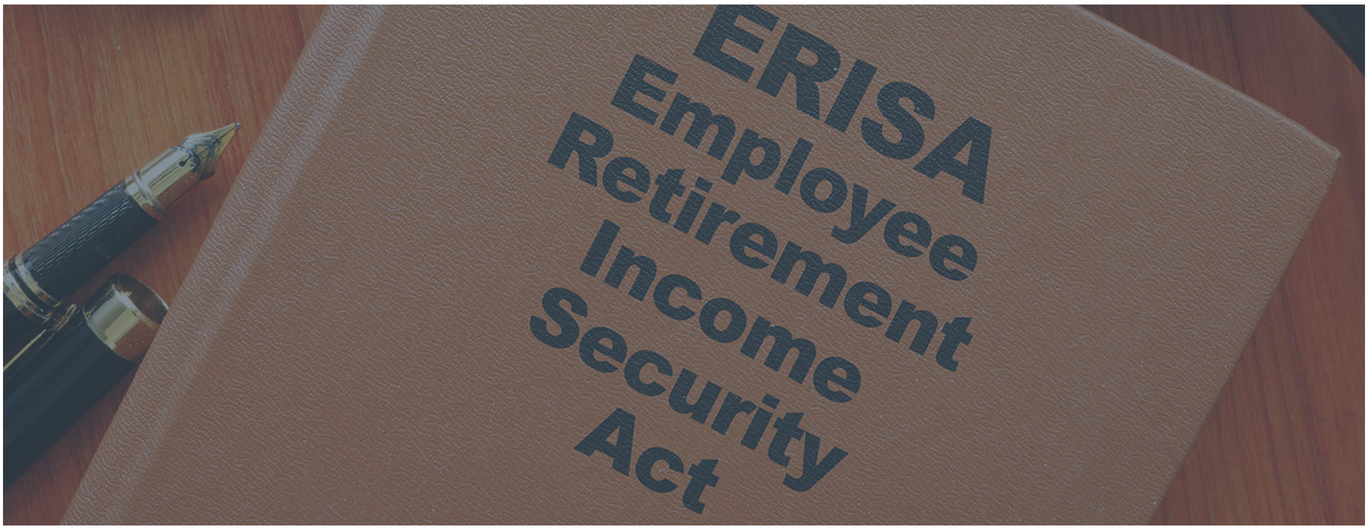

Tuesday, May 5, 2020

Fiduciary Update | May 2020

In this quarter's Fiduciary Update, CAPTRUST's Drew McCorkle provides perspective on monitoring appointed plan fiduciaries with an example of the diligent processes that saved one such fiduciary from liability. He also takes a look at the latest on cybersecurity allegations.

Supreme Court Defines Actual Knowledge

Siding with plan participants, the Supreme Court has held that ERISA's three-year statute of limitations does not begin to run until the participant-plaintiff has actual knowledge of the alleged breach. *Intel Corporation Investment Policy Committee v. Sulyma* (S. Ct. 2-26-2020).

Intel's 401(k) plan used custom-designed target date funds that included alternative investments (e.g., hedge funds, private equity, and commodities). Plan participants sued the plan fiduciaries for using too many alternative investments in the custom target date funds, which resulted in losses from higher fees and underperformance.

Plan participants have three years to bring a fiduciary breach lawsuit from the time that they have actual knowledge of the breach. Or, if they do not have actual knowledge, the suit must be brought within six years of the breach.

Intel provided the plan participant, Sulyma, with numerous communications, including all required disclosures and fund information, more than three years before the suit was filed. It was also established that during this time Sulyma repeatedly visited the plan website, which had information on plan investments, including disclosures indicating that alternative investments were used in the plan's custom target date funds.

The plan fiduciaries argued that the case should be dismissed because Sulyma had actual knowledge that alternative investments were being used in the custom target date funds more than three years before filing suit. Sulyma countered that although he received notices and information and visited the plan website, he was unaware that alternative investments were being used and did not remember reviewing the disclosures.

