THE 401(k) CONUNDRUM IN CORPORATE LAW

Natalya Shnitser*

Abstract

As institutional investors like BlackRock, Vanguard, and State Street have accumulated ever larger stakes in U.S. public companies, their voting behavior has come under increasing scrutiny. Scholarship analyzing voting by institutional investors—and particularly mutual funds—has focused on the passivity of mutual funds as shareholders and their reluctance to vote against the preferences of management. While scholars have explored a variety of theories for such deference, a recurring explanation has emphasized that the largest fund managers also have business lines that offer services to 401(k) retirement plans sponsored by U.S. companies. Accordingly, numerous scholars have advanced the theory that institutional investors—and particularly mutual funds—have been deferential to corporate management out of fear of losing the corporations' retirement plan business.

The theory, though repeated often in corporate law scholarship and in rulemaking proposals, rests on limited empirical findings and outdated assumptions about how corporations make decisions about their retirement plans. This Article makes two key contributions: first, it draws on employee benefits law—including the Employee Retirement Income Security Act of 1974 (ERISA)—to illuminate legal requirements and norms that characterize corporate decision-making about the design and administration of employer-sponsored retirement plans. Second, this Article argues that the dramatic rise of ERISA fiduciary litigation over the last fifteen years has transformed decision-making within plans and constrained the ability of corporate managers to credibly threaten institutional investors who vote against management interests. Newly hand-collected data and survey results reveal that decision-making increasingly lies with plan administrative and investment committees, which draw from a range of roles and expertise within the company and require their members to undergo fiduciary training. Furthermore, insurance companies scrutinize plan governance and investment menus before issuing policies for fiduciary liability insurance. Taken together, these findings cast doubt on the traditional explanation for the voting behavior of institutional investors. A revised and richer understanding of the relationship between institutional investors and corporate retirement plans helps explain newer voting patterns, including institutional investors' increasing willingness to challenge corporate management on certain environmental, social, and governance proposals.

* Associate Professor, Boston College Law School. Thank you to Jill Fisch, Howell Jackson, Arthur Laby, John Langbein, Ray Madoff, Dana Muir, Roberta Romano, Jeff Schwartz, Norman Stein, Andrew Stumpff, Shuyi Oei, Anne Tucker, Fred Yen, Peter Weidenbeck, Jonathan Zytnick and the participants in the American Law & Economics Association Annual Meeting, the National Business Law Scholars Conference, the 11th Annual Employee Benefits & Social Insurance Conference, the Law & Society Conference, the Canadian Law & Economics Association Annual Meeting, and the Boston College Faculty Workshop for helpful comments. All errors are my own.

Table of Contents

Introduction 290
I. The Retirement Business Theory in Law & Finance Scholarship 295
A. *Legal Scholarship* 295
B. *Empirical Scholarship* 301
C. *Limitations of Existing Scholarship* 309
II. The Evolution of Retirement Plan Governance 311
A. *The Regulatory Regime for Employer-Sponsored Retirement Plans* 312
B. *Fifteen Years of ERISA Litigation* 317
C. *The Professionalization and Formalization of Plan Governance* 322
III. Reassessing the Role of Retirement Plans in U.S. Corporate Governance 328
A. *The Relationship between Retirement Plans and Institutional Investors* 329
B. *Implications for Corporate Governance Debates* 330
C. *Implications for Retirement Plan Governance* 332
Conclusion 333

Introduction

As institutional investors like BlackRock, Vanguard, and State Street have accumulated ever larger stakes in U.S. public companies over the last two decades, their voting behavior has come under increasing scrutiny.[1] Scholars and policymakers have sharpened their focus on the incentives and

[1] Institutional investors include hedge funds, pension funds, mutual funds, endowments, insurance companies, and other entities that pool the funds of numerous investors. Among mutual funds, which are the focus of this Article, some are actively managed while others are passively managed. Whereas the managers of actively managed funds pick which stocks the fund will hold, passive funds or "index" funds seeks only to match the performance of a market index. Accordingly, an index fund holds all of the stocks in the index that it tracks. Researchers estimate that, as of 2019, institutional investors owned about 83% of outstanding equity in the average firm in the S&P 500. As of 2020, one of the so-called "Big Three" firms (BlackRock, Vanguard, and State Street) was the largest shareholder in about 70% of S&P 500 firms. *See* Amir Amel-Zadeh, Fiona Kasperk & Martin Schmalz, *Mavericks, Universal, and Common Owners – The Largest Shareholders of US Public Firms* (Eur. Corp. Governance Inst., Finance Working Paper No. 838, 2022) https://ssrn.com/abstract=405951. As of 2022, BlackRock, for example, was one of the three largest shareholders in more than 80% of the companies in the S&P 500. *See* Dawn Lim, *BlackRock Gives Big Investors Ability to Vote on Shareholder Proposals*, Wall St. J. (Oct. 7, 2021), https://www.wsj.com/articles/blackrock-gives-big-investors-ability-to-vote-on-shareholder-proposals-11633617321. For an example of the academic scrutiny, *see* John C. Coates, *The Future of Corporate Governance Part I: The Problem of Twelve* 18 (Harvard Law Sch., Working Paper No. 19-07, 2018) (observing that the rise of index funds is one of the "mega trends" that is reshaping corporate governance and citing concern about the impact of the "pension fund management business" on the incentive of index fund providers).

institutions that animate voting by America's largest shareholders.[2] The attention has intensified as the range of issues subject to precatory shareholder votes has expanded to include proposals on matters such as environmental sustainability, human capital management, equity and diversity, and corporate political spending.[3]

For many years, scholarship analyzing voting by institutional investors—and particularly mutual funds—has focused on the passivity of mutual funds as shareholders, with scholars documenting a pattern in which funds "[r]arely challenge executives, lag other institutions in promoting corporate governance best practices, never bring shareholder proposals, and tend to side with incumbent managers in contested elections."[4] While scholars have explored a variety of theories for such deference, a recurring explanation has emphasized that the largest fund managers also have business lines that offer services to 401(k) retirement plans sponsored by U.S. companies. As a result, the fund managers "have strong incentives to attract and retain such business from public corporations."[5] In this often-repeated argument, scholars have raised the concern that having "company management as a client for 401(k) accounts" may cause the mutual fund manager "to cast its votes in order to appease management—the client—even when doing so is not in the investors' best interest."[6] Accordingly, some scholars have characterized

---

[2] *See, e.g.*, Enhanced Reporting of Proxy Votes by Registered Management Investment Companies; Reporting of Executive Compensation Votes by Institutional Investment Managers, 17 C.F.R. Pt. 200 (Nov. 2, 2022) (justifying the Securities and Exchange Commission's new reporting enhancements in part by noting that "some academic research observes that mutual funds' proxy voting may be affected by business ties such as those where a fund's adviser also manages the firm's pension plan").

[3] Hannah Orowitz, *An Early Look at the 2022 Proxy Season*, HARV. LAW SCH. F. ON CORP. GOVERNANCE (Jun. 7, 2022), https://corpgov.law.harvard.edu/2022/06/07/an-early-look-at-the-2022-proxy-season/(observing that "[o]n the heels of a record-breaking 2021 proxy season, it appears that many proponents were emboldened to submit a greater number of ESG proposals this season, with many making more significant demands on companies" and noting that "several types of proposals attracted majority support for the first-time this season, including shareholder proposals addressing racial equity and civil rights audits, sexual harassment concerns and gender pay equity").

[4] Michal Barzuza, Quinn Curtis & David H. Webber, *Shareholder Value(s): Index Fund ESG Activism and the New Millennial Corporate Governance*, 93 S. CAL. L. REV. 1243, 1247 (2020) (footnotes omitted).

[5] Lucian Bebchuk, Alma Cohen & Scott Hirst, *The Agency Problems of Institutional Investors*, 31 J. ECON. PERSP. 89, 102 (2017).

[6] Sean J. Griffith & Dorothy S. Lund, *Conflicted Mutual Fund Voting in Corporate Law*, 99 B.U. L. REV. 1151, 1157 (2019); *see also* Dorothy S. Lund, *Asset Managers as Regulators,* 171 U. PA. L. REV. 77, 99 ("BlackRock aims to appease (and at the very least, not alienate) a diverse set of clients when adopting regulatory policies: corporate management that chooses which asset manager manages the company's 401(k) accounts, public pension funds, individual investors, and even the U.S. government.").

the rise of institutional investors as "risky"[7] and have made the case for limiting the voting rights of some institutional investors.[8]

In recent years, scholars have observed certain changes in the behavior of funds as shareholders. Since 2017, index funds have begun to demonstrate a willingness to "aggressively challenge" corporate management on environmental and social matters, most notably on board gender diversity and climate change.[9] For example, State Street and BlackRock have adopted policies to withhold votes from the entire nominating committee at companies that do not meet the funds' gender diversity benchmarks,[10] and have supported shareholder proposals on environmental and social issues.[11] To explain this relatively recent phenomenon, some scholars have suggested that the preferences and demands of millennial investors—the current and potential future clients of large asset managers—may outweigh the concerns about losing pension business by challenging corporate management.[12] Others have posited that notwithstanding the pension business ties, the large mutual-fund complexes have acted primarily "out of fear of public retribution" and the recognition that "failure to look like good stewards could lead to potentially costly regulations."[13]

In short, both traditional explanations of mutual fund deference and more recent analyses of growing index fund activism incorporate or respond to what I will call the "retirement business" theory of fund voting. The theory assumes that "corporate managers" can easily punish fund sponsors that vote against their preferences by either replacing them as service providers

---

[7] M. Todd Henderson & Dorothy S. Lund, *Index Funds Are Great for Investors, Risky for Corporate Governance*, WALL ST. J. (June 23, 2017) (observing that institutions such as BlackRock, State Street, and Vanguard face a conflict of interest in that "[c]hallenging management of a company can threaten their ability to retain that company as a client for corporate retirement fund assets").

[8] Dorothy S. Lund, *The Case Against Passive Shareholder Voting*, 43 J. CORP. L. 493, 520–21 (2018) (stating that "a passive fund manager will likely worry that supporting an activist could jeopardize her relationship with the target company and put the fund at risk of losing corporate pension fund assets" and recommending that policymakers consider "restricting passive funds from voting at shareholder meetings").

[9] Barzuza, Curtis & Webber, *Shareholder Value(s)*, *supra* note 4, at 1268.

[10] *Id.* at 1268–69.

[11] Saijel Kishan, Mathieu Benhamou & Jeff Green, *Investors Crank Up Pressure on Companies with Record Climate, Race Proxy Proposals*, BLOOMBERG, Apr. 25, 2022 (observing that "the world's largest money managers led by BlackRock Inc. have thrown unprecedented support behind such proposals, putting even more demands on companies to act" on the "more than 200 environmental and social resolutions submitted to corporations across America" this proxy season).

[12] Barzuza, Curtis & Webber, *Shareholder Value(s)*, *supra* note 4, at 1249 (arguing that "[w]hile index funds might fear management retaliation, we show that a more potent concern is on the horizon: in the next two decades, somewhere between $12 trillion and $30 trillion will pass to the millennial generation," and those assets are "the prize sought by asset managers across the economy").

[13] Jeff Schwartz, *'Public' Mutual Funds*, *in* CAMBRIDGE HANDBOOK ON INVESTOR PROTECTION (Arthur Laby ed., 2022).

for corporate retirement plans or by excluding the funds from the plans' investment menus.[14]

This Article challenges such assumptions and fills in critical gaps in the academic analysis of the connection between employer-sponsored retirement plans and the voting patterns of institutional investors. First, it draws on employee benefits law—including the Employee Retirement Income Security Act of 1974 (ERISA)—to illuminate the processes and legal requirements that characterize corporate decision-making about the design and administration of employer-sponsored retirement plans, the vast majority of which is now structured as defined contribution, individual-account plans. Second, this Article argues that the dramatic rise of ERISA fiduciary litigation since 2008 has transformed decision-making within plans and constrained the ability of "corporate managers" to credibly threaten institutional investors who vote against management interests. Newly hand-collected data and survey findings suggest that individual senior executives are not the primary decision makers. Instead, plan administrative and investment committees now draw from a range of roles and expertise within the company, and require their members to undergo fiduciary training. Furthermore, insurance companies increasingly scrutinize plan governance and investment menus before issuing policies for fiduciary liability insurance. Taken together, these findings advance the claim that by disciplining retirement plan fiduciaries, ERISA litigation has limited the incentives of mutual fund managers to defer to corporate management. The thesis is consistent with evidence of increased fund activism and with newer empirical work documenting declines in funds' so-called "management bias" between 2015 and 2020.[15]

The findings in this Article have significant implications for the regulation of both investment funds and retirement plans in the United States. For fund regulation, the findings urge caution in the use of the "retirement business" theory in current rulemaking for investment funds.[16] The findings also call for a reexamination of academic proposals to prohibit investment managers from engaging in retirement plan administration for employer-spon-

---

[14] *See infra* Section I.A.

[15] David Shugar, As You Sow, Uncovering Conflict of Interests: Proxy Voting Data Reveals Bias for Asset Managers to Favor Clients 5 (2021), https://www.asyousow.org/reports/uncovering-conflict-of-interest (reporting declines in "bias to favor management recommendations with commercial ties" between 2015 and 2020) For example, in the case of BlackRock, the report finds bias of 13.5% on management proposals in 2015, compared with bias of 2.6% in 2020. For T. Rowe Price, the report reveals a decline from 20.0% in 2015 to 4.4% in 2020. *Id.*

[16] The Securities & Exchange Commission cited to the theory in its latest regulation on disclosure requirements for investment fund proxy votes. *See* Enhanced Reporting of Proxy Votes, *supra* note 2 (citing the pension business theory in support of proposed amendments to Form N-PX to "enhance the information mutual funds, exchange-traded funds, and certain other funds report about their proxy votes . . . to help investors identify votes of interest and compare voting records"). Notably, the SEC cited the same concern two decades ago in *Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management Investment Companies*, 68 Fed. Reg. 6564 (Feb. 7, 2003) (raising concern about a conflict of interest when the advisor "also manages or seeks to manage the [company's] retirement plan assets").

sored plans.[17] For retirement plan regulation, this Article documents the impact of ERISA fiduciary litigation on retirement plan governance. It is also the first to shed light on the composition of retirement plan administrative and investment committees, which is rarely disclosed to plan participants or regulators. The analysis of retirement plan governance is especially timely in the wake of recent efforts by institutional investors to "pass through"[18] shareholder voting rights to investors like retirement plans, as well as recent shareholder proposals asking corporate boards to reevaluate investment options in employer-sponsored retirement defined contribution plans.[19] In addition, this Article suggests that by continuing to focus on "retirement business" concerns, both regulators and academics may miss newer sources of risk, including from the rapidly growing multiple-employer retirement plans and collective investment alternatives run by financial institutions.

