

Compliance

Self-Dealing Lawsuit Filed Against Charles Schwab

The complaint alleges that defendants “reaped significant fees and profits at the expense of the plan and its participants.”

By Rebecca Moore editors@assetinternational.com | January 23, 2017

A class action Employee Retirement Income Security Act (ERISA) lawsuit has been filed against Charles Schwab Corporation and its retirement plan fiduciaries alleging fiduciary breaches and prohibited transactions.

The [lawsuit claims](#) plan fiduciaries engaged in the imprudent and disloyal exercise of their discretionary fiduciary authority over the plan to include Schwab’s own affiliated investment products as investment options within the plan and sale of their own services to the plan. The complaint alleges that defendants “reaped significant fees and profits at the expense of the plan and its participants.”

In a statement to PLANADVISER, Charles Schwab said, “It’s our practice not to comment on pending litigation. However, we intend to vigorously defend against this case, and believe it is totally without merit. We are committed to helping employees save for retirement by providing a 401(k) plan with low-cost investment products and independent personalized advice.”

At issue in the case are several types of Schwab Affiliated Products and Services, categorized as: the “Affiliated Funds,” the “Schwab Savings Account,” the “Self-Directed Brokerage,” and the “Interest Free Loan from Unallocated Plan Cash.”

The lawsuit accuses plan fiduciaries of making no meaningful investigation into whether these Schwab Affiliated Products and Services were prudent for the plan, or whether alternative funds offered by other providers would be more appropriate, cost effective or better performing. **Instead, the complaint says they “imprudently and disloyally elected to provide the Schwab Affiliated Products and Services to the Plan in an effort to generate fees for the Schwab Entity Defendants at the expense of the Plan and its participants.”** The lawsuit says the fees were excessive, unreasonable and far exceeded the real costs associated with administering the plan.

The complaint pointed out a 3 to 5 basis point difference in fees between the Schwab S&P 500 Index Fund and the other S&P 500 Index funds. It said while that “may seem small at first glance, the plan had more than \$100 million invested in the Schwab S&P 500 Index Fund each year during the class period, meaning the plan paid hundreds of thousands of dollars in fees more to Schwab than it would have paid to other fund providers even when not compounded.”

The lawsuit noted that since 2011, the fees for Schwab’s S&P 500 Index Fund have remained the same, while the fees for many of its competitors’ S&P 500 index funds have declined. In addition, other new S&P 500 index funds are now offered with lower fees than charged by the Schwab S&P 500 Index Fund. “Thus by 2015, numerous S&P 500 index funds with lower costs and better performance than the Schwab S&P 500 Index Fund were available on the market,” the complaint says.

The lawsuit also says that during the class period, the defendants included seven other Schwab mutual funds, ten Schwab target-date funds, a Schwab stable value fund, a Schwab money market fund, and a Schwab savings account as investment options. It says that like the Schwab S&P 500 Index Fund, many of the other Schwab affiliated funds had higher fees and worse performance than comparable funds from other providers. By year-end 2015, more than \$500 million in plan assets were invested in these Schwab affiliated funds.

The complaint specifically calls out the Schwab Managed Retirement Trust Funds or target-date funds, noting that the Vanguard Target Retirement Funds target-date series had fees more than 80% lower than the Schwab Managed Retirement Trust Funds, and materially outperformed the Schwab funds during the years leading up to the start of the class period.

In 2014, the Schwab defendants replaced the Stable Advantage Money Fund with a Schwab Bank Savings Cash account as an investment option in the plan. According to the lawsuit, the Schwab Savings Account is a demand deposit account at defendant CSBank that pays accountholders interest equivalent to money market rates. The lawsuit sites reports that show stable value funds are conservatively managed to preserve principal and provide a stable credit rate of interest, and because they hold longer-duration instruments, they generally outperform money market funds, which invest exclusively in short-term securities. The Schwab retirement plan fiduciaries are accused of making no meaningful investigation into the merits of including a higher yielding stable value fund offered by another company in lieu of or in addition to the Schwab Stable Value Fund, the Schwab Value Advantage Money Fund, or the Schwab Savings Account, either at the time those investment options were added or on an ongoing basis as part of periodic review of the plan's portfolio.

According to the complaint, Schwab and its affiliates collected fees from several sources arising out of the plan's participation in Schwab's Self-Directed Brokerage Account, including transaction fees and commissions and other fees to individual plan participants who opened Self-Directed Brokerage accounts through the plan. The lawsuit also notes that the complexity and confusing fee schedule make this option non-optimal for less sophisticated investors, but Schwab offered it to all participants. Schwab is accused of not investigating whether a self-directed brokerage account offered by another company would have been a better option for the plan than Schwab's own and of not investigating whether it would have been more appropriate to forgo offering any sort of self-directed brokerage account at all. The defendants are accused of including the account for no other reason than to generate fees for the Schwab defendants at the expense of the plan's participants.

Finally, the lawsuit calls out Schwab for using unallocated plan cash from new contributions, other assets awaiting investment, and from pending distributions and rollovers for their own benefit. Defendant CSBank, as the plan's trustee, held the unallocated plan cash in accounts in the plan's name. The plan's fiduciaries exercised their discretionary authority to give CSBank discretionary authority to invest the unallocated plan cash and retain as compensation for its services any credit, interest or other earnings it achieved on its investments. The lawsuit calls this an interest free loan to CSBank. Schwab is accused of not investigating whether the unallocated plan cash could be used in a different way that benefitted the plan or its participants.

The lawsuit asks that defendants make good to the plan the losses their fiduciary breaches, co-fiduciary breaches and/or prohibited transactions caused the plan; disgorge to the plan any and all property they hold as a result of the fiduciary breaches, co-fiduciary breaches and/or prohibited transactions that in good conscience belongs to the plan, the proceeds of such property to the extent it has been disposed of, and any profits defendants received as a result of holding such property; and provide a full accounting of all fees paid, directly or indirectly, by the plan to the defendants.