Supreme Court interpreted the actual knowledge requirement literally, concluding that if a person is not aware of a fact, no matter how close at hand that fact may be, the person does not have actual knowledge of it. Disclosures to participants alone will not begin the three-year statute of limitations. The plaintiff must in fact have been aware of the information. The case was permitted to proceed. After this decision, it will likely be much harder for plan fiduciaries to have cases dismissed based on the three-year statute of limitations.

Failure to Monitor Fiduciary Committee and Investments

Participants in Fidelity's own 401(k) plan sued the plan's fiduciaries for failing to monitor plan investments and not considering alternate investment vehicles such as separate accounts and collective trusts, among other claims. They also sued the plan sponsor for not properly monitoring the plan fiduciaries. The court concluded that:

- Plan fiduciaries breached their duty to monitor plan investments;
- Plan fiduciaries did not have a duty to consider alternate investment vehicles; and
- The plan sponsor breached its duty to monitor the plan fiduciaries.

Moitoso v. FMR LLC (D. Mass. 3-27-20)

Fidelity offered investments to plan participants through three avenues: (i) core Fidelity investments that were monitored by plan fiduciaries; (ii) hundreds of additional Fidelity investments that were not monitored by plan fiduciaries; and (iii) a brokerage window with a large number of non-Fidelity investments that was also not monitored by plan fiduciaries. It is generally believed that plan fiduciaries are not responsible for monitoring each investment offered in a brokerage window. Fidelity argued that the large group of non-monitored Fidelity investments should be treated as if they were provided through the brokerage window. This would relieve plan fiduciaries of the duty to monitor these investments. The court disagreed. It found that these additional Fidelity funds were not provided through a brokerage window, and the plan fiduciaries breached their duty to monitor these funds.

Plan participants also alleged that the plan fiduciaries breached their responsibility to investigate the use of collective trusts and separate accounts. Although the vast majority of 401(k) plans use mutual funds, collective trusts and separate accounts are sometimes used and can offer cost savings. These investments can be essentially the same underlying investment as mutual funds, but with different regulatory oversight resulting in the lower costs. Many recent plan fees cases have made this claim. The court rejected the plaintiff's claims, concluding that there is no inherent fiduciary duty to investigate alternatives to mutual funds. The judge observed that other courts have found it impossible to make an apples-to-oranges comparison of the two.

Those who appoint plan fiduciaries have a duty to monitor that the plan fiduciaries are carrying out their duties. Plaintiffs in this case sued FMR LLC (Fidelity) for not monitoring the plan fiduciaries, which would make FMR LLC also liable for the plan fiduciary's failure to monitor investments. The court observed that a fiduciary who violates the duty to monitor is responsible for any breaches on the part of the appointed fiduciaries. FMR LLC was found to be equally liable for the plan fiduciaries' breach in failing to monitor investments.

As the case proceeds, it will fall to the defendants, Fidelity and the plan fiduciaries, to prove that any losses sustained were not caused by the fiduciary breach. In other jurisdictions, the plan participants would be required to prove that the breach caused the loss.

Process Prevails in Underperforming Fund Claim

CenturyLink's 401(k) plan offered a single large-cap stock fund that was constructed by the plan fiduciaries using six underlying managers and mutual funds. This apparently took the place of the more common approach of offering separate large-cap growth and value funds as well as a Standard & Poor's 500 Index Fund. The objective was to have a more diversified offering than just utilizing single mutual funds and outperform the broad market index over full market cycles. Since inception—for approximately five years—the fund underperformed its benchmark by an average of 2.11 percent annually. Participants sued the plan fiduciaries for breaching their duties by retaining the underperforming fund.

