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Goldilocks And The 3 Stable Value Fund Lawsuits

By **Samuel Block and Nancy Ross** (April 4, 2018, 11:03 AM EDT)

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Stable value fund litigation looked a lot like the Goldilocks problem. Plaintiff firms sued companies for offering stable value funds that were allegedly too risky or not risky enough, much like Goldilocks' challenge of finding porridge that was just right — not too hot or too cold.

For stable value funds, it turns out, the porridge cannot be too cold. At least that was the opinion of the First Circuit, which became the first appellate court to rule on stable value funds. The opinion in Ellis v. Fidelity Management Trust Company, issued on Feb. 21, 2018, upheld the dismissal of a claim on summary judgment that Fidelity's stable value fund was too conservative.[1]

Before analyzing the opinion, some background on stable value funds and related litigation is necessary. Virtually all companies that offer participant-directed retirement plans permit their participants to elect an income-producing, low-risk, liquid fund, such as a money market fund or a stable value fund. A stable value fund, as the name suggests, is a conservative investment option designed to provide stability, as opposed to growth.

Stable value funds have desirable features. By combining bonds and an investment wrap, participants can achieve bond-like returns without the interest-rate volatility present in bond funds. But those features do not eliminate the risk of losses, they just delay them. Indeed, a stable value fund with a longer duration is riskier than a fund with a shorter duration.

The stability-enhancing features of a stable value fund mean that, if a stable value fund invests in a bond that defaults, the value of the fund will not take an immediate tumble, but the loss will be amortized over a period of time. Over the long run, the performance of a stable value fund approaches the performance of the underlying bond portfolio, minus the expenses of maintaining the wrap coverage and administering the fund.

There is, however, no typical stable value fund. According to "How to Evaluate Stable Value Funds and Their Managers" by Andrew Apostol, "[d]ue to the varying expectations of individual plan sponsors and the range of management techniques used by their stable value managers, there is not a single style or strategy that is common across all stable value funds." For example, the plans for a Silicon Valley startup

or a hedge fund will differ. Even if both aim for stability, the participants likely have different risk targets, which will lead to different markups across stable value funds.

Even though there is no typical stable value fund, there are three typical types of lawsuits filed against fiduciaries offering stable value funds. Fiduciaries have been sued for (1) offering a stable value fund that is too risky and (2) offering a stable value fund that is not risky enough. Considering the litigation risks, a fiduciary may conclude the best option is not to offer a stable value fund at all. Yet fiduciaries have also been sued for (3) not offering a stable value fund.

Let's take a deeper dive into these three bears of a lawsuit.

1. **Too Risky:** Plaintiffs sued JP Morgan Chase, arguing the stable value fund invested in risky, highly leveraged assets — particularly, mortgage-related assets like mortgage-backed securities.[2] The district court later certified a class of participants in more than 300 retirement plans that were invested in 78 stable value funds. Ultimately, JP Morgan Chase paid $75 million to settle the lawsuit.

2. **Not Risky Enough:** So far, plaintiffs have not succeeded with this claim. Plaintiffs have brought such lawsuits against Union Bond & Trust, Fidelity Management Trust, CVS Health, Massachusetts Mutual Life Insurance, and Prudential Retirement Insurance & Annuity, to name a few. In CVS, for example, the district court judge dismissed the claims, holding that fiduciaries need not predict the future and are not liable for deciding to avoid risks that, in hindsight, could have been tolerated.[3] Nor must fiduciaries look at the average stable value fund and provide the same. What matters is if the risk of the investment matches the CVS plan's investment objectives.

3. **Failing to Offer a Stable Value Fund:** Plaintiffs have unsuccessfully sued Chevron, Anthem and Insperity for failing to include stable value funds in their plans' investment lineup. In Chevron, the fiduciary included a money market fund instead of a stable value fund. The court dismissed the case upon concluding that offering a money market fund "as one of an array of mainstream investment options along the risk/reward spectrum" satisfies the Employee Retirement Income Security Act's prudence requirement.[4]

The Ellis opinion, mentioned at the outset of this article, was in the second category. There, members of Barnes & Noble's 401(k) plan sued Fidelity for offering a stable value fund called the Managed Income Portfolio, or MIP. In the MIP, Fidelity allocated "investments away from higher-return, but higher-risk sectors," partly in response to the 2008 financial crisis and partly to secure wrap insurance as insurers exited the market. The MIP exceeded its conservative benchmark, but produced lower returns than competitors' stable value funds. Plaintiffs claimed this violated Fidelity's duty of loyalty and prudence to plan participants.

As for disloyalty, the court "balk[ed] at the notion that a fiduciary violates ERISA's duty of loyalty simply by picking 'too conservative' a benchmark for a stable value fund." The court found it hard to comprehend how a fund defined by its conservativeness could violate the law by being too conservative. The very nature of the fund "warns the investor not to expect robust returns, and aligns expectations and results in a manner that is unlikely to harm or disappoint any investor who selects the fund."

The court admonished the plaintiffs for ignoring "basic and obvious market incentives." The plaintiffs'

loyalty theory largely centered on the assertion that Fidelity prioritized its interest in securing wrap insurance over the beneficiaries' interest in higher returns. But by publishing a more conservative benchmark than its peers, Fidelity risked market share as there were "innumerable options available." In a line helpful in more than just stable value fund cases, the court noted it is not disloyal for a fiduciary to take an action "aimed at furthering an objective [the fiduciary] shared with the beneficiaries," such as a lower-risk investment option.

As for imprudence, the court found the same problems with the plaintiffs' disloyalty claims. The court stated plaintiffs "offer[ed] no authority, and we are aware of none, holding that a plan fiduciary's choice of benchmark, where such a benchmark is fully disclosed to participants, can be imprudent by virtue of being too conservative." As a practical matter, it would be hard or impossible to articulate a standard by which to determine if a benchmark is too conservative.

What the court did in Ellis was to gut the logical core of any argument that a stable value fund is too conservative. Those arguments, the court underscored, impermissibly rely on hindsight. Arguments a fund is "too conservative" arise only when the market performs well and therefore riskier options outperform their more conservative peers. Yet in response to the plaintiffs' best piece of evidence, a colorful email by a Fidelity employee criticizing the MIP's lower returns as compared to its peers, the court mused "one can only imagine the mirror image emails of regret Fidelity's competitors would have written had the markets collapsed instead of rebounding."

While Ellis may lead to fairy tale endings in the First Circuit for defendants, it is too early to tell if other jurisdictions will follow Ellis's logic. In Goldilocks, the girl never returned to the home of the three bears again. While companies cannot be as certain that stable value fund lawsuits will never return, Ellis gives defendants a strong ally in chasing away such cases.

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[1] Ellis v. Fidelity Management Trust Company, No. 17-1693 (1st Cir. 2018).

[2] In re JPMorgan Stable Value Fund ERISA Litig., S.D.N.Y., No. 1:12-cv-02548-VSB

[3] Barchock v. CVS Health Corp., No. CV 16-061-ML, 2017 WL 1382517, at *5 (D.R.I. April 18, 2017)

[4] White v. Chevron Corp. , 2016 BL 281396, N.D. Cal., No. 4:16-cv-00793-PJH, Aug. 29, 2016.

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