Litigation Hot Topics

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Regulations and guidelines put forth by the Department of Labor ("DOL") and other administrative bodies, as well as keeping up to date on case law, are part of fiduciary duties and best practices. As rules continue to change, advisors and plan sponsors need to be aware of how these updates effects their retirement plans.

No matter how compliant or well run a retirement plan, nothing can fully insulate it or its fiduciaries from being sued. But following the regulations and guidelines put forth by the Department of Labor ("DOL") and other administrative bodies, as well as keeping up to date on case law, are part of fiduciary duties and best practices. This article discusses high-level fiduciary basics and court decisions that instruct fiduciary best practice.

Fiduciary basics

Plaintiffs may argue that plans and their fiduciaries violated various provisions of the Employee Retirement Income Security Act ("ERISA") of 1974 by selecting or maintaining funds with high investment fees, failing to monitor and replace underperforming investments, and/or failing to prudently select and monitor a third-party service provider, such as a recordkeeper with high fees.

The Supreme Court ("SCOTUS") is clear regarding the duties of fiduciaries in the selection and monitoring of plan investments. In a unanimous decision, *Hughes v. Northwestern* (S.Ct., 2022), the high court affirmed the duty of fiduciaries to prudently select plan investments.[1] And *Tibble v. Edison* (S.Ct., 2015) confirmed that fiduciaries have a "continuing duty to monitor investments and remove imprudent ones" and that failing to do so could indicate that fiduciaries breached their duty of prudence.[2]

***Tibble* practice tip:**
Trustees have a continuing duty to monitor and remove imprudent investments.

Investment fee claims

Claims that investment fees are too high or that investments underperformed and were not replaced are common. Plaintiffs may compare active funds to passive funds and argue that active funds are not appropriate plan options as they tend to be more expensive than passive ones. Target date funds ("TDFs") are also a growing subject of attack because TDFs with the same retirement year often vary in expense and performance.

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Not FDIC/NCUA Insured	Not a Deposit	May Lose Value
No Bank Guarantee	Not Insured by Any Government Agency	

Case law is clear that simple allegations that a particular fund is "more expensive than other options" or that a plan includes "actively managed" funds are insufficient to state excessive fee claims. By the same token, low-cost options do not automatically satisfy a fiduciary's duty of prudence regarding fees. *Hughes v. Northwestern* (S.Ct., 2022) makes clear that fee-and-expense cases are reviewed with a "context-specific inquiry … [that gives] due regard to the range of reasonable judgments a fiduciary may make based on her experience and expertise."[3] *Hughes* provided an outline of steps included in prudent fiduciary practice:

- Fiduciaries must monitor and control recordkeeping fees.
- Poorly performing investments must be removed within a reasonable amount of time.
- Offering a mix of investments and share classes is permitted, but choose low fee share classes of same investments where available.
- Fiduciary committees should be investment expert or advised by investment experts, follow set procedures, and document all decisions.
- Plan fiduciaries must fully understand all management fees and administrative charges paid.

Passive vs. Active management

A common complaint is that actively managed funds are more expensive than passively managed index funds. But simply comparing active funds to passive ones is not sufficient to state a claim, nor is alleging that active funds were considered over passive options.[4] Building on the decision in *Hughes*, the 9th Circuit in *Davis v. Salesforce.com* (2022) reiterated that:

- Having a mix of active and passive funds on a platform is permitted,
- The duty to monitor goes hand-in-hand with the duty to prudently select investments, and
- When two share classes have the same underlying assets, it is prudent to switch to the lower cost share class when such alternative becomes known.

The 6th Circuit Court of Appeals concluded in *Yosaun Smith v. CommonSpirit Health, et al.* (6th Cir., 2022) that "we know of no case that says a plan fiduciary violates its duty of prudence by offering actively managed funds to its employees as opposed to offering only passively managed funds."[5] The court reasoned that active and passive funds" cater to different investors" and "are not ideal comparators" and that a showing of imprudence requires evidence that:

- An investment was imprudent from the moment it was selected,
- The investment became imprudent over time, or
- The investment was otherwise clearly unsuitable for the goals of the fund based on ongoing performance.

The *Yosaun v. CommonSpirit* (6th Cir., 2022) decision recognized that including active funds in a line-up is acceptable because employees should have the opportunity to realize above-average returns. But the Court also recognized that "Over time, management fees, like taxes, are not trivial features of investment performance." The Court then laid out some guidelines for monitoring investment and recordkeeping fees:

- **Investments** – Select an appropriate benchmark that allows the fees and performance objectives of each fund to be monitored for prudence.
- **Recordkeeping** – Benchmark service providers against plans of similar size, asset levels and services provided, as prudence requires that fees not be excessive relative to the services rendered.

Yosaun confirmed that disappointing short-term performance and higher costs alone do not indicate imprudent decision making in long-term investment portfolios. By the same token, however, simply including "lower cost index fund options is not dispositive" that the selected funds are prudent.[6] Rather, courts look at the totality of evidence, so the inclusion or continued inclusion of a fund with consistent poor performance is imprudent regardless of the strategy or fees.

Target date funds

Suits against target date funds ("TDFs") are on the rise. Some are the result of the disparity of performance between funds of the same retirement date from different fund families. Others are the result of plan fiduciaries utilizing a "high-cost share class when a lower-cost share class [was] available for the exact same investment."[7] Thus, it is not that fiduciaries have a duty to find and offer the cheapest fund, but must identify a lowest cost share class available to the plan. While this analysis applies to all mutual fund selections, plan fiduciaries should be aware that the different facets of TDFs (retirement date, glide path, fees, etc.) require a more complex review.

Service provider claims

Two other types of popular claims, one traditional and one on the rise, are recordkeeping fee claims and cyber security claims.