This Article proceeds as follows. Section I first reviews the existing legal scholarship on mutual fund voting and highlights the pervasiveness of the argument that mutual funds' business ties—and specifically their retirement plan business—have contributed to their deference to corporate management. Next, Section I reviews the existing empirical studies, including the three studies that legal scholars and policymakers have cited repeatedly to support their arguments. Notwithstanding the limitations, caveats, and age of the empirical studies, the findings have been cited extensively. Section II turns to the evolution of retirement plan governance. It first describes the often-overlooked legal requirements under ERISA that govern decision-making by plan fiduciaries. Next, it describes the growth of ERISA fiduciary litigation since 2008 and the resulting formalization of retirement plan governance. Expanded committees, fiduciary training, and fiduciary insurance requirements have constrained the power of those who administer retirement plans to hire or fire service providers based on their voting histories, thus weakening any threat of retribution for challenging corporate managers. Section III describes the policy implications for the governance of both mutual

[17] Lucian Bebchuk & Scott Hirst, *Index Funds and the Future of Corporate Governance: Theory, Evidence, and Policy*, 119 COLUM. L. REV. 2029, 2122 (2019).

[18] Dawn Lim, *BlackRock Gives Big Investors Ability to Vote on Shareholder Proposals*, WALL ST. J., Oct. 7, 2021, https://www.wsj.com/articles/blackrock-gives-big-investors-ability-to-vote-on-shareholder-proposals-11633617321 ("Starting in 2022, BlackRock says its large investors can vote themselves on everything from who sits on boards to executive pay to what companies should disclose on greenhouse gas emissions.").

[19] Austin Ramsey, *Amazon, Comcast Face 401(k) Climate Plans Shareholder Votes*, BLOOMBERG, May 5, 2022, https://news.bloomberglaw.com/daily-labor-report/amazon-comcast-face-401k-climate-analysis-shareholder-votes (noting that both shareholder proposals would "require Amazon's and Comcast's boards to prepare reports that review retirement plan investment options and determine whether they align with the company's climate action goals"). Notably, in its filing appealing the shareholder proposal, Amazon emphasized that "the company's board doesn't manage 401(k) plan investment options. Like most large plans, a committee of fiduciaries with personal liability over plan assets is responsible for investment decisions." *Id.* Understanding decision-making within employer-sponsored retirement plans is thus increasingly critical for scholars and practitioners of corporate law. *See infra* Section II.

funds and retirement plans and identifies the additional empirical work necessary to reassess the impact of retirement plan ties on mutual fund voting.

I. The Retirement Business Theory in Law & Finance Scholarship

This Section demonstrates the evolution and widespread adoption of the "retirement business" theory in corporate law scholarship. Despite its prevalence in recent business law scholarship, the theory has relatively limited empirical support, much of which also predates key developments in retirement plan governance. Section I.B describes the handful of papers cited repeatedly in support of the retirement business theory.[20] As Section I.C argues, both the legal and the empirical scholarship have overlooked key elements of institutional design: how decisions about retirement plans are made, who makes them, and the laws and lawsuits that constrain the decisionmakers' choices. Moreover, recent developments in the law that governs retirement plans in the United States further limit the applicability of the existing empirical studies, most of which use data from 2001–2011.

A. Legal Scholarship

The growth of institutional investors and the resulting impact on corporate governance in the United States has animated corporate law scholarship for much of the last two decades.[21] By 2019, institutions held about 83% of outstanding equity in the average firm in the S&P 500.[22] While the category of "institutional investors" includes mutual funds, pension funds, hedge funds, bank trust departments, insurance companies, and endowments, legal scholarship has focused particularly on the role of mutual funds and the investment managers that control the vast pool of assets in these funds. As John Morley has noted, the "[f]uture of American capitalism belongs to a handful of giant investment managers."[23] As of 2018, registered investment companies such as mutual funds collectively held assets worth over $22 trillion, with half of this amount belonging to BlackRock, Vanguard, State

---

[20] As discussed in Section I.B below, the following studies have been cited repeatedly in legal scholarship and policy analyses: Gerald F. Davis & E. Han Kim, *Business Ties and Proxy Voting by Mutual Funds*, 85 J. Fin. Econ. 552 (2007) (cited 530 times); Rasha Ashraf, Narayanan Jayaraman & Harley E. Ryan, Jr., *Do Pension Related Business Ties Influence Mutual Fund Proxy Voting? Evidence from Shareholder Proposals on Executive Compensation*, 47 J. Fin. & Quant. Analysis 567 (2012) (cited 89 times); Dragana Cvijanović, Amil Dasgupta & Konstantinos E. Zachariadis, *Ties that Bind: How Business Connections Affect Mutual Fund Activism*, 71 J. Fin. 2933 (2016) (cited 114 times).

[21] John D. Morley, *Too Big to Be Activist*, 92 S. Cal. L. Rev. 1407, 1410 (2019) (describing the "tidal wave" of academic scholarship on the impact of consolidation in corporate ownership).

[22] *See* Amel-Zadeh, Kasperk & Schmalz, *Mavericks, Universal, and Common Owners – The Largest Shareholders of US Public Firms*, *supra* note 1, at 10.

[23] Morley, *Too Big to Be Activist*, *supra* note 21, at 1409.

Street, and Fidelity, the four biggest investment managers.[24] As of 2022, BlackRock, Vanguard Group Inc., and State Street Corp. together owned an average 20% of every company in the S&P 500 Index.[25]

The growth of institutional investors—and of their power as shareholders—has made for a rich research agenda in corporate law. Shareholders who hold voting shares have the right to elect and remove directors, to approve certain fundamental transactions such as mergers or dissolutions, and to vote on various other matters put to a shareholder vote by either the board or by shareholders. For public companies, federal securities laws require companies to put to a vote the precatory proposals that have been submitted by shareholders in accordance with the federal proxy rules.[26] For example, at Amazon's 2022 annual meeting of shareholders, the shareholders were asked to vote on nineteen matters: the election of eleven directors, the ratification of Amazon's independent auditor, an advisory vote on executive compensation, the approval of a stock-split, and fifteen different shareholder proposals. Amazon's board recommended that shareholders vote for each of the first four proposals. It recommended that shareholders vote against each of the fifteen shareholder proposals, which included a proposal requesting a report on disparities in Amazon's health and safety practices, a proposal requesting additional disclosure of Amazon's lobbying activities, a proposal to modify director elections to include more candidates than board seats, and a proposal requesting a diversity and equity audit, among others.[27]

At Amazon, like at other public companies, institutional investors hold significant equity stakes, with the Vanguard Group holding 6.6% of the common stock and BlackRock, Inc. holding 5.7% (as of 2022, only Jeff Bezos held a larger stake with 12.7%).[28] Accordingly, scholars have sought to track the voting patterns of various funds and to understand the incentives and constraints that dictate how institutional investors vote the shares within their control. The behavior of so-called "passive investors"—including exchange traded funds (ETFs) and index funds—has been the subject of extensive analysis and debate among academics.

For some scholars, the rise of index funds has raised concerns about "systemwide adverse consequences on corporate governance."[29] Lucian Bebchuk and Scott Hirst have argued that index fund managers are incentivized to "(1) underinvest in stewardship and (2) defer excessively to the

---

[24] *Id.*

[25] Saijel Kishan, Mathieu Benhamou & Jeff Green, *Investors Crank Up Pressure on Companies with Record Climate, Race Proxy Proposals*, Bloomberg, Apr. 25, 2022.

[26] *See* 17 C.F.R. § 240.14a-8 (2020).

[27] Amazon, Inc., Notice of 2022 Annual Meeting of Shareholders & Proxy Statement, https://s2.q4cdn.com/299287126/files/doc_financials/2022/ar/Amazon-2022-Proxy-Statement.pdf.

[28] *Id.* at 87.

[29] Lucian Bebchuk, Alma Cohen & Scott Hirst, *The Agency Problems of Institutional Investors*, 31 J. Econ. Persp. 89, 90 (2017).

preferences and positions of corporate managers."[30] In analyzing the incentives for the "excessive" deference to management, Bebchuk and Hirst devote considerable attention to the retirement plan business as an "important" source of revenue for investment managers. They note that index fund managers derive a substantial proportion of their revenues from 401(k) plans by providing administrative services to such plans (for example, acting as the plan recordkeepers), and by having their index funds included in the menu of investment options available to plan participants (for example, having Fidelity, BlackRock, or State Street index funds on the 401(k) plan menu from which individual participants select how to invest their retirement savings). According to Bebchuk and Hirst, index fund managers "can reasonably expect that the extent to which corporate managers view them favorably might influence their revenues from 401(k) plans."[31]

In effect, then, Bebchuk and Hirst suggest that the preferences of "corporate managers" impact which service providers and funds are selected for the employer-sponsored retirement plans. They note that whether corporate managers actually exert such influence isn't critical so long as index fund managers *believe* that to be true. In that case, index fund managers will have the incentive to adopt relatively deferential "principles, policies and practices" across all funds. As Bebchuk and Hirst write, "rather than tending to vote at particular client companies in ways that managers of those companies are likely to prefer, an index fund manager can set its general principles, policies, and practices to enhance the likelihood of supporting management in votes across all portfolio companies," a phenomenon that they refer to as "general management favoritism."[32] To ameliorate the conflicts that the authors identify, Bebchuk and Hirst propose either prohibiting investment managers from engaging in retirement plan administration for employer-sponsored plans or requiring more particularized disclosure of the business relationships between index fund managers and portfolio companies."[33]

Other scholars have made similar claims about the conflicts of interest facing investment managers. In analyzing the voting decisions of mutual funds, Sean Griffith and Dorothy Lund identify the "nefarious conflict of interest that often pits the institution against its own investors."[34] Specifically, they argue that because "company management is a large source of 401(k) assets invested in mutual funds, as well as an actual or potential client for other services . . . the fund sponsor has an incentive to cast investor proxies in favor of management—the client—even when voting with management is not in its investors' best interests."[35] Thus, in an environment where

[30] Lucian Bebchuk & Scott Hirst, *Index Funds and the Future of Corporate Governance: Theory, Evidence, and Policy*, 119 Colum. L. Rev. 2029, 2062–63 (2019).

[31] *Id.* at 2062.

[32] *Id.* at 2064.

[33] *Id.* at 2122.

[34] Griffith & Lund, *supra* note 6, at 1176.

[35] *Id.*

competing on fees is increasingly challenging for mutual funds, Griffith and Lund suggest that mutual fund sponsors look to maintain "close relationships" with "management," which they identify as "the source of corporate 401(k) assets."[36] In light of such conflicts of interests, Griffith and Lund urge Delaware courts to reconsider treating the votes of institutional shareholders as disinterested.[37] Lund further suggests that lawmakers consider "restricting passive funds from voting at shareholder meetings."[38]

Other scholars have focused on the structure of investment managers and the funds they manage.[39] Morley, for example, looks to the conflicts facing investment managers to explain why big investment managers like Vanguard and Fidelity, which have accumulated an "astonishing amount" of common stock in America's public companies, are unlikely to engage in "aggressive" shareholder activism. As Morley explains, "[a] large investment manager thus has to balance not only the interests of its many investment management clients, but also the interests of customers in its many other business lines—not to mention the manager's own shareholders."[40] For example, he notes that "Fidelity's 401(k) business serves the human resources departments of many of America's big companies . . . ."[41] He posits that if one of Fidelity's funds "went around terrorizing the CEOs of S&P 500 companies," that "might complicate Fidelity's efforts to build relationships with them." He suggests that even if Fidelity didn't manage a particular company's 401(k), its desire to have Fidelity funds on the company's 401(k) plan menu would make Fidelity wary of the "risk of retaliation by the company."[42]

Not everyone shares the same concerns about the incentives of passive institutional investors. Jill Fisch, Assaf Hamdani, and Steven Davidoff Solomon acknowledge "the risk that Vanguard and Fidelity will vote the shares of their funds in favor of management rather than in the best interests of the fund shareholders, in order to curry favor from management and win or retain 401(k) plan business" but argue that the need to compete with both other passive and actively-managed funds for investment dollars creates a sufficient incentive to engage in corporate governance.[43] Jeff Schwartz suggests that "fear of public retribution" for being poor stewards prompts mu-

---

[36] *Id.* at 1179.

[37] *Id.* at 1158.

[38] Lund, *supra* note 8.

[39] Mutual fund sponsors differ in their business models, including not only with respect to relative size of any 401(k) plan or other business lines, but also along other dimensions such as: the ownership structure of the fund sponsor and advisor, the particular mixture of passive and active funds, and the nature of the clients. *See* Jill Fisch, Assaf Hamdani & Steven Davidoff Solomon, *The New Titans of Wall Street: A Theoretical Framework for Passive Investors*, 168 U. Pa. L. Rev. 17, 21–24 (2019).

[40] Morley, *supra* note 23, at 1417.

[41] *Id.* at 1438.

[42] *Id.*

[43] Fisch, Hamdani & Davidoff Solomon, *supra* note 39, at 18–65.

tual funds to "participate in corporate governance just enough to ward off public opprobrium and potential regulation."[44]

Other scholars have focused on recent evidence of shareholder activism, at least on some issues and from some institutional investors. Michal Barzuza, Quinn Curtis, and David Webber have sought to explain the emerging evidence of activism on the part of index funds. Since 2015, such funds have taken a "leading role in challenging management and voting against directors in order to advance board diversity and corporate sustainability."[45] Barzuza, Curtis, and Webber acknowledge the concerns about pension business conflicts but suggest that the "fierce contest to win the soon-to-accumulate assets of the millennial generation, who place a significant premium on social issues in their economic lives" creates incentives for index funds to challenge management on certain issues.[46]

All of the articles described in this Section, as well as others included in Table 1 below, have one thing in common: they cite the same three empirical studies to support the various versions of the "retirement business theory." The empirical findings and the limitations of existing studies are discussed below.

---

[44] Schwartz, *supra* note 13.

[45] Barzuza, Curtis & Webber, *supra* note 4, at 1243.

[46] *Id.* at 1244.

