Supreme Court Ruling Puts 401(k) Fiduciaries on Guard

Plan sponsors can take steps to defend against participant lawsuits

By Stephen Miller, CEBS
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Following the U.S. Supreme Court's 8-0 ruling in *Hughes v. Northwestern University* (https://www.supremecourt.gov/opinions/21pdf/19-1401_m6io.pdf), employers that sponsor defined contribution retirement plans should step up efforts to ensure that their plans' mutual fund offerings are still prudent investments, retirement plan advisors said.

In its Jan. 24 ruling, the Supreme Court held that the U.S. Court of Appeals for the 7th Circuit erred in relying on the plan participants' ability to choose from a large selection of investments, including low-cost index funds, to excuse allegedly imprudent decisions by fiduciaries who oversaw the retirement plan at Evanston, Ill.-based Northwestern University. *Hughes* was remanded back to the 7th Circuit (www.shrm.org/ResourcesAndTools/legal-and-compliance/employment-law/Pages/Supreme-Court-Revives-ERISA-Fiduciary-Breach-Case-Against-Northwestern.aspx) for reconsideration.

The lawsuit was brought by current and former university employees who claimed that the plan fiduciaries violated the Employee Retirement Income Security Act's (ERISA's) duty of prudence by:

- **Failing to monitor and control record-keeping fees,** resulting in unreasonably high costs to plan participants.
- **Offering mutual funds and annuities in the form of retail share classes** that carried higher fees than those charged by otherwise-identical institutional share classes of the same investments.
- **Offering complex investment options** that were likely to confuse investors.

Two of Northwestern University's 403(b) plans were at issue in the case.

"While 403(b) plans differ in some respects from 401(k) plans sponsored by for-profit businesses, the issues raised by plaintiffs are more or less identical to those raised in excessive fee lawsuits against corporate 401(k) sponsors," and so the court's clarification of fiduciaries' duties is binding on 401(k) plans as well, said Mike Barry, a senior consultant at Chicago-based retirement plan advisory firm October Three.

According to law firm Seyfarth Shaw's annual report on workplace class action settlements (https://www.workplaceclassactionreport.com/), the top 10 ERISA settlements in 2021 totaled $837 million, more than double the 2020 total of $380 million, largely as a result of "class action filings challenging defined contribution plan (401(k) and 403(b) plan) fees and investments," the report said.

Among current cases that could be affected by the *Hughes* ruling, a lawsuit now before a federal district court in Texas (https://www.plansponsor.com/tdf-suite-questioned-erisa-lawsuit-fluor-corp/) alleges that the target-date funds that plan fiduciaries selected as the default investments for automatically enrolled participants charged excessive fees, while another suit before a district court in Washington state (https://www.planadviser.com/lawsuit-alleges-choice-target-risk-funds-caused-losses-participants/) alleges that a plan's target-risk funds underperformed meaningful benchmarks.

Easier Path for Participant Lawsuits

The Supreme Court ruled that "determining whether petitioners state plausible claims against plan fiduciaries for violations of ERISA's duty of prudence requires a context-specific inquiry of the fiduciaries' continuing duty to monitor investments and to remove imprudent ones," as articulated in the court's 2017 *Tibble v. Edison Int'l* (https://casetext.com/case/tibble-v-edison-intl-14) decision.

The Supreme Court "rejected the 7th Circuit's reliance on the availability of lower-cost alternatives as a defense to claims that the cost of certain funds and of plan record-keeping was unreasonably high," Barry explained. The ruling's "emphasis that a court's analysis of prudence issues must be 'context-specific' may make it more difficult for sponsor fiduciaries to win such motions to dismiss" participant lawsuits in the future, he said.

He added that "this—and all such cases—should remind us all that a good fiduciary process demonstrates a reasoned selection and monitoring process for each and every investment in the plan—both from the perspective of performance, as well as cost," and that plan-investment monitoring must be ongoing.

"Since the pleading standard for breaches of fiduciary duty are context-specific, as the Supreme Court unanimously determined, it will be more difficult to have such claims dismissed at the motion to dismiss stage," Marcia Wagner of The Wagner Law Group in Boston told FiduciaryNews.com. (https://fiduciarynews.com/2022/01/after-supreme-court-ruling-are-tdfs-a-ticking-time-bomb-of-fiduciary-liability/?ct=t%28EMAIL_CAMPAIGN_1_25_2022_17_45%29)

Similarly, Ronald Mann, a professor of law at Columbia University, blogged (https://www.scotusblog.com/2022/01/court-reaffirms-duties-of-retirement-plan-sponsors-to-monitor-and-update-plan-options/) that "the most important part of the opinion probably will be its rejection of the 7th Circuit's 'exclusive focus on investor choice,' which reflects a decisive holding that it is not enough to insulate sponsors from liability to identify well-designed options that employees could have chosen. Rather, sponsors have an ongoing duty to protect employees from making poor investment choices by monitoring and removing those choices from the menu of the plan."

Michael Weddell, an attorney and retirement director at consultancy WTW (formerly Willis Towers Watson), cautioned not to read too much into the ruling. "*Hughes* was a win for the plaintiffs, but ... the situation already was favorable for plaintiffs, and it remains that way."

The key takeaway: "All of a plan's designated investment funds must be prudent."

WTW has tracked 40 new class action lawsuits begun during 2021, Weddell said, with "midsize 401(k) and 403(b) plans being sued frequently, not just the jumbo plans." Cases are often settled in the early stages of litigation, "making lawsuits less expensive for plaintiffs' attorneys" but still costly for plan sponsors, he noted.

Action Items

"A good fiduciary process demonstrates a reasoned selection and monitoring process for each and every investment in the plan—both from the perspective of performance, as well as cost," wrote Nevin Adams (https://www.ntsa-net.org/news-resources/scotus-gives-excessive-fee-suit-plaintiffs-another-shot#.YfBYg3IJDvE.linkedin), chief content officer and head of retirement research at the American Retirement Association in Arlington, Va.

Weddell advised: "The best course for fiduciaries will continue to be to make their plans unattractive targets for lawsuits," by taking steps such as:

- **Conducting periodic due diligence** and taking responsive steps to improve investments and record-keeping fees and services.
- **Hiring experts to benchmark retirement plan fees** periodically and, less frequently, conduct a defined contribution record-keeping search.
- **Appending key documentation** for these due diligence projects to a fiduciary committee's minutes, where they can be readily located if a lawsuit is filed years later.

Another helpful suggestion, he recommended, "is to look on the web for information about [comparative] plan fees to see the same documents that a plaintiff's attorney might examine," such as annual Form 5500 filings.

Citing *Hughes,* District Court Declines to Dismiss 401(k) Fee Complaint

In the first decision since the Supreme Court's ruling in *Hughes v. Northwestern University*, "a Georgia federal district court held in favor of plaintiffs and declined to dismiss allegations that defendant's 401(k) plan included costly and under-performing funds and charged excessive recordkeeping fees," according to Kyle Hansen and Tulio Chirinos (https://www.ntsa-net.org/news-resources/scotus-gives-excessive-fee-suit-plaintiffs-another-shot#.YfBYg3IJDvE.linkedin), attorneys at law firm Proskauer in New York City.

In declining to dismiss plaintiffs' investment management fee claims in *Goodman v. Columbus Regional Healthcare System* (https://benefitslink.com/src/ctop/goodman-mdga-01252022.pdf), the district court "expressed its view that *Hughes* 'suggested' that a defined contribution plan participant may state a prudence claim by merely alleging that the plan offered higher priced retail class mutual funds instead of available identical lower-cost institutional class funds," the attorneys noted.

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