Recordkeeping fee claims

Fiduciaries must benchmark recordkeeping fees against similarly sized plans, plans with similar fees, and/or plans from the same recordkeeper. Those considerations are only part of the analysis because plans used for comparison must also be similar "relative to the services rendered."[8] In other words, if you benchmark your plan cost to a plan paying the same amount, but the benchmarked plan is receiving more services for the money, you could be found to be paying excessive fees.

Cyber security claims

Criminals are highly sophisticated at gaining access to plans and participants' personal information. The risk is high because breaching just one participant account could provide access to an entire plan.

Fiduciary litigation tends to focus on a plan's failure to prudently select and monitor a third-party service provider that allowed a breach.[9] Fiduciaries must ensure that providers such as recordkeepers "use reasonable security procedures and practices suitable or adequate to protect" participant information.[10] If a breach does occur, there should be procedures in place to notify participants, as timely notification can lower the risk of "identity theft and various other forms of personal, social, and financial harm."[11]

The DOL's employee benefit security administration provides guidance to assist plans and participants in being cyber compliant:

- Cybersecurity Program Best Practices
- Tips for Hiring a Service Provider with Strong Security Practices
- Online Security Tips

Takeaways

The 6th Circuit in *Forman v. TriHealth, Inc.* summed up the basic requirements of prudent plan management developed by SCOTUS and other courts:

- A sound and documented rationale for the selection of a fund or service provider
- Ongoing and documented monitoring of that fund or provider for soundness
- A complete understanding of all plan fees and expenses, including revenue sharing fees
- A determination that the fund and provider meet the stated goals of the plan[12]

One aspect of prudent plan management is a rigorous selection and monitoring process.[13] To be prudent, such a program should evaluate all funds and providers according to the same criteria, including proprietary funds and providers.[14] It should include criteria and a process for reviewing and/or removing funds that demonstrates a "consistent history of underperformance"[15] or service providers that are high priced or demonstrate lax oversight and policies. And remember, while it is acceptable to offer a mix of active and passive funds, do not offer high-priced retail classes if lower-priced institutional class shares of the same funds are available. Similarly, as reiterated in *Forman*, make sure that the prices paid to service providers are commensurate with the services being provided to the plan when compared to similarly situated plans.

One way to ensure the implementation of a prudent selection and monitoring program is the development of a solid investment policy statement ("IPS") and the consistent following of that IPS.[16] While "it is undisputed that an IPS is not required under ERISA,"[17] having one is generally considered good fiduciary practice, provided that it is well written and consistently followed.

The prospect of litigation can be daunting, but sound policies and procedures can put plans and fiduciaries in the best position to avoid or defend claims.

Fiduciary best practices checklist

- Maintain a prudent process to select and monitor investments and service providers.
- Analyze and monitor all funds and providers equally, including proprietary options.
- Document rationale for each choice.
- Maintain a diversified line-up of active and passive funds.
- Use lowest priced share class when possible and practical.
- Consider removing underperforming mutual funds, particularly if they also carry high fees.
- Understand the fees and the services received in return for fees paid.
- Understand how services compare to similarly situated plans.
- When selecting and monitoring service providers, review their cyber security protocols.
- Train participants on cyber security dos/don'ts to prevent data breaches.
- Review the EBSA's guidance on cyber best practices

THIS MATERIAL WAS PREPARED BY INTEGRATED RETIREMENT. INTEGRATED RETIREMENT IS SOLEY RESPONSIBLE FOR ACCURACY, CONTENT AND ANY VIEWS EXPRESSED HEREIN.

1. See, *Hughes v. Nw. Univ.,* 142 S. Ct. 737 (2022).
2. See, *Tibble v. Edison International,* 135 S. Ct. 1823 (2015).
3. *Hughes v. Nw. Univ.*
4. See, *Davis v. Salesforce.com, Inc.,* 9th Cir., No. 21-15867 (4/8/22).
5. *Yosaun Smith v. CommonSpirit Health,* et al., 6th Cir., No. 21-5964, 6th Cir. (2022).
6. See, *Goodman v. Columbus Reg'l Healthcare Sys., Inc.,* M.D. Ga., No. 4:21-cv-00015 (2/2/21).
7. See, *Morales v. Quest Diagnostics Inc.,* D.N.J., No. 2:23-cv-00118 (1/10/23).
8. See, *Yosaun; Singh et al. v. Deloitte LLP et al.,* S.D.N.Y., No. 1:21-cv-08458 (1/13/23).
9. See, *Bartnett v. Abbott Laboratories et al.,* N.D. IL, No. 1:20-cv-02127 (2/8/21).
10. See, *Greg Torrano v. Horizon Actuarial Services LLC,* N.D.GA, No. 1:22-mi-99999 (2022).
11. Id.
12. See, *Forman v. TriHealth, Inc.,* 6th Cir., No. 21-3977 (7/13/22).
13. See, *Mills v. Molina Healthcare, Inc.,* C.D. Cal., No. 2:22-cv-01813 (3/18/22); *Locascio v. Fluor Corp.,* N.D. Tex., No. 3:22-cv-00154 (1/24/22); Mattson v. Milliman, Inc., W.D. Wash., No. 2:22-cv-00037 (1/13/22).
14. See, *Reetz v. Lowe's Cos. Inc. et al.,* W.D. NC, No. 5:18-cv-00075 (10/12/21).
15. See, *Goodman v. Columbus.*
16. See, *Reetz v. Lowe's Cos. Inc. et al.,* W.D. NC, No. 5:18-cv-00075 (10/12/21).
17. See, *Falberg v. Goldman Sachs Grp.,* Inc., S.D.N.Y., No. 1:19-cv-09910 (9/14/22).

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