TABLE 1: SELECTED EXAMPLES OF THE PROLIFERATION OF THE "RETIREMENT BUSINESS" THEORY IN LEGAL SCHOLARSHIP

Kahan & Rock (2007)[47]	"For many mutual fund complexes, the management of corporate pension plans is an important source of revenues. Governance activism could lead to a loss of such business, not just with respect to the activist fund, but for the complex as a whole."
Gelter (2013)[48]	"Moreover, some observers have criticized possible conflicts of interest of mutual fund managers. Arguably, fund managers are sometimes inclined to please *corporate managers*, who are in the position to direct employees' 401(k) wealth to investment companies that do not object to the firm's corporate governance practices." (emphasis added).
Bebchuk & Hirst (2019)[49]	"The largest index fund managers and active managers all derive business from 401(k) services, and therefore have strong incentives to attract and retain such business from public corporations . . . . Index fund managers can reasonably expect that the extent to which *corporate managers* view them favorably might influence their revenues from 401(k) plans . . . . Setting general principles, policies, and practices more deferentially enhances the likelihood that *corporate managers* will view the index fund manager more favorably and does so without producing any inconsistency in the treatment of clients and nonclients." (emphasis added).
Griffith & Lund (2019)[50]	"Mutual fund sponsors often count company management as a client for 401(k) accounts or other services. Such conflicts may cause the sponsor to cast its votes in order to appease *management-the client*-even when doing so is not in the investors' best interest." (emphasis added).
Fisch, Hamdani & Davidoff Solomon (2019)[51]	"One concern is that potential business ties between sponsors and *companies' management* may affect passive funds' voting behavior . . . . These services create the risk that Vanguard and Fidelity will vote the shares of their funds in favor of management rather than in the best interests of the fund shareholders, in order to curry favor from management and win or retain 401(k) plan business." (emphasis added).

[47] Marcel Kahan & Edward B. Rock, *Hedge Funds in Corporate Governance and Corporate Control*, 155 U. PA. L. REV. 1021, 1055 (2007).

[48] Martin Gelter, *The Pension System and the Rise of Shareholder Primacy*, 43 SETON HALL L. REV. 909, 960–61 (2013).

[49] Bebchuk & Hirst, *supra* note 30, at 2062–64.

[50] Griffith & Lund, *supra* note 6, at 1157.

[51] Fisch, Hamdani & Davidoff Solomon, *supra* note 39, at 65.

Morley (2019)[52]	"Fidelity's 401(k) business serves the *human resources departments* of many of America's big companies, and an activist hedge fund that attacked these companies might complicate Fidelity's efforts to build relationships with them. The same would be true even if Fidelity did not manage a company's 401(k). Fidelity's desire to have its funds included in the 401(k) menu that another manager assembles for the company would expose Fidelity to the risk of retaliation by the company." (emphasis added).
Barzuza, Curtis & Webber (2020)[53]	"Many of the largest fund managers also have significant 401(k) practices that involve selling retirement plan services to companies who might be the subject of activist campaigns. Challenging *management* at these firms could risk these lucrative contracts . . . . Evidence shows that threat of retaliation has at least partially explained mutual fund passivity. For the most part, we agree with the existing literature that the threat of *managerial retaliation* is real and induces index fund passivity." (emphasis added).
Gomtsian (2020)[54]	"A separate stream of literature focuses on conflicts of interest inherent in the business models of asset managers that discourage active shareholder engagement . . . . *Company managers* may influence decisions where to invest employees' pension savings. Corporate managers may threaten to change the company's existing financial services providers if asset managers affiliated with them do not support the management." (emphasis added).

B. Empirical Scholarship

Just as the rise of institutional investors prompted a new direction in legal scholarship, so too did it spur new empirical work in economics and finance. Table 2 briefly summarizes the empirical studies that have examined the relationship between mutual fund voting and the existence of retirement business ties. In the paragraphs that follow, this Section examines closely the three studies most commonly cited by both legal scholars and policymakers.

[52] Morley, *supra* note 21, at 1438.

[53] Barzuza, Curtis & Webber, *supra* note 4, at 1259, 1309. The authors note that while index funds have shown some appetite for activism on diversity and environmental matters, they have frequently voted in support of executive pay packages. As the authors posit, "[i]t is difficult to imagine a better way to trigger managerial retaliation than voting against its pay." *Id.* at 1309.

[54] Suren Gomtsian, *Voting Engagement by Large Institutional Investors*, 45 J. Corp. L. 659, 681 (2020).

TABLE 2: SELECTED EMPIRICAL STUDIES & KEY FINDINGS

Source	**Data Analyzed (Voting & Business Ties)**	**Key Findings**
Rothberg & Lilien (2006)[55]	2003–2004 voting policies and voting data for five fund families, four of which have a retirement business line, as well as voting data for three more financial services companies whose main business was in areas other than mutual funds or asset management generally	No evidence that mutual funds let the "nonfund" parts of their companies influence their votes.
Davis & Kim (2007)[56]	2001 and 2004 proxy voting information on governance-related shareholder proposals opposed by management; 2001 data on pension business ties, as measured by receiving any fees paid for retirement-related services (binary "client" vs. "non-client" distinction) and number of pension clients	Votes at specific portfolio firms appear to be independent of client ties among all the fund families in the sample; however, the more business ties a fund company has, the less likely it is—in the aggregate—to vote in favor of shareholder proposals that are opposed by management.
Taub (2009)[57]	Voting records of select advisors to mutual funds for proxy season spanning 2005–2006; 2005 data for assets managed for defined contribution plans	Instances of support by a mutual fund family for shareholder-sponsored resolutions declined as the value of assets the adviser had under management through defined contribution plans increased.
Ashraf, Jayaraman & Ryan, Jr. (2012)[58]	Votes cast by mutual funds between 2004–2006 on shareholder proposals relating to executive compensation; binary (0/1) classification of pension business ties based on Department of Labor (DOL) and Securities and Exchange Commission (SEC) filings	Pension-related business ties influence fund families to vote with management at all firms, including client and non-client firms.

[55] Burton Rothberg & Steven Lilien, *Mutual Funds and Proxy Voting: New Evidence on Corporate Governance*, 1 J. BUS. & TECH. L. 157, 171 (2006) (finding "no evidence that the funds are allowing nonfund considerations to affect their proxy-voting decisions").

[56] Davis & Kim, *supra* note 20, at 564, 569 (2007) (concluding that "votes at specific portfolio firms appear to be independent of client ties among all the fund families in our sample," and "that the more business ties a fund company has, the less likely it is to vote in favor of shareholder proposals that are opposed by management").

[57] Jennifer S. Taub, *Able but Not Willing: The Failure of Mutual Fund Advisers to Advocate for Shareholders' Rights*, 34 J. CORP. L. 843, 875 (2009).

[58] Ashraf, Jayaraman & Ryan, Jr. *supra* note 20, at 567.

Source	Data Analyzed (Voting & Business Ties)	Key Findings
Cvijanović, Dasgupta & Zachariadis (2016)[59]	Votes cast by mutual funds between 2003–2011 on all proposals for every Russell 3000 company; independent variable is total compensation of a fund family for services related to 401(k) plans	Business ties significantly influence pro-management voting at the level of individual pairs of fund families and firms; however, the association is significant only for *shareholder-sponsored proposals* and stronger for those that pass or fail by relatively narrow margins.
Duan, Jiao & Tam (2021)[60]	Votes cast by mutual funds between 2011–2019; DOL Form 5500 data on retirement plan services provided; binary (0/1) classification for the provision of trustee services	Mutual funds "conflicted" by one type of pension business – namely the provision of trustee services to corporate plans – are more supportive of management proposals and less supportive of shareholder proposals than other mutual funds without the trustee business ties.
Shugar (2021)[61]	Funds proxy voting data from 2015–2020; DOL Form 5500 data on retirement plan providers from the year 2019	The major fund managers considered, including BlackRock, State Street, T. Rowe Price, and Vanguard, all vote with management of their customers at a significantly higher rate than with management of non-customers, although such "bias" has generally decreased between 2015-2020.

The first of the three empirical studies most commonly cited in scholarship and policymaking is the 2007 study by Gerald Davis and Han Kim. In their article, the authors examine mutual fund mangers' "conflicting incentives" with respect to shareholder activism. As the authors posit, on the one hand, some forms of shareholder activism may lead to higher valuations for the portfolio company that would, in turn, benefit the fund investors. On the other hand, the fund managers' willingness to live up to their "fiduciary responsibilities" to their investors may be "compromised" in firms where mutual fund parents manage employee benefit plans.[62] The authors gather

[59] Cvijanović, Dasgupta & Zachariadis, *supra* note 20, at 2933.

[60] Ying Duan, Yawen Jiao & Kinsun Tam, *Conflict of Interest and Proxy Voting by Institutional Investors*, 70 J. Corp. Fin. (2021).

[61] Shugar, *supra* note 15.

[62] Davis and Kim cite the example of Armstrong World Industries in 1990 switching its $180 million employee savings plan to Fidelity Investments from Vanguard Group, after Fidelity withdrew its opposition to a law that the company supported. Davis & Kim, *supra* note 20,

2004 mutual fund proxy voting information for 21 mutual funds families. The proxy voting information became available in August 2004 due to newly enacted SEC requirements. The sample of portfolio companies consists of the publicly traded members of the 2001 Fortune 1000. The authors use the 2001 Securities and Exchange Commission (SEC) Form 13F filings to identify institutional ownership and Department of Labor (DOL) Form 5500 filings to obtain data on fees paid to providers for retirement-related services. Thus, pension business data and portfolio company ownership dates back to 2000–2001. Mutual fund votes are from 2003–2004, with the authors examining fund voting across six kinds of shareholder proposals opposed by management.[63] However, in the absence of sufficient variation within and across fund families on four of the six proposal types, the analysis on client ties and mutual fund voting is performed only on *two types* of shareholder proposals: those concerning poison pills and golden parachutes.[64] Ultimately, the authors find that "the overall pattern of null results suggests that there is no direct relation between client ties and voting in our mutual fund sample," a finding that is consistent with an earlier study by Burton Rothberg and Steven Lilien.[65] Moreover, the authors uncover no evidence in their data of retaliatory switching of service providers. In fact, they note for "the 120 cases in which Fidelity, Vanguard, Putnam, or T. Rowe Price were the

---

at 554. This single example from 1990 has been repeated numerous times in academic scholarship. *See, e.g.*, Bernard S. Black, *Shareholder Passivity Reexamined*, 89 MICH. L. REV. 520, 602 (1990); Dorothy S. Lund, *The Case Against Passive Shareholder Voting*, 43 J. CORP. L. 493, 513 (2018); Marcel Kahan & Edward B. Rock, *Hedge Funds in Corporate Governance and Corporate Control*, 155 U. PA. L. REV. 1021, 1055–56 (2007). Davis and Kim also cite an often-repeated quote from John Bogle that he offered in support of the SEC's proposed regulation to require mutual funds to disclose their proxy votes: ''Votes against management may jeopardize the retention of clients of 401(k) and pension accounts." The authors note that a Fidelity spokeswoman is on the record as stating that ''[t]here is no correlation between how we vote with respect to whether someone is a 401(k) client or not'' *See* Gretchen Morgenson, *A Door Opens. The View Is Ugly*, N.Y. TIMES, Sept. 12, 2004.

[63] The most prevalent proposals were to limit executive compensation and/or other awards (45 cases), report on political contributions (28 cases), require an independent board chair (40 cases), redeem or require a shareholder vote on the poison pill (39 cases), require annual elections of directors (32 cases), expense stock options (28 cases), repeal or vote on golden parachutes (22 cases), and allow for cumulative voting (19 cases). Davis & Kim, *supra* note 20, at 560.

[64] A "poison pill" (also known as a shareholder rights plan) is a defense mechanism used by corporations to prevent or discourage hostile takeover attempts. Poison pills serve to increase the bargaining power of the incumbent board. A "golden parachute" refers to an agreement with a senior executive for the payout of substantial compensation if the company is taken over by another firm, and the executive is terminated as a result of the merger or takeover. Like a poison pill, a golden parachute is typically used to discourage an unwanted takeover attempt.

[65] Davis & Kim, *supra* note 20, at 563. Rothberg and Lilien looked at whether mutual fund "parents" with other lines of business (including retirement business) would favor management over shareholders as compared to "pure-play" funds. They found no such favoritism in their data. *See* Burton Rothberg & Steven Lilien, *Mutual Funds and Proxy Voting*, *supra* note 54, at 171.

recordkeepers in 2001 and we could locate 2002 data in FreeERISA.com, we find only one clear case of turnover."[66]

Davis and Kim also investigate whether aggregate votes at the mutual fund family level are related to pension business ties. To do so, they consider the number of clients as the independent variable of interest, with the percentage of votes cast in favor of shareholder proposals opposed by management among portfolio firms as the dependent variable. Here, the authors find some evidence suggesting that the number of retirement business clients has a significant and negative influence on the propensity to vote in favor of shareholder proposals generally. The authors conclude that "a mutual fund company with heavy business ties may adopt voting policies and guidelines that lead to fewer votes against management across all portfolio firms, thereby reducing the risk of alienating the management of client firms."[67] Therefore, "although individual votes appear evenhanded, business ties affect the overall voting practices at the fund family level."[68] The authors conclude that the funds' decision to appear evenhanded was heightened by the new disclosure requirements adopted during this period.

In a 2012 study, Rasha Ashraf, Narayanan Jayaraman, and Harley Ryan, Jr., find that fund families with pension ties are more likely to vote with management against shareholder proposals on executive compensation at both client and nonclient firms.[69] The authors begin with the premise that because mutual funds benefit when they receive pension fund business from companies, fund managers have an incentive to support management and vote against shareholder proposals, which creates a potential conflict of interest if the interests of the mutual fund investors and those of corporate management diverge.[70]

To test their hypothesis, the authors analyze the association between pension-related business ties and fund-family votes on 340 shareholder-sponsored executive compensation proposals over the 2004–2006 period.[71] Pension business ties are measured in a dichotomous way: a business tie exists if the fund family is a service provider in any of the plans offered by a firm (among the public firms that received shareholder proposals during the relevant period). Voting is analyzed at the fund-family level: following Davis and Kim, Ashraf, Jayaraman, and Ryan, Jr. compute the percentage of support by a fund family on a given proposal by dividing the total number of funds within the family that vote for a proposal by the total number of funds in the family that are eligible to vote on the proposal. They then create a dummy variable that equals 1 if the majority of the funds in the family sup-

[66] Davis & Kim, *supra* note 20, at 563.
[67] *Id.* at 569.
[68] *Id.* at 569.
[69] Ashraf, Jayaraman & Ryan, Jr., *supra* note 20, at 567.
[70] *Id.* at 569–70.
[71] In total, the authors analyze 18,000 votes cast by 143 fund families, 67 with pension-related business ties and 76 without ties. *Id.* at 568.

port a proposal, and 0 otherwise. From their analysis of nearly 18,000 votes cast, the authors conclude that fund families with pension ties "tend to vote with management at all firms, possibly to maintain reputation and to minimize the potential for lawsuits."[72] Notably, the analysis shows that the pension ties do not influence voting at the level of individual proposals after the authors control for fund family heterogeneity.

