” Again, the committee’s decision must be communicated to the plaintiffs’ attorneys, though only during an 18-month period.

Breaking Down the Settlement

So what does the settlement show us? Here are our key observations:

- There is a continued emphasis by plaintiffs on low-cost share classes, without regard to other factors that a committee is entitled to consider, such as the availability of revenue sharing that could produce a lower net cost to participants.
In addition, there is a new push toward the use of even less expensive collective trusts and separately managed accounts, despite the fact that low cost is not the only factor that committees should consider. Although institutional class mutual funds, collective trusts, and separately managed accounts may be readily available to larger plans, smaller plans may not have access to all of these lower-cost investments. That said, we are beginning to see movement away from mutual funds and into collective trusts for mid-sized and even smaller plans. (In fact, that’s how stable value funds are often offered to small plans.)

- We see a preference among plaintiffs (or at least plaintiffs’ lawyers) for setting record keeping fees on a per-participant rather than pro rata basis. Their argument seems to be that this results in a fee that more accurately reflects the costs for the services and that the fee does not automatically grow with increases in the value of assets or with new contributions. (Their argument of how a record keeper’s fee is determined—e.g., a fixed dollar amount per participant—does not necessarily extend to how the fee must be allocated among participant accounts. The allocation of the fee might be done on a pro rata basis.) This position has gained some traction among plaintiffs despite the fact that there is no statutory or regulatory guidance requiring per-participant fees.

- It also is clear that plaintiffs’ attorneys prefer that plans avoid investments with revenue sharing or that, if there is revenue sharing, it should be paid into the accounts of the participants whose accounts generated the revenue sharing. In any case, their positions continue to focus on transparency by providers and scrutiny by plan committees.

Conclusion

Plan committees and their advisors should resist the temptation to dismiss the Anthem allegations and settlement as applying only to large plans. Instead, they need to consider that the case illustrates possible trends that the plaintiffs’ bar is asserting about the fiduciary processes that plan committees need to follow … or proceed at their peril. They need to be aware of the costs of both services and investments and weigh the impact on participants. Since plan committees may not be aware of all the alternatives and may lack the resources to gather relevant information and make decisions, they should consider obtaining professional advice from advisors that have worked with plans similar to theirs. And these advisors should consider the benefit to themselves and their clients of taking on a fiduciary role.