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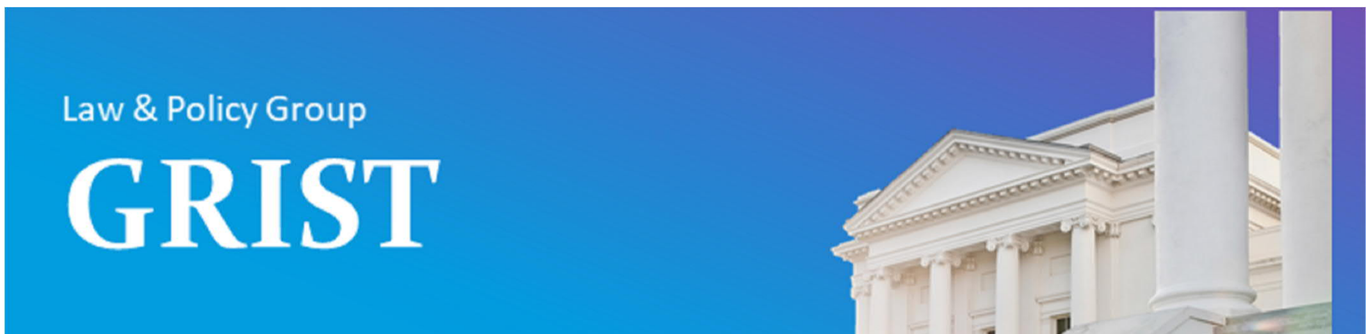

Fidelity wins dismissal of ERISA lawsuit over 'infrastructure fees'

By Mercer's Ellen Stone, Margaret Berger and Brian Kearney
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Fidelity has won a dismissal of a class action brought by 401(k) plan participants over "infrastructure fees" charged to third-party mutual funds on the company's investment platform (In re Fidelity ERISA Fee Litig., No. 19-10335 (Feb. 14, 2020)). The plaintiffs alleged the company's imposition of the fees violates ERISA's fiduciary-duty rules. But the court dismissed all claims after finding Fidelity didn't act in a fiduciary capacity when setting the fees. The plaintiffs have appealed the court's decision in this case, which consolidates three lawsuits making similar claims against Fidelity.

Infrastructure fees disputed

Fidelity describes the infrastructure fee as compensation for the cost of maintaining its "FundsNetwork" investment platform. Fidelity negotiates with mutual fund managers to set the fee, which is a fixed amount based on the mutual fund's assets under management, offset by other revenue Fidelity receives from the fund.

The plaintiffs claimed the fee bears no relation to Fidelity's cost for maintaining its platform, but instead is a "pay-to-play" charge for access to the company's retirement plan investors, who ultimately pay the cost through higher investment fees. The plaintiffs alleged the infrastructure fee's true purpose is to make up for lost revenue-sharing income at a time when investors prefer low-cost, passive investments like index funds. For purposes of the motion to dismiss, Fidelity conceded the fee is designed to make up for lost revenue-sharing. However, the company maintained that the fee is a properly negotiated, arms-length payment for Fidelity's services.

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Court finds Fidelity isn't a fiduciary

The plaintiffs claimed Fidelity breached its fiduciary duties by imposing the infrastructure fees. But this claim can only be valid if Fidelity acts in a fiduciary capacity. Under ERISA, individuals act in a fiduciary capacity to the extent they exercise any discretionary authority or control over the management of a plan or its assets. The plaintiffs proposed three theories to support their claim that Fidelity was a fiduciary — and the court rejected all three:

- Discretion in setting compensation. The plaintiffs claimed Fidelity acted as a fiduciary when it negotiated the infrastructure fees with mutual fund managers. A service provider with unilateral authority to determine its fees can act in a fiduciary capacity when setting its compensation. But when a service provider negotiates its fee — as Fidelity did — courts have held that the provider acts in its own interest and is not a fiduciary for the plan.

- Control over participants' accounts. The plaintiffs also claimed Fidelity exercised control over the omnibus accounts that hold the plans' assets and through which Fidelity executes all trades and maintains all investments. But the plaintiffs made no claim that Fidelity failed to follow instructions from plan participants and administrators or improperly redirected investments to mutual funds that were subject to infrastructure fees. Instead, Fidelity acted as a "directed trustee," which by definition lacks the discretion and control that ERISA requires for fiduciary status.

- Control over investment menu. The court rejected the plaintiffs' claim that Fidelity's control over the menu of investment options available to plans makes the company a fiduciary. The contracts between Fidelity and plan sponsors make clear that the sponsors — not Fidelity — select which investment options are available to participants. Several other courts have held that a platform provider does not become a fiduciary merely by deciding which investment options to offer plan sponsors.

ERISA disclosure claim unaddressed

The plaintiffs also alleged Fidelity mischaracterized the infrastructure fees to avoid having to disclose them to retirement plan customers as indirect compensation — i.e., compensation received from sources other than the plan or sponsor — under ERISA's fee disclosure rules. The plaintiffs claimed the alleged failure to disclose the fees caused the plan to enter into a service contract that was intrinsically unreasonable — resulting in a prohibited transaction and fiduciary breach. The court dismissed this claim, stating it required at least one defendant to be a fiduciary — something the plaintiffs failed to plausibly allege. In dismissing the claim on these grounds, the court never addressed whether Fidelity violated ERISA's disclosure rules.

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- In re Fidelity ERISA Fee Litig., No. 19-10335 (Feb. 14, 2020)

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- Fidelity faces lawsuits, investigations over 401(k) fees (March 21, 2019)

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