A 2016 study by Dragana Cvijanović, Amil Dasgupta, and Konstantinos Zachariadis shows that for a subset of shareholder proposals, pension ties affect pro-management voting at the level of individual pairs of fund families and firms. The authors use mutual fund voting data on all proposals for firms in the Russell 3000 over the 2003 to 2011 period to study the extent to which retirement business ties with portfolio firms affect proxy voting by mutual funds.[73] To assess "business ties," the authors estimate the compensation derived from 401(k) plans, finding that among fund families with pension business ties, "the average (median) total compensation is $2.25 million ($220,000)."[74]

After combining compensation data and voting data, the authors "show that mutual funds' voting is significantly influenced by their business ties with portfolio firms."[75] While the results hold for given pairs of fund families and firms, even at the level of individual proposals, and "after controlling for the recommendations of the Institutional Shareholder Services (ISS), the association is statistically significant only for shareholder-sponsored proposals. The association is stronger for proposals that pass or fail by narrow margins."[76] A shift from no business ties to some business ties leads to an increase in pro-management voting of over 12% for proposals that pass or fail by less than 20%. According to the authors, their findings support the hypothesis that "corporate managers" use "credible threats of future punishment" to influence the voting of institutional investors with which they have business relationships, particularly for proposals for which the outcome of the vote is a close call.[77]

While the empirical studies cited by legal scholars and the SEC rely on data through 2011, a newer study by Ying Duan, Yawen Jiao, and Kinsun Tam incorporates voting data through 2019. Although the study is focused in large part on voting by public pension funds, the authors also analyze voting by mutual fund families, including those characterized as "conflicted" by the presence of "pension business ties."[78] To assess pension business ties, the authors review DOL Form 5500 records to identify which mutual fund families provide pension services, including trustee services, record keeping,

---

[72] *Id.*
[73] *See* Cvijanović, Dasgupta & Zachariadis, *supra* note 20, at 2937.
[74] *Id.* at 2940.
[75] *Id.* at 2934.
[76] *Id.* at 2933.
[77] *Id.* at 2935.
[78] Duan, Jiao & Tam, *supra* note 60.

accounting, investment management, and other services. The empirical results shown in the paper, however, only include pension business ties through the provision of trustee services (and not other types of services). The authors report that mutual fund families that provide trustee services to corporate plans are more supportive of management proposals and less supportive of shareholder proposals than other mutual fund families without such "conflicts." While the reported finding is significant, the results not reported are also notable. In particular the authors acknowledge that "[u]ntabulated analyses also show the results in the previous sections are similar albeit slightly weaker if non-trustee corporate pension services, such as record keeping, accounting, and investment management, are included in measuring [mutual fund families'] pension business ties."[79] The authors suggest that the trustee relationship may be "particularly important" to mutual fund families, but the notion that only one type of service-provider relationship generates statistically significant conflicts strains the underlying premise of the retirement business theory.

Finally, in addition to the academic studies, a recent analysis by As You Sow, a non-profit whose stated mission is to promote environmental and social corporate responsibility through shareholder advocacy, links millions of proxy voting records from 2015–2020 to commercial relationships. The author reports that the major fund managers considered, which were BlackRock, State Street, T. Rowe Price, and Vanguard, "all vote with management of their customers at a significantly higher rate than with the management of non-customers."[80] According to the author, "proxy voting biases favoring clients occurred at all four asset managers on management resolutions and occurred at three of the four asset managers on environment, social, and governance (ESG) resolutions; and climate-related resolutions."[81]

Notably, however, the findings presented in the study also reveal declines in bias findings between 2015 and 2020. Table 3 below summarizes the data from the As You Sow report to show changes in reported "management bias" between 2015 and 2020. For example, in the case of BlackRock, the report finds bias of 13.5% on management proposals in 2015, compared with bias of 2.6% in 2020. For T. Rowe Price, the report reveals a decline from 20.0% in 2015 to 4.4% in 2020.[82]

---

[79] *Id.*
[80] Shugar, *supra* note 15, at 4.
[81] *Id.*
[82] *Id.* at 5.

TABLE 3: CHANGE IN "MANAGEMENT BIAS" BETWEEN 2015 AND 2020 IN THE AS YOU SOW ANALYSIS[83]

Management Proposals

	Management Proposals (2015)	Management Proposals (2020)	Change in Bias from 2015 to 2020
BlackRock	13.5%	2.5%	-11%
State Street	12.8%	3.4%	-9.4%
T. Rowe Price	20.0%	4.4%	-15.6%
Vanguard	5.1%	0.0%	-5.1%

Shareholder Proposals

	Shareholder Proposals (2015)	Shareholder Proposals (2020)	Change in Bias
BlackRock	14.1%	3.5%	-10.6%
State Street	25.3%	7.7%	-17.6%
T. Rowe Price	50.4%	-1.2%	-51.6%
Vanguard	-21.5%	1.6%	+ 23.1%

Despite the declines in reported bias, the report concludes that "proxy voting by major asset managers favors their clients—a clear conflict of interest" and calls for "[m]ore stringent reporting requirements and new technological and policy solutions . . . to remove proxy voting conflicts of interest."[84]

In sum, of the academic studies, one finds a link between "retirement business" compensation and votes at client firms, and only on shareholder-sponsored proposals. One finds a link between "retirement business" and voting on both shareholder and management proposals, but only for one type of retirement business.[85] Others find a more attenuated association between having some "retirement business"—measured in different ways across all studies—and more "pro-management" votes across all portfolio firms on shareholder proposals concerning executive compensation and poison pills. The As You Sow analysis does find that voting by major asset managers favors their clients but also effectively documents striking declines in such "bias" over the 2015–2020 period. The next Section highlights limitations of the existing empirical studies, including the lack of adequate focus on the rules that govern decision-making within employer-sponsored plans. Later sections proceed to fill in the gaps in the analysis.

---

[83] *Id.*
[84] *Id.* at 4.
[85] Duan, Jiao & Tam *supra* note 60.

C. Limitations of Existing Scholarship

This Section highlights the limitations of the existing analyses and articulations of the "retirement business" theory. As an empirical matter, because the academic studies use different methodologies, including different ways of measuring both a fund manager's "retirement business" and the fund manager's voting preferences, direct comparisons across the studies are necessarily limited. Importantly, however, all but one of the academic studies considers mutual fund voting data from 2001-2011.[86] As this Article shows, the regulatory landscape for retirement plans in the United States has changed significantly since then.

While the studies differ in their empirical methodology, both the empirical work and the legal scholarship share the same theoretical focus on the potential divergence between the preferences of the investors (i.e., those whose money is held by the mutual funds) and the asset managers who make voting decisions.[87] In other words, the existing scholarship concerns itself almost exclusively with the incentives of the asset managers and their ability to meet their fiduciary and stewardship obligations.[88] If the preferences of the asset managers diverge from those of the investors, scholars have expressed concern both about the costs to the investors themselves, as well as to the viability of the traditional U.S. corporate governance model, in which shareholders play an important role.

Given its focus on the decisions of mutual funds, the existing scholarship overlooks key elements of the institutional context in which decisions about pension plans are made. Even though decisions by pension plans about which service providers to use and which mutual funds to include on the plan menus are critical to the "retirement business" theory, existing scholarship simply assumes that such decisions are made by company "manage-

---

[86] The Duan, Jiao & Tam study, *supra* note 60, collects data on all types of retirement business ties but presents findings only for trustee services and not for other types of retirement business ties.

[87] Scholars have noted that fund vote decision-making "takes place at three levels": at the level of the board of directors, at the level of the fund advisor, and at the level of individual portfolio managers. This dynamic "complicate[s] the task of analyzing mutual fund voting behavior." *See* Stephen Choi, Jill Fisch & Marcel Kahan, *Who Calls the Shots? How Mutual Funds Vote on Director Elections*, 3 Harv. Bus. L. Rev. 36, 41 (2013). Over time, and in response to new federal requirements, "most asset managers have created centralized governance offices that handle the voting and engagement functions for all of the funds, or clusters of funds, administered by the manager." *See* Ann Lipton, *Family Loyalty: Mutual Fund Voting and Fiduciary Obligation*, 19 Tenn. J. Bus. L. 175, 187 (2017).

[88] *See, e.g.*, Bebchuk & Hirst, *supra* note 30, at 2037 (analyzing "two types of incentive problems that push the stewardship decisions of index fund managers away from those that would best serve the interests of index fund investors"); Ashraf, Jayaraman & Ryan, Jr., *supra* note 20, at 570 ("Mutual funds have a fiduciary responsibility to act in the interests of their shareholders. Shareholder proposals provide one mechanism via which mutual funds can influence firm policies to benefit shareholders."); Davis & Kim, *supra* note 20, at 553 (noting that the "fiduciary responsibilities [of mutual fund managers] may be compromised if mutual fund parents manage employee benefit plans (such as 401(k) plans) for their portfolio firms at the behest of management").

ment"[89] or by "firm executives,"[90] and that angering "firm managers"[91] carries the risk of retribution in the form of decreased "retirement business" for a particular fund family.[92]

This Article suggests that understanding the institutional context and legal constraints that shape decision-making about corporate retirement plans is critical for a reevaluation of the pension business theory. As Section II.A demonstrates, a complex body of law has developed to govern (1) who makes the relevant decisions about which service providers to select for the plans, (2) how the process must be carried out, and (3) the legal obligations imposed on retirement plan fiduciaries. Indeed, while much of the existing scholarship is concerned with potential fiduciary breach on the part of asset managers, the same work appears to assume that a corporate "manager" angry about how a particular Fidelity fund voted on executive compensation proposals, for example, can simply switch to State Street for recordkeeping services. Such an assumption is not consistent with applicable legal requirements for employee benefit plans.

Put simply, the Employee Retirement Income Security Act of 1974 (ERISA) has established numerous constraints on the ability of "firm managers" to make decisions for employer-sponsored retirement plans that are not motivated solely by the interest of plan participants and beneficiaries. Section II.A sets forth the legal regime that has guided plan governance over the last five decades. Even though the legal regime is nearly five decades old, plan decisions in defined-contribution plans are considerably more salient and administratively burdensome than decisions for defined benefit plans, which could be made without any direct impact on plan participants.[93] Moreover, an unprecedented amount of litigation over the selection of ser-

---

[89] Davis & Kim, *supra* note 20, at 553 ("However, fund managers have to trade off the potential benefits of activism, or even simply voting against management, with the potential costs of offending client firms' management.").

[90] Cvijanović, Dasgupta & Zachariadis, *supra* note 20, at 2934 ("Since the choice of fiduciaries for 401(k) plans lies in the hands of firm executives who may be opposed to shareholder activism, there has been widespread suspicion that mutual funds may vote their proxies in a conflicted manner.").

[91] Ashraf, Jayaraman & Ryan, Jr., *supra* note 20, at 587 (noting that "mutual funds benefit when they receive pension fund business from firms, which creates a potential conflict of interest that produces an incentive for fund managers to support firm management and to vote against shareholders proposals").

[92] *See, e.g.*, Bebchuk & Hirst, *supra* note 30 ("Index fund managers can reasonably expect that the extent to which corporate managers view them favorably might influence their revenues from 401(k) plans."). Bebchuk and Hirst do acknowledge that, within public companies, the choices about retirement plan service providers and investment options "are subject to fiduciary duties," but they contend that "the decision-makers often have a number of reasonable choices, and in such cases the views and preferences of corporate managers could influence these employees' decisions." *Id.* at 2062–63.

[93] For example, investment decisions for a defined benefit plan, in which the plan sponsor bore the investment risk, did not directly impact, and did not require extensive communication to, plan participants. In contrast, changes to the investment menu of a 401(k) plan or a switch to a different recordkeeper directly impact individual participants and have to be carefully communicated by the plan administrators.

vice and investment providers for retirement plans has put plan fiduciaries on the defensive. As a result, over the last decade, U.S. corporations have become much more deliberate about who makes decisions about the firms' retirement plans, and how such decisions are made to ensure compliance with ERISA's fiduciary requirements and minimize the risk of litigation.

The next Section turns to the legal regime for employer-sponsored retirement plans, and to the changes that have altered the regime since 2008. It shows that the institutional environment that existed when the empirical studies were performed has changed significantly. To the extent that such changes undermine the feasibility of corporations to "punish" asset managers for their votes as shareholders, such changes help to explain the more recent willingness of institutional investors to challenge and vote against the preferences of corporate managers.

II. The Evolution of Retirement Plan Governance

As the previous Section has shown, existing scholarship evaluates data from over a decade ago and does not closely examine how U.S. companies actually make decisions about service providers and investment options for their plans. Yet understanding decision-making within retirement plans is critical for any theory that relies on the ability and willingness of plan sponsors to condition the selection of a particular service provider or fund on the fund manager's support for management at the corporate ballot box.

This Section first lays out the key elements of the regulatory regime for plan governance under ERISA. It shows that even five decades ago, the drafters of ERISA were keenly aware of the importance of formality and process in plan administration, as well as of the risks of abuse by those with close ties to the plan. Next, this Section details the rise in lawsuits challenging plan administration, and particularly the selection of service providers and investment options for plan menus. It shows that the consequences of such litigation, including costly settlements and disruptions in the fiduciary insurance market, have led to institutional changes in plan administration and governance. In particular, plans have delegated decision-making away from corporate boards and executives to committees comprised of employees and advisers with relevant expertise and with appropriate fiduciary training. Decision-making by plan committees has become more formal, with an emphasis on procedural prudence. Insurance companies providing fiduciary liability insurance have responded to the rise in ERISA litigation by raising rates and eligibility requirements, thereby serving as important monitors of retirement plan governance. Taken together, these changes have constrained the ability of plan fiduciaries to use plan assets to curry institutional investor support for corporate management, thus further straining the theoretical foundation for the "retirement business" theory.

A. *The Regulatory Regime for Employer-Sponsored Plans*

The regulatory regime for employer-sponsored plans dates back to 1974, when Congress enacted ERISA. At the time, traditional defined benefit pensions were the most common type of retirement benefit offered by private-sector employers.[94] In such defined benefit arrangements, employers took on the financial responsibility and risk of paying out pension benefits from the time of retirement until the former employees' deaths, with employees not playing any active role in the process. The drafters of ERISA sought to address a number of challenges that had plagued such plans in the preceding decades, including mismanagement and theft, long and idiosyncratic vesting requirements, and inadequate protections in cases of employer bankruptcy.[95] In the decades since the passage of ERISA, most U.S. employers have ceased to offer defined benefit pension plans.[96] Although federal law does not require private sector employers to offer any retirement benefits, approximately two-thirds of workers have access to an employer sponsored plan.[97] The most common kind of arrangement today is the defined-contribution plan, such as a 401(k) plan.[98]

In a typical 401(k) plan arrangement, employees elect to defer pre-tax earnings to what are effectively individual investment accounts. Employers may also make contributions to the employees' accounts. Employees then select how to invest the funds in their accounts using menus of investment options and terms selected by their employers. Employees bear the entire investment risk: at retirement, employees are entitled to receive only the amounts that have accrued in their individual accounts.[99] Employer sponsors, meanwhile, bear the responsibility for plan administration, including the preparation of plan documents, the selection of service providers, the construction of the investment menu, the communications with plan partici-

---

[94] *See generally* James A. Wooten, The Employee Retirement Income Security Act of 1974: A Political History (1st ed. 2004).

