Insights, News & Events

SUPREME COURT REVIVES ERISA SUIT AND HIGHLIGHTS THE NECESSITY TO MONITOR PLAN INVESTMENT OPTIONS: A 5-STEP COMPLIANCE ROADMAP

Insights
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In a unanimous decision that should serve as a wakeup call to those administrating employee retirement plans, the Supreme Court just reaffirmed and highlighted the ongoing duty of ERISA plan fiduciaries to monitor investment options – and remove imprudent investment options – in satisfying their fiduciary duties. By an 8-to-0 vote (Justice Amy Coney Barrett took no part in the consideration or decision) in yesterday's *Hughes v. Northwestern University*, the Court found that plan fiduciaries cannot rely on the participants' ultimate choice over their investments to excuse allegedly imprudent investment options offered and retained by the plan. Although the ruling does not significantly alter any existing interpretations of fiduciary liability standards, the decision still highlights best practices for plan sponsors in administering their retirement plans and defending current or potential investment option litigation. This Insight provides plan administrators with a five-step roadmap to ensure compliance with yesterday's decision.

The Explosion of Excessive Fee Litigation Against University 403(b) Plans

Hundreds of class actions have been brought under ERISA alleging a breach of fiduciary duty in connection with the fees of investment options (and associated recordkeeping fees) in the last few years. While the cases originally focused on 401(k) plans, these cases shifted focus to include university 403(b) plans with 12 such cases filed in 2016.

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Originally filed in 2016, *Hughes v. Northwestern University* brought claims against two Northwestern 403(b) retirement plans: the Northwestern University Retirement Plan ("Retirement Plan") and the Northwestern University Voluntary Savings Plan ("Savings Plan"). Northwestern University is the administrator of both plans. Plaintiffs alleged that plan fiduciaries failed to satisfy their fiduciary duty of prudence in a number of ways, most notably by:

- failing to monitor and control recordkeeping fees, resulting in unreasonably high costs to plan participants;
- creating confusion and contributing to poor investment decisions by participants as a result of the excessive number of investment options available; and
- offering "retail" class investment options with higher fees than those charged by otherwise identical "institutional" class investment options.

To support the first allegation, plaintiffs pointed to fact that Northwestern University continued to contract with two separate recordkeepers for the Retirement Plan and only consolidated to a single recordkeeper for the Savings Plan in late 2012. In support of the second allegation, plaintiffs highlighted the adjustment of investment options from 429 investment options available between the Plans (with 242 investment options available to Retirement Plan participants and 187 investment options available to Savings Plan participants) to a limited core set of about 40 investment options. In support of the third allegation, plaintiffs provided a 10-page list of funds available to plan participants, the retail expense ratios participants are charged, and the expense ratios charged by the same mutual funds to institutional investors.

Lower Court Proceedings

The federal trial court dismissed the plaintiffs' case. Among other reasons, the court found that Northwestern did not commit a breach of fiduciary duty simply by including underperforming investment options or those with "excessive" record-keeping fees because participants could avoid the alleged issues by selecting other investment options under the Plans. In addition, the court found that the inclusion of certain types of funds or investment options does not constitute a fiduciary breach solely because plaintiffs believe a different type of fund makes a better

long-term investment option. Similarly, the court found that Plan participants could select from available options to keep recordkeeping expense ratios low rather than selecting an investment option with a ratio that the participant deemed too high.

The Seventh Circuit Court of Appeals affirmed the dismissal. It noted that, for ERISA violations, plaintiffs must plausibly allege actions that were objectively unreasonable such that a prudent fiduciary in the same position could not have concluded that an alternative action would do more harm than good. It noted that the types of funds plaintiffs wanted were available to them, thus "eliminating any claim that plan participants were forced to stomach an unappetizing menu." It said that plans could generally offer wide range of investment options and fees without constituting a breach of fiduciary, and concluded that the ultimate outcome of an investment, including poor performance, is not proof of imprudence.

The Supreme Court agreed to review the case to address the question of "whether allegations that a defined-contribution retirement plan paid or charged its participants fees that substantially exceeded fees for alternative available investment products or services are sufficient to state a claim against plan fiduciaries for breach of the duty of prudence under ERISA."

The Supreme Court Decision and the Continuing Importance of Tibble

In a decision delivered by Justice Sotomayor, the Supreme Court unanimously vacated the Seventh Circuit's decision and remanded the case for further proceedings. The Court found that the Seventh Circuit ultimately focused on only one component of the duty of prudence: the obligation to provide a diverse menu of investment options under the Plans. However, the Supreme Court noted that such an analysis does not apply the principles it set forth in the 2015 case of *Tibble v. Edison Int'l*.

That case explained that plan fiduciaries not only have to provide a diverse menu of investment options, but they have an ongoing duty to monitor investments and remove imprudent options. Simply providing a broad array of investment options is insufficient to satisfy this burden, even in defined contribution plans with participant directed investments. The Supreme Court found that the Seventh

Circuit did not apply *Tibble*'s guidance when rendering its decision. SCOTUS said the appeals court did not review whether the Plan fiduciaries conducted an independent evaluation of whether the investment options were prudently included in the Plans. Even if the investment options were prudent at the time of inclusion, an investment option may become imprudent and must be removed within a reasonable time in order to satisfy the duty of prudence.

For that reason, the categorical rules applied by the Seventh Circuit in finding that the existence of options available within the Plans insulated the fiduciaries from allegations of a breach of fiduciary duty were flawed. In sum, SCOTUS said the Seventh Circuit should have considered whether the allegations, as a whole, plausibly allege a violation of the duty of prudence as articulated in the 2015 *Tibble* decision.

5-Step Roadmap for Plan Administrators Going Forward

One point of interest is found in Justice Sotomayor's conclusion of the case which states that, "at times, the circumstances facing an ERISA fiduciary will implicate difficult tradeoffs, and courts must give due regard to the range of reasonable judgments a fiduciary may make based on her experience and expertise." No other guidance is provided on when to utilize personal experience and expertise in the fulfillment of fiduciary duties. This language, seeming to cede to the importance of personal experience and expertise, should certainly not be read as a diminishment of the ERISA prudent man standard to which an ERISA fiduciary is held.

The *Hughes* decision ultimately did not introduce a new standard, or eliminate an existing standard, to evaluate whether fiduciaries satisfy the duty of prudence for investment options under ERISA. Instead, it highlights the importance of monitoring investment options and making timely changes to the investment lineup when necessary. Satisfaction of the duty of prudence remains a procedural analysis, requiring thorough review, analysis, and documentation for fiduciary actions. Going forward, plan fiduciaries should follow this five-step roadmap:

- Ensure plans include a reasonable number of diversified investment options;
- Regularly, and carefully, monitor each investment alternatives for return and costs;

- Regularly, and carefully, monitor where the plan stands against peer plans of like sizes in terms of cost to participants;
- Consider retaining independent experts to assist with, or take on, fiduciary duties relating to investments; and, of course,
- Keep detailed, written, and contemporaneous records of committee meetings.

Conclusion

If you have any questions about how best to effectively administer, and document the administration of, your plans to satisfy fiduciary duties under ERISA and to limit potential exposure, please contact the authors of this Insight, your Fisher Phillips attorney, or any member of our Employee Benefits and Tax Practice Group. To ensure you stay up to speed with the latest developments, make sure you are subscribed to Fisher Phillips' Insight System to get the most up-to-date information.