LEGAL UPDATE

Robo-Advisors

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With the flurry of commentary and analysis concerning the decision by the Court of Appeals for the Fifth Circuit invalidating the DOL Fiduciary Rule, other interesting cases fly under the radar, such as a March decision by the District Court for the Northern District of Illinois in *Scott v. Aon Hewitt Advisors, LLC,* a case dealing with the issues of when a service provider becomes a fiduciary and, for service providers who clearly are fiduciaries, which of their actions subject them to potential liability under ERISA for breach of fiduciary duty. In that case, Caterpillar had contracted with Aon Hewitt Financial Advisors (AFA) to provide investment advisory services to plan participants. AFA then sub-contracted with Financial Engines, a roboadvisor, to provide investment advisory services to plan participants. Plaintiff alleged that AFA was receiving excessive fees from Financial Engines which amounted to an improper kickback because AFA allegedly did not perform any material services in exchange for those fees.

In dismissing the claims, the District Court acknowledged that AFA was a fiduciary to the plan for the purpose of providing investment advice to plan participants, but that did not make AFA a fiduciary for all purposes. Under ERISA, a party not specifically named as a fiduciary of a plan owes a fiduciary duty only "to the extent" that: it (i) has discretionary authority over plan administration; (ii) offers investment advice for a fee to plan participants; and (iii) exercises any discretionary authority or control over management of the plan or its assets. The "to the extent" language is critical, because it demonstrates that fiduciary status under ERISA is not an all or nothing proposition. The question that a Court must determine in connection with a case involving a breach of fiduciary duty under ERISA is "whether a person was acting as a fiduciary...when taking the action subject to complaint." The Court of Appeals for the Third Circuit, in *Santomenno ex rel. John Hancock Trust v. John Hancock Lift Ins. Co.,* indicated that this language requires that there be a nexus between the alleged basis for fiduciary responsibility and the alleged wrongdoing.

With respect to the claim that AFA had received excessive fees, the District Court indicated that a service provider who negotiates its own compensation with a plan fiduciary is not a fiduciary for that purpose, and other courts have held that a plan fiduciary's negotiation of its own compensation is a nonfiduciary issue as a matter of law. Further, Caterpillar was free to select a different investment adviser or no investment advice service provider at all. Further, the Financial Services Agreement between Caterpillar and AFA, which Caterpillar had the final authority to accept or reject, disclosed Financial Engines as a subadvisor. Additionally, AFA's compensation was based on the number of plan participants and plan assets, factors over which it had no control. With respect to AFA's decision to hire Financial Engines as a subadvisor, the District Court noted that courts have held that a decision which is strictly a corporate management business decision imposes no fiduciary duties, because a fiduciary who acts in a strictly business capacity is not acting with respect to a plat'. In short, AFA was a fiduciary under the plan solely for the purpose of providing investment advice, and the complaint did not allege that AFA had provided defective investment advice. AFA did not have any fiduciary duty to plan participants during its arm's length negotiations with Caterpillar regarding its compensation or its appointment of Financial Engines as a subadvisor.

The District Court also rejected plaintiffs claims the AFA had entered into a prohibited transaction by receiving excessive compensation. The Court found that DOL regulations establish that a service provider may hire a subcontractor to provide some or all of its services, confirming that bundled services agreements are permissible under ERISA. It cited language from the preamble to the DOL's Best Interest Contract Exemption which stated that the reasonable compensation standard under ERISA Section 408(b)(2) looks at the reasonableness of the compensation for all of the services, and there is no requirement to allocate specific compensation to specific services. That is, the plaintiff could not argue that AFA was overpaid for a specific service that it performed; rather it was required to establish that the total compensation that Caterpillar paid was unreasonable.

Challenges to robo-advisor arrangements were similarly rebuffed in *Fleming v. Fidelity Management Trust Co., Chendes v. Xerox HR Solutions* and *Patrico v. Voya Fin. Inc.* In light of these decisions, plaintiffs' challenges to these robo-advisor arrangements will need more factual support in order to succeed.

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