[95] *Id.* at 5; *see also* Daniel Fischel & John H. Langbein, *ERISA's Fundamental Contradiction: The Exclusive Benefit Rule*, 55 U. Chi. L. Rev. 1105, 1108 (1988).

[96] U.S. Gov't Accountability Off., GAO-18-111SP, The Nation's Retirement System: A Comprehensive Re-Evaluation is Needed to Better Promote Future Retirement Security 1–2 (2017) (noting that "employer-sponsored plans . . . have experienced a shift from traditional defined benefit (DB) plans that generally provide set monthly payments for life, to defined contribution (DC) account-based plans, like 401(k)s") [hereinafter GAO Report].

[97] *Id.*

[98] The Bureau of Labor Statistics reports that as of 2020, 52% of workers in the United States had access only to defined contribution retirement plans, while another 12% had access to both defined contribution and defined benefit plans. Only 3% of private industry workers had access to defined benefit plans only. U.S. Bureau of Labor Statistics, TED: The Economics Daily, *67 percent of private industry workers had access to retirement plans in 2020* (Mar. 1, 2021), https://www.bls.gov/opub/ted/2021/67-percent-of-private-industry-workers-had-access-to-retirement-plans-in-2020.htm.

[99] *See generally* Colleen E. Medill, Employee Benefits Law: Policy & Practice 22 (5th ed. 2018) (stating that "[a]t retirement, the balance in the account is the sum of past contributions plus interest, dividends, and capital gains or losses").

pants, and the compliance with various audit, tax, disclosure, and reporting requirements.[100] A central claim in this Article is that what happens inside the plan of any particular company—that is, who makes the relevant decisions and how such decisions are made—is critical for assessing any links between the "retirement business" and the behavior of asset managers as shareholders. This Section delves into the legal constraints and institutional norms that shape decision-making *within* plan sponsors. Section II.C then describes how a decade of ERISA litigation has reshaped such internal processes.

ERISA has several mandatory requirements for the administration of employer-sponsored retirement plans covered by Title I. These requirements formalize plan administration and the sharing of plan information with both plan participants and regulatory agencies. The key mandatory requirements include the following: first, the plan must be established and maintained in writing.[101] The written instrument must describe the procedure for allocation of fiduciaries' responsibilities for the management and administration of the plan, and must identify a "named fiduciary" who has the authority to control and manage the plan operations and administration.[102] The plan document must also specify the procedure for amending the plan, including the identity of the person or persons who have the authority to amend the plan.[103] Plan assets must be held in a trust by one or more trustees.[104] In addition, ERISA imposes a series of reporting and disclosure requirements, a number of which have been expanded over the years to provide additional information about plan expenses to plan participants, plan fiduciaries, and federal regulators.[105]

---

[100] The current allocation of risk and responsibility in defined contribution plans differs significantly from the allocation of risk and responsibility in defined benefit plans, which were prevalent in the post-World War II period. A participant in a traditional defined benefit pension plan generally expected that upon retirement, the former employer would provide monthly checks in the mail, and as such, the participant had relatively little reason to be concerned with the inner workings of the retirement plan or the investment decisions of the plan administrators. In contrast, participants in defined contribution plans are necessarily exposed to and affected by the administrative and investment decisions made for the plan. Changes to service providers (e.g., recordkeepers) or the investment menus directly affect participants and must be communicated appropriately by the plan administrators.

[101] Employee Retirement Income Security Act of 1974 § 402(a), 29 U.S.C. § 1102(a).

[102] The legislative history provides that "a written plan is required so the employee may know who is responsible for operating the plan. Therefore, the plan document is to provide for the "named fiduciaries" who have authority to control and manage the plan operations and administration. A named fiduciary may be a person whose name actually appears in the document or may be a person who holds an office specified in the document . . . ." H.R. Conf. Rep. No. 93-1280 (1973). Importantly, the plan document does not have to name a specific individual but may instead identify the named plan fiduciary as a committee or as the company that sponsors the plan. *See* DOL Reg. § 2509.75-5, 29 C.F.R. § 2509.75-5.

[103] Employee Retirement Income Security Act of 1974 § 402(b), 29 U.S.C. § 1102(b).

[104] ERISA requires that plan assets be held in trust by one or more trustees and used only to benefit the participants or to pay reasonable plan expenses. Employee Retirement Income Security Act of 1974 § 403, 29 U.S.C. § 1104(a)(1)(A)(i)–(ii).

[105] Part 1 of Title 1 of ERISA sets forth the reporting and disclosure requirements. The requirements include, for example, a summary plan description, a summary of material modifi-

The drafters of ERISA also recognized the potential harm to plan participants from transactions with plan "insiders," including the employer sponsors, service providers, owners of the plan sponsors, the fiduciaries who exercise discretion and control over the plan, and other so-called "parties-in-interest."[106] Given prior instances of abuse of and looting from retirement plans, the drafters prophylactically prohibited plan fiduciaries and other persons "closely associated with the plan from engaging in transactions that involve plan assets."[107] As a result, such transactions cannot take place unless a statutory or administrative exemption applies.[108]

In addition to prohibiting nearly all transactions with those closest to the plan, the drafters also imposed standards of conduct on those acting as plan fiduciaries. Indeed, fiduciary standards and fiduciary liability are presently at the heart of the ERISA regulatory regime. ERISA recognizes five types of fiduciaries: (1) named plan fiduciaries; (2) plan administrators; (3) plan trustees; (4) plan investment managers; and (5) so-called "functional" fiduciaries. A review of each role helps to illuminate traditional plan governance structures in employer-sponsored retirement plans.

As discussed above, ERISA requires that every plan must have at least one named fiduciary, who is designated in the plan document as having the overall "authority to control and manage the operation and administration of the plan."[109] Every plan also needs an administrator. If the plan document does not designate a plan administrator, then the employer sponsor becomes the plan administrator by default and bears the fiduciary liability described below.[110] Commonly, the plan sponsor designates a committee of employees

cations, and an annual report for the plan. In 2012, the Department of Labor promulgated new fee-disclosure regulations to help both plan fiduciaries and plan participants better understand the costs associated with various plan services and plan investments. *See* 29 C.F.R. § 2550.408b-2(c)(iv) (establishing specific disclosures that service providers must provide to plan fiduciaries to help ensure that the fiduciaries have the necessary information to assess both the reasonableness of the compensation to be paid for plan services and potential conflicts of interest that may affect the performance of those services); Fiduciary Requirements for Disclosure in Participant-Directed Individual Account Plans, 29 C.F.R. § 2550.404a-5(c)–(d) (requiring plan administrators to provide participants with certain "plan-related" and "investment-related" fee information).

[106] Employee Retirement Income Security Act of 1974 § 3(14), 29 U.S.C. § 1002 (14).

[107] Medill, *supra* note 93. The purpose of ERISA's prohibited transaction rules is to "make illegal per se the types of transactions that experience had shown to entail a high potential for abuse." *Id.* (citing Donovan v. Cunningham, 716 F.2d 1455, 1464–65 (5th Cir. 1983)).

[108] The prohibited transaction rules of ERISA § 406 are so broad that Congress had to create a number of statutory exemptions in order to allow the plans to function. These statutory exemptions are listed in ERISA § 408 and include the exemption that allows for the payment of "reasonable" compensation to service providers to the plan. Employee Retirement Income Security Act of 1974 § 408(b)(2), 29 U.S.C. § 1108(b)(2). The Department of Labor also issues administrative exemptions to the prohibited transaction rules.

[109] Employee Retirement Income Security Act of 1974 § 402(a)(1), 29 U.S.C.A. § 1102(a).

[110] Employee Retirement Income Security Act of 1974 § 3(16)(A), 29 U.S.C. § 1002(16)(A).

to serve as the plan's administrator.[111] As Section II.C describes, the composition of such committees has changed in recent years.

In addition to requiring a named plan fiduciary and a plan administrator, ERISA also requires a plan trustee to hold the plan assets. The trustee is a fiduciary role.[112] The trustee's discretionary authority can vary across plans, and all or a portion of the plan assets held by the trustee may be managed and invested by an investment manager. To qualify as an "investment manager" under ERISA, the manager must be a bank, insurance company, or registered investment adviser with the power to manage, acquire, or dispose of any asset of the plan. ERISA requires that the investment manager acknowledge in writing that the manager is a fiduciary with respect to the plan.[113]

Finally, ERISA also imposes fiduciary status on so-called "functional fiduciaries," irrespective of their roles or formal titles. ERISA defines a fiduciary based on the functions actually performed and includes anyone who has discretionary authority or control respecting the management of plan assets, anyone with discretionary authority or responsibility in the administration of the plan, and anyone who renders investment advice concerning plan assets for compensation.[114] Accordingly, a person can become an ERISA fiduciary without knowing or intending that result.

Fiduciary status under ERISA carries significant responsibility and liability, including personal liability for fiduciary and co-fiduciary breach.[115] Fiduciary duties include the duty of loyalty to plan participants, the duty of prudence, the duty of prudent diversification, and the duty to follow plan terms. The duty of loyalty requires that a fiduciary must act "solely in the interest" of plan participants and beneficiaries, and for the exclusive purposes of "providing benefits to the participants and their beneficiaries" and "defraying reasonable expenses of administering the plan."[116] In other

---

[111] *See* Colleen E. Medill, *Regulating ERISA Fiduciary Outsourcing*, 102 IOWA L. REV. 505, 515 (2017) (stating that "if the corporate-entity employer who sponsors the plan does not want to be liable for the fiduciary administrative responsibilities associated with the operation of the plan, the employer may designate an individual or a committee to serve as the section 3(16) plan administrator" and highlighting that "the employer may outsource the responsibilities of a section 3(16) administrator to a third-party professional plan administrator"). Given the complex regulatory framework under ERISA, "employers have become increasingly interested in outsourcing the federal-fiduciary responsibilities associated with plan operation and administration." *Id.* at 507. Notably, while such delegation is permissible under ERISA, employer sponsors retain fiduciary obligations in the selection and oversight of any service providers to the plan.

[112] Employee Retirement Income Security Act of 1974 § 403, 29 U.S.C. § 1002(21).

[113] Employee Retirement Income Security Act of 1974 § 3(38), 29 U.S.C. § 1002(38).

[114] Employee Retirement Income Security Act of 1974 § 3(21), 29 U.S.C. § 1002(21).

[115] Co-fiduciary duties under ERISA impose liability on one fiduciary for the breach of fiduciary responsibility by another fiduciary under certain conditions, including in circumstances where the fiduciary "has knowledge of a breach by such other fiduciary, unless he makes reasonable efforts under the circumstances to remedy the breach." Employee Retirement Income Security Act of 1974 § 405, 29 U.S.C. § 1105.

[116] Employee Retirement Income Security Act of 1974 § 404(a)(1)(A), 29 U.S.C. § 1104(a)(1)(A).

words, those subject to ERISA's fiduciary obligations must act with an "eye single" to the interests of the plan's participants and beneficiaries.[117] Importantly, this requirement applies to the officers, employees, agents, or other representatives of the plan sponsor who serve as plan fiduciaries.[118] The duty of prudence requires that a plan fiduciary must act "with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use."[119] The ERISA standard, therefore, is not that of a layperson but instead that of a prudent investment professional.

A fiduciary who breaches her obligations is liable to "make good to such plan any losses to the plan resulting from each such breach, and to restore to such plan any profits of such fiduciary which have been made through use of the assets."[120] Given the risk of personal liability, individuals who are asked to serve in a fiduciary capacity commonly request indemnification and fiduciary liability insurance coverage.[121] Plan assets can be used to purchase fiduciary liability insurance so long as the policy permits recourse by the insurer against the fiduciary if a court finds that a breach of fiduciary duty has occurred.[122] The recourse requirement does not apply for policies purchased by the employer (using corporate assets) or by the individual.

The rise in ERISA litigation has heightened awareness of and demand for fiduciary liability insurance. The same litigation trends, however, have made ERISA fiduciary liability insurance more costly and difficult to obtain, with insurers now playing an important monitoring role over retirement plan

---

[117] Donovan v. Bierwith, 680 F.2d 263, 271 (2nd Cir. 1982).

[118] In a departure from the common law of trusts, from which the drafters of ERISA borrowed heavily, ERISA permits officers, employees, agents, or other representatives of the plan sponsor also to serve as plan fiduciaries. Employee Retirement Income Security Act of 1974 § 408(c)(3), 29 U.S.C. § 1108. Scholars have observed that this decision by the drafters of ERISA potentially places such individuals "in a position of divided loyalties between the plan participants and the plan sponsor." *Id.*; Medill, *supra* note 93, at 466.

[119] Employee Retirement Income Security Act of 1974 § 404(a)(1)(B), 29 U.S.C. § 1104(a)(1)(B).

[120] ERISA § 409 provides that a fiduciary "who breaches any of the responsibilities, obligations, or duties imposed upon fiduciaries by this subchapter shall be personally liable to make good to such plan any losses to the plan resulting from each such breach, and to restore to such plan any profits of such fiduciary which have been made through use of assets of the plan by the fiduciary, and shall be subject to such other equitable or remedial relief as the court may deem appropriate, including removal of such fiduciary." Employee Retirement Income Security Act of 1974 § 409, 29 U.S.C. § 1109.

[121] Attorneys representing plan sponsors and fiduciaries routinely advise fiduciaries to obtain such insurance coverage. *See, e.g.*, Ropes & Gray Podcast, *ERISA 401(k)/403(b) Fiduciary Developments: The Grab Bag Episode*, at 12:58 (June 23, 2022), https://www.ropesgray.com/en/newsroom/podcasts/2022/June/Podcast-ERISA-Fiduciary-Developments-The-Grab-Bag-Episode ("ERISA does not require fiduciaries to purchase such coverage [but] it is certainly prudent to have it, as it protects the plan fiduciaries against personal liability imposed upon them by ERISA to restore losses to the plan caused by any breaches.").

[122] Employee Retirement Income Security Act of 1974 § 409(b), 29 U.S.C. § 1110.

governance. The evolution of lawsuits targeting 401(k) plans and plan fiduciaries is described in the Section below.