The judge first noted that whether a fiduciary has satisfied its duty of prudence is an objective inquiry, and courts focus on the process rather than the outcome, and that the test of prudence is one of conduct and not a test of the result of the performance of the investment. She then evaluated the process and analytics used in the design of the fund as well as details of the process utilized to monitor the fund. She found that a thorough and diligent process had been followed in the establishment of the fund. With respect to monitoring, she observed that "to plausibly establish a claim for a breach of duty to monitor, a plaintiff must allege facts plausibly establishing that no reasonable fiduciary would have maintained the investment." In CenturyLink's situation, a diligent process for ongoing monitoring of the fund was in place and followed. The judge also noted that the fund had earned a return averaging more than 11 percent per year since inception. The plan fiduciaries' motion to dismiss was granted. *Birse v. CenturyLink, Inc.* (D. Colo. 3-5-20)

Pension Actuarial Equivalent Lawsuits Proceed

A number of lawsuits have been filed alleging that pension plans paid improperly low benefits to some pensioners and their survivors by using incorrect actuarial assumptions. Generally, these cases allege that outdated mortality assumptions or interest rates were used to calculate joint and survivor or early retirement benefits, resulting in understated benefits, violating ERISA's rules.

A new suit against United Parcel Service makes the same basic allegations. Recent motions to dismiss by Anheuser-Busch, Rockwell Automation, and Huntington Ingalls Industries have all been denied. In each of these cases, the judges found that plan participants had made sufficient allegations that the actuarial assumptions used to calculate benefits were unreasonable and did not meet ERISA's actuarial equivalence requirement. One similar case in this area that was settled, but these cases, along with others, will proceed.

New Cyberloss Case Filed

A participant in the Abbott Laboratories Stock Retirement Plan lost $245,000, apparently through cyberfraud. The cyberthief tried to access the participant's account using her date of birth and last four digits of her Social Security number. When that was rejected, the cyberthief elected to receive a one-time email code rather than answer online security questions. The participant did not receive the one-time security code, but the cyberthief did. With access to the account, the cyberthief added a new SunTrust bank account to receive distributions. Confirmation of the new bank account was sent by "snail mail" to the participant—even though she had previously indicated a preference for email.

The cyberthief then contacted the plan recordkeeper, Alight, by phone to request transfer of $245,000. Again, to verify security, a one-time code was emailed, which the cyberthief apparently intercepted and the participant did not receive. A letter was mailed to the participant confirming the fund transfer. However, the fund transfer was not completed until four days after the call. The day after the transfer, the participant realized a withdrawal had been made from her account. If the participant had instead received an email, the transaction could perhaps have been interrupted. Law enforcement was alerted, and an investigation conducted. The cyberthief was linked to a computer located in India, and only a portion of the distribution was recovered. Approximately $59,000 was recovered from SunTrust and income tax of approximately $49,000 was also restored to the participant's account—leaving $137,000 missing. Discussions with the plan sponsor resulted in an offer to restore only a small percentage of the amount stolen. The claims above followed. *Bartnett v. Abbott Laboratories* (E.D. Ill. filed 4-3-20) The defense may offer a different perspective.

As cybersecurity continues to be a hot topic within the retirement industry, it will be interesting to learn how the case plays out.

General Release Extends to ERISA Fiduciary Breach Claims

An employee of George Washington University, Melissa Stanley, participated in the university's retirement plans. In 2016, for reasons unrelated to the retirement plans, she entered into a settlement agreement with GWU that included a general release of future claims against GWU. Two years later, she filed a lawsuit alleging that fiduciaries of GWU's retirement plans breached their fiduciary responsibilities by overpaying for plan recordkeeping services and investments and improperly retaining multiple recordkeepers. GWU sought to have the claim dismissed based on Stanley's earlier release. The release included an exception permitting Stanley to pursue any claims she might have for vested benefits under employee benefit plans. Stanley argued that the exception should permit her to bring the broad fiduciary duty claims in this case. The district court disagreed, concluding that Stanley could sue only for benefits due under GWU's employee benefit plans. The broader fiduciary breach claims were barred. That decision was upheld on appeal. *Stanley v. George Washington University* (D. D.C. 2019; 1st Cir. 3-24-2020)

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