

## LEGAL UPDATE

# The Need to Investigate Collective Trusts

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Some recent Court decisions have taken different approaches to the issue of a plan fiduciary's obligation to consider collective trusts and insurance company separate accounts as alternative investments to mutual funds. This is an issue for the applicable fiduciaries of tax-qualified plans because Code Section 403(b) plans cannot, in general, invest in collective trusts or separate accounts. *Johnson v. Provident Health and Services*, 403(b) (Value Plan) (W.D. Wash. 2018). In *In Re M&T Banks Corporation ERISA Litigation* (S.D.N.Y. 2018), plaintiffs argued that defendants had failed adequately to investigate the availability of collective trusts and separate account alternatives for several nonproprietary mutual funds in the plan. Plaintiffs argued that the mutual fund alternatives offered no material service or other advantage to plan participants but cost the plan

but otherwise materially indistinguishable alternatives." The District Court would in all likelihood have rejected a generalized grievance, based on the proposition recognized by all courts that "Nothing in ERISA requires every fiduciary to scour the market to find and offer the cheapest possible fund (which might, of course, be plagued by other problems)." *Hecker v. Deere*, 556 F. 3d 575 (7<sup>th</sup> Cir. 2009). To provide context, the District Courts are rendering decisions at the earliest stage of the proceedings, and the same type of analysis applies in this context as with respect to institutional shares v. retail shares. Defendants may ultimately be able to persuade the Court that they had legitimate reasons for selecting mutual funds rather than collective trusts or separate accounts, but that determination will be made at a later stage in the proceedings. Note, also, that in the event that for a particular service a collective trust charges more than a mutual fund, the same analysis would be applicable. For example, in *Baird v. Blackrock Institutional Trust Company, N.A.* (N.D. Cal. 2018), a collective trust charged a higher securities lending fee than a mutual fund.

In contrast, in *Larson v. Aliana Health Systems*, 2018 WL 4700372 (D. Minn. October 1, 2018) and *White v. Chevron*, 2016 WL 4502808 (C.D. Cal. 2016), the District Courts concluded that it was not a breach of fiduciary duty to fail to offer lower cost collective trust funds and insurance company separate accounts. Defendant indicated that mutual funds offer greater transparency than the other two

millions of dollars in unnecessary fees. Defendants, citing *Spano v. Boeing*, 125 F. Supp. 3d 848 (S.D. Ill. 2014) argued that ERISA plan fiduciaries are not required to choose separate accounts over mutual funds, and that mutual funds carried additional reporting governance and transparency requirements that might make them more attractive to plan participants than collective trusts and separate accounts. The District Court indicated that even if true, at the motion to dismiss stage of pleadings, these arguments do not preclude plaintiffs from proceeding with the litigation. Explaining its decision, the District Court stated that "Plaintiffs' alternative investment argument is not a generalized grievance that the Plan lacked collective trusts and separate accounts: it is based on allegations that Defendants breached their fiduciary duties by selecting particular mutual funds over specific lower cost,

investment alternatives and have important regulatory safeguards attached such as diversification requirements, limitations on leverage, and mandatory oversight by a largely independent board of directors. These Courts concluded that ERISA requires neither the inclusion nor exclusion of collective trusts and separate accounts. In *White v. Chevron*, the District Court stated that the comparison was apples to oranges, because while the fees for the collective trusts would have been less, these lower fees would have been at the expense of other factors that warranted the higher fees. Rather, it is a judgment call for the applicable plan fiduciary to provide some context to these cases. In *Terraza v. Safeway*, plaintiff alleged (unsuccessfully) that the placement of collective trusts and separately managed accounts into an ERISA plan was a *per se* ERISA violation, based on the theory that these alternative investments were not subject to prospectus and SEC registration requirements; they therefore were necessarily inferior to mutual funds.

**Takeaway**—Although the failure to consider collective trusts and separate accounts may not be a breach of fiduciary duty, it may be an evolving best practice for the applicable plan fiduciary to at least consider such alternatives.

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