B. Fifteen Years of ERISA Litigation

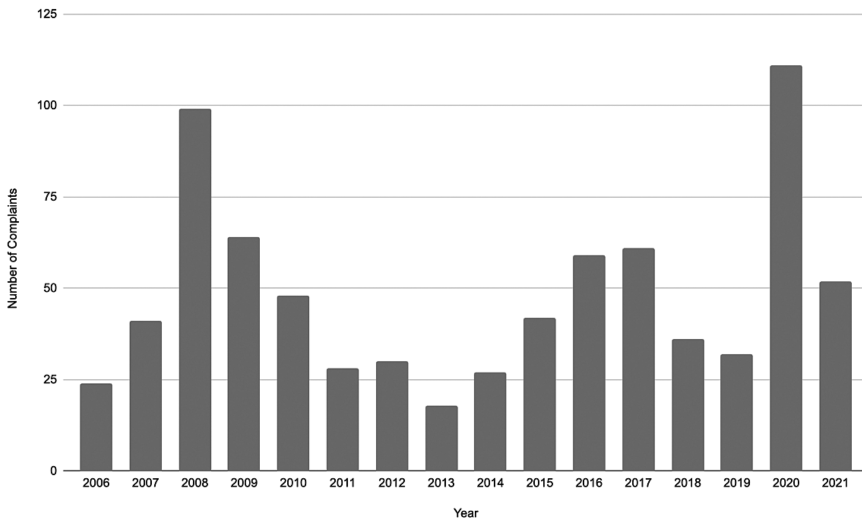
As 401(k) type retirement plans have grown in the United States, so too has the scrutiny of such plans by participants, regulators, and plaintiffs' lawyers. As Chart 1 demonstrates, since the first such case was brought in 2006, there have been hundreds of lawsuits alleging that retirement plan fiduciaries breached their obligations to plan participants and beneficiaries.[123] Aggregate data suggests that there have been multiple waves of cases, with the first spike in cases between 2008–2009, then another spike between 2015–2017, and the latest spike starting again in 2020.[124] The litigation shows no signs of slowing. There have been more than 200 cases filed since 2020 and as of June 2022, "there [were] proposed class actions currently pending in more than half of the U.S. federal district courts."[125]

[123] George S. Mellman & Geoffrey T. Sanzenbacher, *401(k) Lawsuits: What Are the Causes and Consequences?*, Ctr. For Ret. Rsch. B.C., Issue in Brief No. 18-8 (May 2018), http://crr.bc.edu/wp-content/uploads/2018/04/IB_18-8.pdf; Jayne Zanglein, *Fees and Expenses Litigation in Defined Contribution Plans,* ERISA Litigation (Bloomberg BNA 2021).

[124] Goodwin Procter LLP, *ERISA Litigation Update* (Dec. 16, 2021), https://www.goodwinlaw.com/publications/2021/12/12_16-erisa-lit-quarterly.

[125] Jacklyn Wille, *Flood of 401(k) Fee Lawsuits Spur Wave of Early Plaintiff Wins*, Bloomberg L. (Apr. 5, 2022); *see also* Valerie Ge, *Pace of ERISA-related lawsuits remains high in Q4*, Pens. & Inv. (Jan. 25, 2023), https://www.pionline.com/rcblog/pace-erisa-related-lawsuits-remains-high-q4 (reporting that "[d]uring the fourth quarter of 2022, 48 ERISA-related lawsuits were filed and/or updated").

CHART 1: NUMBER OF COMPLAINTS RELATED TO 401(K) PLAN FEES & INVESTMENTS, 2006-2021[126]



The bulk of such lawsuits, which name as defendants not only the plan sponsors but also the individual fiduciaries who served on plan committees during the relevant time periods, have been "excessive fee" cases focused specifically on the selection of service providers and funds for the plan.[127] The lawsuits are commonly brought as class actions, often on behalf of thousands of current and former plan participants and beneficiaries. The cases fall into two key categories. The first category includes cases that allege excessive recordkeeping and administrative fees being charged to plan participants.[128] The second category includes cases that challenge the selection and retention of allegedly overpriced and underperforming investments, particularly in instances where higher-cost retail shares are included on plan menus instead of lower-cost institutional share classes of the same investments.[129] Within the latter category, a subset of cases involve so-called "pro-

[126] The data in Chart 1 was assembled using the LexMachina database to search for complaints related to 401(k) plans over the 2006–2021 period.

[127] Carrigan v. Xerox Corp., No. 3:21-cv-01085-RNC, 2022 WL 1137230, Brief of the Amicus Curiae Chamber of Commerce of the United States of America in Support of Defendants' Motion to Dismiss (D. Conn. Nov. 11, 2021) (noting that "[i]ncreasingly, dozens of individuals have found themselves named as class-action defendants (from every member of a defendant's board of directors to lower-level human resources personnel)"); *see also* Robert Iafolla & Jacklyn Wille, *U.S. Chamber's 'Unique' Court Strategy Targets 401(k) Fee Cases*, BLOOMBERG L. (Mar. 17, 2022).

[128] In these types of cases, a common allegation involves the fiduciaries' failure to factor in revenue-sharing fees paid by mutual fund managers to recordkeepers and other service providers. *See* Zanglein, *supra* note 117, at 34.I.

[129] Ropes & Gray, *supra* note 115; *see also* Zanglein, *supra* note 117, at 34.II.B (noting that plaintiff claims commonly include the claim that fiduciaries breached their obligations by

prietary" fund cases, in which plaintiffs claim that plan fiduciaries breached their fiduciary duties and engaged in prohibited transactions by selecting for the plan menu funds affiliated with the plan sponsor.[130]

Since 2008, the case law, including several Supreme Court cases, has clarified the scope of fiduciary obligations in the construction of 401(k) plan menus and the selection and oversight of various service providers to the plan.[131] Over the years, the courts have had to reconcile the existence of the so-called ERISA § 404(c) safe harbor, which limits the liability of an ERISA fiduciary for the individual choices that participants make over the allocation of assets in their accounts, with the fiduciary obligations to administer and manage the plan in a loyal and prudent manner.[132]

Early cases were relatively skeptical of claims that investment options on menus, including those with high fees, should give rise to liability in light of the ERISA § 404(c) safe harbor. In *Hecker v. Deere*, the Seventh Circuit found that a menu that included high-cost funds did not give rise to fiduciary liability. The court focused on the overall size of the menu, noting that it offered "23 different Fidelity mutual funds, two investment funds managed by a Fidelity Trust, and a fund devoted to Deere's stock."[133] The court gave particular consideration to the plan's use of a brokerage window, which allowed participants to select from 2,500 funds across a variety of fund complexes for an additional fee.[134] Menu size as a defense was also endorsed in cases like *Braden v. Wal-Mart*, leading to the result that, for a time, plan investment menus that offered at least some good options could benefit from the protection of the ERISA § 404(c) safe harbor.[135]

---

either "offering mutual fund investment options instead of lower cost separate accounts; offering more expensive actively managed funds as investment options instead of index funds, or offering more expensive retail class mutual funds as investment options instead of institutional class funds").

[130] Zanglein, *supra* note 117, at 34.II.B (clarifying that in such cases "[p]laintiffs claim that fiduciaries, by choosing proprietary funds, selected expensive or poorly performing proprietary funds in order to benefit the employer or its affiliates and thus violated their fiduciary duties to the plan and the plan participants").

[131] *See, e.g.,* Tussey v. ABB, Inc., 2019 WL 3859763, at 3 (W.D. Mo. Aug. 16, 2019) (stating that "this kind of litigation has made a 'national contribution' in the clarification and refinement of a fiduciary's responsibilities and duties" and that such litigation has "not only educated plan administrators throughout the country, it [has also] educated the Department of Labor").

[132] Employee Retirement Income Security Act of 1974 § 404(c), 29 U.S.C. § 1104(c) (providing that in a plan that permits a participant or beneficiary to exercise control over the assets in his account, "no person who is otherwise a fiduciary shall be liable under this part for any loss, or by reason of any breach, which results from such participant's or beneficiary's exercise of control"). DOL regulations implementing § 404(c) set forth a series of conditions that plans must meet in order to avail themselves of the § 404(c) safe harbor.

[133] Hecker v. Deere & Co., 556 F.3d 575, 578 (7th Cir. 2009).

[134] *Id.* at 581.

[135] The court in *Wal-Mart* drew a comparison with *Hecker v. Deere & Co.*, which involved a fiduciary duty claim based on excessive fees where participants had access to over 2,500 mutual funds, noting that the district court in *Hecker* found it "untenable" that all of the more than 2,500 available investment options had excessive expense ratios. The *Wal-Mart* court then noted that "[t]he far narrower range of investment options available in this case makes more

Over time, the courts shifted their focus away from the size of the overall menus to the process of selecting and reviewing investment menu options and service provider arrangements. In the 2015 *Tibble v. Edison International* case, Edison International offered retail-class mutual funds as part of its 401(k) plan, even though otherwise identical institutional-class funds that charged lower fees were available. The mutual funds on Edison's menu also gave a portion of the fees collected back to plan service providers, which thereby reduced Edison's administrative costs.[136] Plan participants argued that the continued inclusion of the higher-cost funds in the plan was a "continuing violation" of ERISA. With its focus on the process of menu construction and oversight, the court emphasized that even in a defined-contribution plan where participants choose their investments from the plan menu, plan fiduciaries are required to conduct their own independent evaluation to determine which investments may be prudently included in the plan's menu of options, and such fiduciaries have a continuing duty to "monitor investments and remove imprudent ones."[137]

In 2022, the Supreme Court explicitly addressed the "large menu defense" in *Hughes v. Northwestern University*, a case in which the plaintiff-participants alleged that Northwestern's retirement plan fiduciaries, including the Retirement Investment Committee, violated ERISA's duty of prudence in the following ways: by offering a menu of investment options that was too broad and thereby causing participant confusion and poor investment decisions, by failing to monitor and control recordkeeping fees, and by offering retail share class mutual funds and annuities that carried higher fees than those charged by otherwise identical institutional share classes.[138] In a unanimous decision, the court held that maintaining an unusually large number of investment options on a plan menu will not absolve a fiduciary of its failure to continually monitor and remove or replace poor-performing, high-cost or otherwise imprudent investments from the menu. In rejecting the so-called "large menu" defense, the Supreme Court emphasized that the Seventh Circuit's approach elided the duty of prudence requirements that apply to plan fiduciaries in the construction and oversight of the plan's investment menu.[139]

As numerous ERISA cases have wound their way through the courts, the costs associated with litigation have likewise climbed, with practitioners observing that "litigation is very, very expensive."[140] If the case proceeds beyond a motion to dismiss to discovery, "it becomes very, very expensive

plausible the claim that this Plan was imprudently managed." Braden v. Wal-Mart Stores, Inc., 588 F.3d 585, 596 (8th Cir. 2009).

[136] Tibble v. Edison Int'l, 575 U.S. 523, 525–26 (2015).

[137] *Id.* at 529–30.

[138] Hughes v. Nw. Univ., 142 S. Ct. 737, 738 (2022).

[139] *Id.* at 742.

[140] Jacklyn Wille, *Spike in 401(k) Lawsuits Scrambles Fiduciary Insurance Market*, Bloomberg L., Oct. 18, 2021 (quoting Rhonda Prussack, senior vice president and head of fiduciary and employment practices liability at Berkshire Hathaway).

even for smaller plans."[141] Large settlement amounts in fee cases have also drawn significant attention.[142] In the 2014–2017 period, for example, the top ten ERISA class action settlements totaled $992.23 million on average. The top ten ERISA class action settlements totaled $313.4 million in 2018, $376.35 million in 2019, $380.01 million in 2020, and $411.05 million in 2021.[143] Examples of 401(k) suit settlements since 2015 include: Wells Fargo ($32.5 million); John Hancock ($14 million), McKinsey & Co. ($39.5 million), Allianz ($12 million), American Airlines ($22 million), Northrop Grumman ($16.75 million), MassMutual ($30.9 million), Novant Health ($32 million), Boeing ($57 million), Ameriprise ($27.5 million), and Lockheed ($62 million).[144]

The volume of both the lawsuits and the settlement amounts has drawn the attention and the concern of industry groups, who have sought to underscore the legal exposure of those associated with ERISA plans, and the significant increases in the fiduciary insurance costs.[145] The general consensus at present is that 404(c) regulations provide only limited relief: employers are still responsible for selecting prudent investment choices, and for monitoring the investment options and managers chosen for the plan.[146] Accordingly, attorneys have counseled plan sponsors on ways to limit their litigation risk and exposure. Ropes & Gray LLP, for example, has been a self-professed "broken record" in its advice that "following good fiduciary practices" will be one of the most important defenses against a potential

---

[141] *Id.*

[142] *Id.* (noting that "settlements can be significant, particularly if the defendant is a financial company that puts its inhouse funds in its retirement plan," with $430 million in settlements in that subset of cases since 2015, including more than a dozen eight-figure deals); *see also* Jacklyn Wille, *Suits Over 401(k) Fees Nab $150 Million in Accords Big and Small*, BLOOMBERG L., Aug. 23, 2022 (reporting that "[t]he recent explosion in 401(k) fee litigation has spawned more than $150 million in settlements just in suits filed in the past three years, driven by eight-figure deals signed by Wells Fargo & Co., McKinsey & Co., and Walgreen Co., along with more than two dozen smaller deals worth less than $5 million").

[143] Seyfarth, 18TH ANNUAL WORKPLACE CLASS ACTION LITIGATION REPORT 2 (2022), https://www.seyfarth.com/dir_docs/publications/2022_Workplace_Class_Action_Report_Ch1_2.pdf.

[144] José M. Jara, *ERISA: Thou Shall Not Pay Excessive Fees!*, ABA REAL PROPERTY, TRUST AND ESTATE LAW REPORT (2019), https://www.americanbar.org/groups/real_property_trust_estate/publications/ereport/rpte-ereport-winter-2019/; *see also* Jacklyn Wille, *In-House 401(k) Fund Suits Cost Financial Companies $430 Million*, BLOOMBERG L., June 3, 2021.

[145] Robert Steyer, *Sponsors Rocked by Fiduciary Insurance Hikes*, PENS. & INV., Sept. 20, 2021 (stating that "[e]rupting ERISA litigation is forcing defined contribution sponsors to endure higher fiduciary liability insurance premiums, with some renewals costing double or triple and most averaging double-digit increases"); *see also* Carrigan v. Xerox Corp., Civil Action No. 3:21-cv-01085-RNC, Brief of the Amicus Curiae Chamber of Commerce of the United States of America, Nov. 11, 2021 (noting the "recent surge of class actions challenging the management of employer-sponsored retirement plans" and lamenting the "cascade of changes in the insurance marketplace," including "inflating insurance costs" that have made it "all-but impossible to obtain adequate insurance coverage").

[146] The Vanguard Group, Inc., *Best Practices for Plan Fiduciaries* 26 (2019), https://institutional.vanguard.com/iam/pdf/FBPBK.pdf.

lawsuit and more likely to persuade a judge.[147] The firm, like other similarly situated advisers, counsels that "a well-documented process that is used consistently and in good faith should provide a strong defense for plan fiduciaries."[148] Good fiduciary practices include the following: (1) regularly meeting with an investment advisor to evaluate the performance of each fund on the investment menu in comparison to its peers; (2) carefully selecting and monitoring service providers to the plan; and (3) issuing requests for proposals (RFPs) on a periodic basis to benchmark recordkeeping fees, investment advisor fees, and any other fees that are being paid from plan participant account balances.[149]

As the next Section shows, many plan sponsors have heeded the advice from counsel as well as the demands from fiduciary liability insurance providers, resulting in the adoption of numerous governance changes that formalize, professionalize, and constrain decision-making within employer-sponsored retirement plans.

C. *The Formalization of Plan Governance*

Over the last decade, retirement plan governance has been characterized by the establishment and expansion of administrative and investment committees, the specialization and training of committee members, and the formalization of the decision-making processes. A number of such changes specifically aim to distance and insulate corporate leadership, including the board of directors, from responsibility and liability under ERISA.

a. Formation, Formalization & Professionalization of Plan Committees

While ERISA only requires plans to identify the "named fiduciary" for the plan, over the last decade, plan sponsors have increasingly set up one or more committees "of appropriate parties from within the plan sponsor company" to handle plan administration and investment matters. Companies have been spurred to form committees, and to carefully consider the composition of such committees, to mitigate ERISA litigation risk. Specifically, committees have been formed to formalize and professionalize fiduciary decision-making and to explicitly shield corporate boards and C-suite executives from potential ERISA exposure.[150]

---

[147] Ropes & Gray, *supra* note 121 ("And I'm sure we sound like a broken record here because we've continued to stress this in this series, but putting in place and following good fiduciary practices will be one of the most important defenses against a potential lawsuit and more likely to persuade a judge.").

[148] *Id.*

[149] *Id.*

[150] Marcia S. Wagner & Thomas E. Clark, *The Evolution of ERISA Fiduciary Best Practices*, Investments Wealth Monitor 17 (2016), https://info.wagnerlawgroup.com/hubfs/docs/ERISAFiduciaryBestPractices_000.pdf. In cases where the employer-sponsored retire-

Attorneys representing plan sponsors have counseled that while ERISA does not require a committee, appointing a committee as a named fiduciary is likely to result in "more careful attention to plan issues" and also serve to relieve the company's owner or board from most responsibilities for the plan.[151] The owner's or board of directors' responsibility would be limited to prudently appointing committee members and monitoring their overall performance."[152]

Larger plan sponsors now commonly set up two committees: the Investment Committee, which handles investment selection and monitoring, and the Administrative Committee, which handles daily operations of the plan, including documentation and compliance matters.[153] Recent practice recommendations include using a committee charter or including relevant language in the plan document to define committee structure and responsibilities, including "the number of members, the required presence of senior officers, the reporting relationship to senior management (or board, if applicable), the selection and removal process of members, the purpose and frequency of meetings, voting procedures and guidelines, as well as the procedure for generating minutes for each meeting."[154] Committees typically report to senior management within a firm.[155]

Who sits on such committees? Understanding the committee composition is critical for examining potential links between the "retirement business" and how institutional investors vote, particularly vis-a-vis the preferences of corporate management. Prior scholarship has largely glossed over this point, assuming in many instances that "corporate management" makes decisions about the retirement plan investment options and service providers. The assumptions stem in part from the lack of transparency about membership on plan committees. Indeed, while plans are required to list a "named fiduciary," nothing in ERISA requires plan sponsors to disclose the

ment plan holds company stock, practitioners advise that "it may be advisable to appoint an independent fiduciary rather than the top executives" to limit conflict of interest concerns in potential "stock-drop" lawsuits. In such lawsuits, plaintiffs typically allege losses to the plan from plan investment in company stock. *See, e.g.,* Rebecca Moore, *Establishing a Retirement Plan Committee*, PLANSPONSOR (Dec. 15, 2020), https://www.plansponsor.com/in-depth/establishing-retirement-plan-committee/?layout=print.

[151] Rebecca Moore, *Establishing a Retirement Plan Committee*, PLANSPONSOR (Dec. 15, 2020), https://www.plansponsor.com/in-depth/establishing-retirement-plan-committee (quoting Carol Buckmann, co-founding partner at Cohen & Buckmann P.C.).

[152] *Id.*

[153] *Id.* Some larger plan sponsors have also started to establish "settlor committees" to handle "plan design decisions that aren't treated as fiduciary decisions.

[154] Vanguard, *supra* note 140, at 17.

[155] According to Vanguard, "the trend is to report to the senior management team, on the theory that the board is not as well-positioned to focus on the level of detail that effective oversight entails." *Id.* at 13. Some plans have also formally delegated to human resources managers the authority to appoint plan committee members. *See*, *e.g.*, Xerox Corporation Savings Plan Form 5500 (2021)(stating that the "Plan Administrator Committee is appointed by the Vice President of Human Resources of the Company and is responsible for the general administration of the Plan and for carrying out the Plan provisions.").

individuals who make up particular committees. Accordingly, committee membership information is not readily available even for plan participants.[156]

Industry surveys and practitioner guidance point to the "professionalization" of plan committees, a trend that is also consistent with efforts to limit C-suite exposure to ERISA liability.[157] Those selected to serve on plan committees are chosen "for their different roles in the company that may touch the plan in one way or another, including finance, human resources, labor, etc."[158] At present, the most common criteria for determining who participates on committees is job title, with expertise a close second (particularly on the investment committee), and willingness to participate a distant third.[159] The majority of committees have between five and ten participants, with smaller organizations more likely to have fewer than five committee participants and large organizations more likely to have between five and ten participants.[160] Table 4 draws from ERISA litigation records to provide examples of committee composition.

---

[156] For this reason, lawsuits challenging plan administration often name "John Doe 1-10," for example, as members of the relevant plan committees. Specific names are commonly not available unless the litigation proceeds through the discovery process.

[157] Vanguard, *supra* note 140, at 16 (stating that "[i]ndividuals chosen for the committee should have relevant experience, either in investment, plan administration, or both" and "should be familiar with their duties and responsibilities under the law," and recommending that "[i]f an organization lacks individuals with appropriate qualifications, the committee members should pursue relevant knowledge through training programs or professional counsel").

[158] Wagner & Clark, *supra* note 150, at 17.

[159] Plan Sponsor Council of America, Retirement Plan Committees 2 (2021) https://www.psca.org/sites/psca.org/files/Research/2021/2021%20Snapshot_Ret%20Plan%20Com_FINAL.pdf.

[160] *Id.* at 3.

TABLE 4: SAMPLE COMMITTEE COMPOSITION[161]

Company Name	Committee (as of year)	Committee Composition
Target Corp., Inc.	Investment Committee (2013–2014)	Chief Financial Officer, Senior Vice President-Financial Planning & Analysis, Vice President-Pay and Benefits, Chief Human Resources Officer, Chief Information Officer
RadioShack, Corp.	Administrative Committee (2009–2013)	Vice President & Treasurer; Human Resources Director, Employee Benefits; Director of Employee Benefits; Vice President of Compensation & Human Resources Data, Vice President of Merchandising Operations; Vice President, Finance; Vice President, Strategic Development
Charles Schwab, Corp.	Employee Benefits Administrative Committee (2011–2017)	Executive Vice President, Human Resources; Senior Vice President, Compensation & Benefits; Chief Operating Officer; Vice President, Investment Services Segments; Senior Vice President of Advisor Services Technology Solutions; Senior Vice President, Mobile Apps; Senior Vice President, Investor Services; Senior Vice President, Schwab Advisor Services
T. Rowe Price Group, Inc.	U.S. Retirement Program Trustees (2011–2017)	Vice President & Portfolio Manager; Director of Finance & Corporate Services; Vice President & Head of Total Rewards Program; Chief Financial Officer & Treasurer, Vice President, Head of Compensation & Benefits

With increasing frequency, those selected to serve on plan committees are required to undergo fiduciary training. Such training is quickly becoming a "best practice" for plan administration, particularly given the Department of Labor inquiries about formalized training in its recent examinations and audits of defined contribution plans.[162] Attorneys representing plan sponsors "highly recommend" that employee fiduciaries undergo training "at least every two or three years," and that new fiduciaries "should receive fiduciary

[161] Information in this table draws on the review of litigation records in ERISA cases, including those that advanced sufficiently far in the litigation process to allow some discovery to take place.

[162] Wagner & Clark, *supra* note 150.

training prior to or shortly after assuming their role."[163] Training not only protects the plan participants, the employer, and the fiduciaries themselves, but, as discussed below, it also may be required by the plans' fiduciary insurer.

In recent years, legal and investment professionals themselves have taken on greater roles on plan committees. Survey data suggests that approximately two-thirds of organizations have legal counsel participate in committee meetings, with large organizations especially likely to have such legal counsel participation.[164] At the same time, and likely at least as a result of greater attorney and investment professional participation, the process by which committees make decisions has become considerably more formal, with a heavy emphasis on the documentation of steps necessary to demonstrate the satisfaction of ERISA's prudence requirements.

b. Formalization of Process to Select Investments, Investment Managers, and Other Service Providers

Both the rise of ERISA lawsuits challenging plan fees and service provider arrangements and the Supreme Court's articulation of the "continuing monitoring" requirements in *Tibble* have motivated retirement plan committees to make decisions in a more systematic manner. The additional fee disclosure requirements promulgated by the Department of Labor in 2012, which expanded the fee disclosures that service providers must provide to the plan, give plan sponsors the tools to more easily evaluate fees and make better-informed decisions.[165]

With respect to the selection of investments and investment managers for the plan, investment committees are encouraged to adopt an Investment Policy Statement (IPS) that defines the purpose, objectives, and measures of success for the plan, summarizes the plan's investment strategy, and describes the process for evaluating money managers. After adopting an IPS, plan fiduciaries (typically the investment committee) must ensure that the investments and the managers that it selects are consistent with the IPS

---

[163] Nancy Gerrie & Joanna Kerpen, *Best Practices for ERISA Plan Fiduciary Governance*, Defined Contributions Insights 18 (Winter 2020) https://www.winston.com/images/content/2/2/v3/228255/Plan-Fiduciary-Best-Practices-2020.pdf; *see also* Michael Abbott, Foley & Lardner LLP, *ERISA Fiduciary Training – Should Employee/Fiduciaries Live Without It?*, July 20, 2019, https://www.foley.com/en/insights/publications/2019/07/erisa-fiduciary-training-live-without-it.

[164] Plan Sponsor Council, *supra* note 160, at 2 (reporting that legal counsel participation is routine "among only half of organizations with fewer than 1,000 plan participants," in contrast to the "91.9 percent of organizations with more than 5,000 participants" that report legal counsel participation on plan committees).

[165] *See* 29 C.F.R. § 2550.408b-2(c)(iv), *supra*, note 105.

goals, suitable for plan participants, and reasonable in the fees charged to the participants.[166]

With fees as the focus of recent ERISA litigation, all plan committees are strongly advised to select service providers and investment menu options through a Request for Proposals (RFP) process. An RFP process entails soliciting and comparing information and bids from multiple potential providers. Because the RFP process is quite "difficult and time-consuming," plan sponsors are not likely to undertake it more often than necessary.[167] Importantly, the committees' work does not end once the initial providers have been selected. Indeed, to satisfy the ongoing monitoring obligation set forth in *Tibble*, the committees must remain vigilant and exert appropriate oversight on behalf of the plan. Regular benchmarking is considered an essential "prophylactic" measure against ERISA lawsuits. Finally, practitioners advising plan sponsors widely urge careful documentation of the decision-making process since litigants, courts, and regulators will review meeting minutes when assessing cases of potential fiduciary breach. Accordingly, careful documentation is critical in establishing "procedural due diligence," which is an important factor in demonstrating good fiduciary practices.[168]

As a result of the dynamics described above, changes to service providers are not likely to occur on a whim; instead, given the regulatory environment for retirement plans, such changes are now more likely to take place pursuant to a structured and time-consuming process. Moreover, for larger plans under the close watch of plaintiff attorneys, any such changes are likely to draw attention and scrutiny. Switching recordkeepers for the plan on the whim of a senior executive or board member, without undergoing sufficient diligence and documentation to demonstrate the benefit for plan participants, would expose plan fiduciaries (including potentially the senior executives and board members) to personal liability under ERISA.

c. Fiduciary Insurance Providers as Governance Monitors

The rise in ERISA litigation against plan fiduciaries has driven up demand for fiduciary liability insurance, "wreak[ing] havoc" in a market previously considered inexpensive compared to other business insurance.[169]

[166] VANGUARD, *supra* note 146, at 24 (advising that hiring, evaluating and, as necessary, terminating money managers for the plan is a "fundamental responsibility" of plan fiduciaries that requires "a disciplined process for manager selection and evaluation").

[167] PLANSPONSOR, 2021 Best Practices Conference, Benchmarking Investments and Fees (Nov. 2021), https://www.plansponsor.com/2021-best-practices-conference-benchmarking-investments-fees/.

[168] VANGUARD, *supra* note 146, at 17. Accordingly, "Vanguard encourages plan sponsors to take documentation seriously." *Id.*

[169] Wille, *supra* note 140 (reporting that "[a] sharp spike in lawsuits over retirement plan fees has wreaked havoc on the market for fiduciary liability insurance, which provides protection for companies accused of mismanaging their employee benefit plans" and noting that

Insurance providers, in turn, have not only increased premium costs and retention amounts,[170] but have also "bulked up" their own diligence process in important ways.[171] As practitioners have observed, insurance carriers are "well aware of what's going on in the courts" and have calibrated their risk assessments accordingly.[172] Therefore, insurance carriers request detailed information about plan governance features, including the plan's approach to "fiduciary processes, monitoring investments, and benchmarking vendors."[173] Plans must also provide information about the investments included on the plan menus. Plans that include options other than index funds, that is, funds that may draw the scrutiny of plaintiffs' attorneys, must justify the inclusion of such investment options on the plan menu.[174] In some cases, insurance providers impose additional governance requirements, such as requiring fiduciaries to undergo additional training.[175]

III. Reassessing the Role of Retirement Plans in U.S. Corporate Governance

Law and finance scholarship from the last decade has analyzed extensively the behavior of institutional investors—and particularly mutual funds—as increasingly important shareholders in America's public companies. The scholarship, as well as related regulatory efforts by the Securities & Exchange Commission, have been animated by a concern that mutual fund managers may not be meeting their fiduciary obligations to their investors to maximize the value of the investments. Scholars have proposed various forces behind this "fiduciary gap," with a particular focus on the incentives of mutual fund managers to maintain good relationships with "corporate managers." Under the often repeated "retirement business" theory, mutual funds managers have sought to remain in the good graces of corporate management so as to win over, or at least not risk losing, public companies' retirement plan business.

However, in focusing on the fiduciary gap in mutual fund management, scholars and policymakers have overlooked the fiduciary obligations that an-

---

"[u]ntil recently, these policies were simple to acquire and inexpensive compared to other business insurance").

[170] *Id.* (writing that "[t]he biggest changes have been in retentions—the amount of money a company must pay out-of-pocket before insurance coverage kicks in, similar to a deductible" with "virtually every insurer" now "insisting on seven-figure retentions for excessive fee cases").

[171] Ropes & Gray, *supra* note 121 (observing "fiduciary insurance carriers bulking up their due diligence process when quoting or renewing fiduciary coverage").

[172] Ropes & Gray, *supra* note 121 (stating that "providers of this insurance [are] well aware of what's going on in the courts, and we're beginning to see questions from the carriers that are specifically focused and directed at the potential risk exposure of ERISA litigation").

[173] *Id.*

[174] Webinar: PlanSponsor, Best Practices Conference: Benchmarking Investments and Fees (Nov. 10, 2021) (on file with author).

[175] Gerrie & Kerpen, *supra* note 155, at 18.

imate decision-making about corporate retirement plans. An underlying assumption of the legal and empirical work to date has been that "corporate managers" can make decisions on behalf of the employer-sponsored retirement plans to advance their own interests, including shareholder support for management-friendly proposals.

As this Article has shown, decisions about employer-sponsored retirement plans have always been regulated and constrained by ERISA, which imposes both institutional requirements on plan decisionmakers and subjects such decisionmakers to fiduciary standards of loyalty and prudence. While such "laws on the books" have been in place since 1974, enforcement by private plaintiffs has increased dramatically over the last fifteen years. Since 2008, hundreds of lawsuits have specifically challenged how corporate retirement plans have been run, with special scrutiny of the selection of mutual funds and service providers. The legal exposure has in turn reshaped the "corporate governance" within employer-sponsored retirement plans. Under the watchful eyes of plaintiff attorneys, plans have formalized and professionalized decision-making within retirement plans to meet the procedural prudence standard. The roles of corporate executives have been limited to shield such executives from potential ERISA liability. As the next Sections show, the transformation of retirement plan administration has important implications both for shareholder-management dynamics and for the evolution of retirement savings in the United States.

A. *The Relationship between Retirement Plans and Institutional Investors*

Mutual fund managers today have less reason to be concerned about the impact of the funds' votes as shareholders on managers' ability to retain or attract retirement business from U.S. public companies. This new dynamic is the result, at least in part, of changes in the laws and norms that govern employer-sponsored retirement plans in the United States. An unintended result of the ERISA fiduciary litigation over the past fifteen years has been to free mutual fund managers from credible threats of retaliation by corporate managers. While managers will undoubtedly still have preferences for how shareholders vote their shares, ERISA litigation—and the scrutiny from plaintiff attorneys and the Department of Labor—has discouraged board member and C-suite participation in decision-making about which investment funds to include in plan menus, and which service providers to select as recordkeepers and trustees for the plans. To be clear, managerial influence over plan decisions is still possible, but such influence is likely to be less common and more muted.[176] Changes to service providers or investment op-

[176] *See, e.g.*, Jennifer Williams-Alvarez, *UnitedHealth CFO Added to Lawsuit Over 401(k) Offerings*, Wall St. J., Aug. 24, 2022 (describing a complaint alleging that "UnitedHealth Group Inc.'s finance chief allegedly put business interests first and ignored information that the company's 401(k) plan was filled with low-performing target-date funds"). The impact of ER-

tions are necessarily disruptive to plan participants and are closely scrutinized by various stakeholders (and for this reason, changes to service providers are relatively rare).[177]

With a mitigated threat of retaliation through retirement business dollars, mutual fund advisers have fewer reasons to deviate from their fiduciary obligations to the fund investors. Indeed, a growing literature is exploring why mutual funds, and particularly index funds, seem increasingly willing to challenge corporate management. While the reasons are almost certainly multifaceted and may include both pressure from current investors and competition for future clients, changes on the retirement plan side likely also factor into the changing behavior.

B. *Implications for Corporate Governance Debates*

A richer understanding of the relationship between institutional investors and their portfolio companies informs several current debates in corporate law. First, it helps to explain the recent willingness of some institutional investors—and particularly some mutual funds—to vote against management on certain ESG-related proposals. As others have suggested, doing so likely helps the funds attract future (millennial) investors.[178] And while doing so may have once come with a risk of losing some retirement business clients, the risks are lower today. The findings in this Article are also consistent with the declines in "management bias" reported in the As You Sow analysis. Thus, we may expect that funds will continue to support a variety of ESG proposals going forward, including those that may be at odds with management preferences. Relatedly, as some mutual funds advisers embrace pass-through voting—which gives fund investors the ability to cast their own votes at public company annual meetings—decision-making by U.S. retirement plans will be even more critical. While this Article has highlighted the formalization and professionalization of plan governance, further changes are likely if retirement funds are to take on additional voting responsibilities previously handled by the likes of BlackRock.[179]

The findings in this Article also bear on the debate about the SEC's ongoing efforts to enhance reporting of proxy votes by registered investment companies in order to "deter fund votes motivated by conflicts of interest

---

ISA litigation, together with the governance changes described in Section II.C., *supra*, suggest that the likelihood of such influence has decreased over the last decade.

[177] Plan sponsors disclose the plans' service providers in DOL filings and, in some cases, in filings with the Securities & Exchange Commission. Various trade publications track investment menu and service provider changes. *See, e.g.*, Rob Kozlowski, *401(k) Investment Lineup Tweaks Reveal a Big Focus on Fees*, Pens. & Inv. (Aug. 1, 2022), https://www.pionline.com/defined-contribution/401k-investment-lineup-tweaks-reveal-big-focus-fees (reporting on investment menu changes among corporate 401(k) plans).

[178] Barzuza, Curtis & Webber, *supra* note 4, at 1243.

[179] Lim, *supra* note 18 (reporting on BlackRock's plans to have its large investors vote themselves on matters put to the shareholder vote).

that compromise the fund's voting on proposals considered beneficial for the fund's investors."[180] In the November 2022 final rule, the SEC cites, in support of the enhanced disclosure requirements for votes on executive compensation, that "some academic research finds that mutual funds' proxy voting may be affected by their business ties with the portfolio firms where the fund's adviser also manages the firm's pension plan."[181] The SEC cites the three empirical studies discussed in Section I above. As this Article has demonstrated, however, those studies not only overlook the institutional context for decision-making within retirement plans, but they also analyze data that predates the wave of ERISA litigation described in Section II. While there are compelling reasons to enhance disclosure requirements for registered investment funds, the academic work cited by the SEC does not reflect the last fifteen years of developments in employee benefits law that affect the conflict-of-interest concerns cited by the agency.

Finally, starting with the 2022 proxy season, shareholder proxy proposals have begun to target corporate retirement plans. As part of the ESG activism efforts, shareholders have asked the boards of Comcast and Amazon to prepare reports that review retirement plan investment options, and to determine whether the investment options align with their climate action goals. Amazon and Comcast sought no-action letters from the SEC pursuant to Rule 14a-8(i)(7). Amazon argued, for example, that the "proposal relates to the Company's ordinary business operations (the compensation and benefits provided to employees)."[182] Although the SEC had previously granted no-action letters for proposals relating to employer-sponsored plans, the SEC declined to grant Amazon's request in this case. Importantly, as Amazon noted in its materials to the SEC, the *board* does not have "responsibility for or other control over" the retirement plan.[183] Instead, "as is customary for large retirement plans, a management-level committee serves as the Plan fiduciary that, with the assistance of third-party advisors, is responsible for selecting the Plan's investment options."[184] Amazon then emphasized that plan fiduciaries are subject to the ERISA loyalty and prudence obligations, which require that plan investments be selected solely in the interest of plan participants and beneficiaries.

Although the 2022 proposals were ultimately rejected by Amazon and Comcast shareholders, similar proposals are likely to appear at more companies in future years, particularly given the SEC's willingness to allow cli-

[180] *See, e.g.*, Enhanced Reporting of Proxy Votes by Registered Management Investment Companies; Reporting of Executive Compensation Votes by Institutional Investment Managers, 86 Fed. Reg. 57478 (proposed Oct. 15, 2021) (to be codified at 17 C.F.R. § 240.14Ad-1).

[181] Enhanced Reporting of Proxy Votes by Registered Management Investment Companies; Reporting of Executive Compensation Votes by Institutional Investment Managers, *supra* note 2.

[182] Letter from SEC Rule 14a-8 Review Team to Ronald O. Mueller, Apr. 8, 2022, https://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2022/aysraphaelamazon040822-14a8.pdf.

[183] *Id.*

[184] *Id.*

mate-related shareholder proposals to proceed on the grounds that they raise significant policy issues that transcend ordinary business operations.[185] If adopted by shareholders, such proposals would ostensibly require board members to involve themselves in the administration of the company-sponsored retirement plans. Such involvement would buck the "best practices" for plan governance that have emerged over the last decade, including the delegation of control to committees and the professionalization and training of plan fiduciaries.

C. Implications for Retirement Plan Governance

The fifteen years of ERISA fee litigation and the subsequent changes in retirement plan governance also have significant employee benefits implications. At present, employer-sponsored retirement plans—and their regulators—are grappling with the role of ESG considerations and cryptocurrencies in the construction of plan menus, the provision of annuity or "lifetime" income for plan participants, and the growing cybersecurity risks facing employee benefit plans.[186]A key concern across all of these policy considerations is the ability of private-sector plan administrators to make prudent decisions solely in the interest of plan participants and beneficiaries. Understanding who makes decisions on behalf of employer-sponsored plans, and how such decisions are actually made, is critical to the policy analysis. And yet, while there is an extensive literature on the composition of corporate boards and retirement boards in the public sector, there has been to date almost no visibility into or research on the composition of retirement plan committees in the private sector. This Article offers the first empirical look at the changing composition of administrative and investment plan committees, and demonstrates the need for further transparency and data on such committee composition.

Indeed, even as larger plans have sought to "professionalize" retirement plan committees and to ensure greater expertise and training, the latest wave of retirement plan fee litigation is pushing plan sponsors to outsource ever more responsibility over plan administration to various third-party pro-

[185] Lawrence K. Cagney et al., *Shareholder Climate Activism Comes for 401(k) Plans: Lessons Learned from Amazon and Comcast*, MONDAQ (June 10, 2022), https://www.mondaq.com/unitedstates/executive-remuneration/1201000/shareholder-climate-activism-comes-for-401k-plans-lessons-learned-from-amazon-and-comcast.

[186] For an overview of the U.S. retirement system and key current challenges, *see* GAO Report, *supra* note 96; *see also* U.S. Department of Labor, Fact Sheets, *Final Rule on Prudence and Loyalty in selecting Plan Investments and Exercising Shareholder Rights*, Nov. 22, 2022 (noting that "over the last approximately 40 years, the Department has periodically considered how ERISA's fiduciary duties of prudence and loyalty apply to plan investments that promote environmental, social, or governance goals" and clarifying "that fiduciaries may consider climate change and other environmental, social, and governance (ESG) factors when they make investment decisions and when they exercise shareholder rights").

fessionals.[187] Some plan sponsors are also taking advantage of recent legislative changes to join so-called pooled employer plans or multiple-employer plans run by professional employer organizations (PEOs), which offer centralized administration and expertise on retirement plan matters.[188] The "outsourcing" of retirement plan administration means that now various third-parties—such as the pooled plan providers, professional employer organizations, and the various financial institutions that advise and consult for the plans—are making the relevant decisions about which service providers to hire and which mutual funds to include on plan menus. Moreover, mutual funds may no longer be the investment vehicle of choice for employer-sponsored plans, with such plans increasingly filling their menus with separate accounts and collective investment trusts. Therefore, while the "retirement business" theory focuses on the relationship between mutual fund advisers and corporate managers, such a concern is increasingly out of date and out of sync with current developments in plan administration and the investment of retirement assets.[189]

Conclusion

The findings in this Article make clear that a reevaluation of the "retirement business" theory is overdue. Although the theory raises important questions, it overlooks key elements of its own causal mechanisms and makes flawed assumptions about how retirement plans operate in the United States. Moreover, the empirical findings that use decade-old data no longer accurately reflect the institutional context in which the relevant decisions are made. This Article shows that changes in employee benefits law have altered the cost-benefit calculus for institutional investors. Diminished concern about managerial retaliation through the funds' retirement business is consistent with recent mutual fund votes, including the growing willingness of index funds to vote against the preferences of corporate management. Given the dramatic growth of both employer-sponsored retirement plans and mutual funds, as well as the increasingly important role that both play in current

---

[187] *See, e.g.*, Natalya Shnitser, *Are Two Employers Better Than One? An Empirical Assessment of Multiple-Employer Retirement Plans*, 45 J. Corp L. 743 (2020).

[188] *See, e.g.*, Michael Katz, *More Companies Dive Into Pooled Employer Plans*, PlanSponsor (Apr. 27, 2022), https://www.plansponsor.com/in-depth/companies-dive-pooled-employer-plans/ ("PEPs can also mean less risk for employers . . . [from the] surge in excessive-fee lawsuits filed in recent years against companies providing retirement plans.").

[189] The BrightScope/ICI Defined Contribution Plan Profile: A Close Look at 401(k) Plans, 2018, at 2, https://www.ici.org/system/files/2021-07/21_ppr_dcplan_profile_401k.pdf (reporting that mutual funds held 43 percent of large private-sector 401(k) plan assets in 2018 while CITs held 33 percent of assets, and noting also that in the largest plans "a larger share of assets was held in CITs" than in mutual funds); *see also* Brian Anderson, *CITs On Pace to Overtake Mutual Funds in DC Plans by 2025*, 401KSpecialist, https://401kspecialistmag.com/cits-on-pace-to-overtake-mutual-funds-in-dc-plans-by-2025/ ("The use of collective investment trusts in defined contribution plans is surging, and if the trend continues CITs assets in retirement plans are expected to overtake mutual funds within the next four years.").

social, economic, and political debates, a clear understanding of how they operate and interact is especially timely.