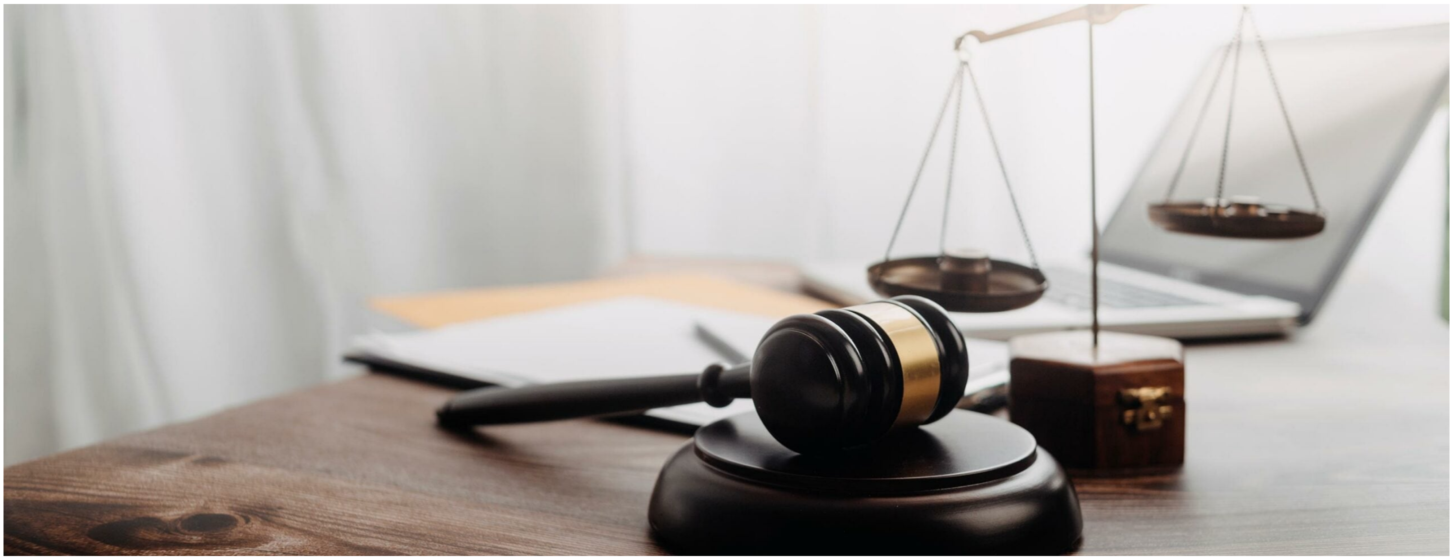

Fiduciary Update | August 2022

Thoughtful Dismissal of Fees Case by U.S. Court of Appeals: Process Prevails

In a thoughtful and thorough decision, the U.S. Court of Appeals for the Sixth Circuit has affirmed dismissal of a suit alleging overpayment of fees and improper use of actively managed funds. *Smith v. CommonSpirit Health* (6th Cir. 2022). CommonSpirit was sued alleging that:

- actively managed mutual funds should have been replaced with less expensive, better-performing, passively managed mutual funds,
- underperforming investments were imprudently retained,
- plan recordkeeping fees were too high, and
- investment expenses were too high.

We recently reported on *Hughes v. Northwestern University*, the Supreme Court decision that seemed to make it more difficult for plan fiduciaries to have fees cases dismissed. *CommonSpirit* is the first circuit court of appeals decision to analyze these issues since the *Hughes* decision was handed down.

The court in *CommonSpirit* grounded its decision in investment basics, noting the relatively recent advent of index funds, the range of investment options available, and the variety of investors who may prefer distinctly different types of investments. The judge provided a thorough review of bedrock principles that apply to plan fiduciaries as they carry out their duties and how their actions will be evaluated if called into question. He initially noted the context in which fiduciaries' decisions are made, saying:

[W]hether the [fiduciary] is prudent in the doing of an act depends upon the circumstances as they reasonably appear to him at the time when he does the act and not at some subsequent time when his conduct is called in question.

In the last analysis, the circumstances facing an ERISA fiduciary will implicate difficult tradeoffs, and courts must give due regard to the range of reasonable judgments a fiduciary may make based on her experience and expertise.

In response to the argument that investors should be skeptical of an actively managed fund's ability to outperform its index benchmark, the court noted that:

[Actively managed funds are] a common fixture of retirement plans, and there is nothing wrong with permitting employees to choose them in hopes of realizing above-average returns over the long life span of a retirement account…. It is possible indeed that denying employees the option of actively managed funds, especially for those eager to undertake more or less risk, would itself be imprudent.

The judge noted that, for a claim to survive a motion to dismiss, the allegations in the complaint must show that it is *plausible* that a breach occurred, not that it was merely *possible* or *conceivable,* saying:

[A] showing of imprudence [does not] come down to simply pointing to a fund with better performance…. In addition, these claims require evidence that an investment was imprudent from the moment the administrator selected it, that the investment became imprudent over time, or that the investment was otherwise clearly unsuitable for the goals of the fund based on ongoing performance…. [It is] largely a process-based inquiry.

This reinforces the importance of ongoing monitoring of investments and taking appropriate action. The plaintiffs alleged that comparative underperformance of 0.63 percent demonstrated imprudent retention of a fund. The judge challenged the plaintiffs' use of five-year results as a primary basis for replacing a fund, saying:

Precipitously selling a well-constructed portfolio in response to disappointing short-term losses, as it happens, is one of the surest ways to frustrate the long-term growth of a retirement plan. Any other rule would mean that every actively managed fund with below-average results over the most recent five-year period would create a plausible ERISA violation.

Sustaining dismissal of the recordkeeping fees claim, the judge noted that the plaintiff failed to provide sufficient facts that could move the allegation from possibility to plausibility. There were no allegations that the fees paid were excessive relative to the services received.

The investment management fee was also dismissed because sufficient facts were not alleged. The judge observed that the plan offered investments with fees ranging from 0.02 percent to 0.82 percent, with an average fee of 0.55 percent. This range and the average were evidence that the plan included a variety of actively and passively managed funds. He concluded with the familiar statement 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)."

This case is good news for plan fiduciaries. It is sure to be relied on as they defend the numerous suits filed in this area.

Have a Thoughtful Reason for Not Using the Least Expensive Share Class

About a month after its decision in *CommonSpirit*, the Sixth Circuit Court of Appeals addressed a claim not made in *CommonSpirit* and partially reinstated a fees case that had been dismissed by the district court. One allegation in the newer case was that the plan's fiduciaries imprudently offered more expensive share classes when less expensive share classes of the same investment were available. The judge noted that different investments of the same strategy or type that are more or less expensive or perform better or worse are not reasonable comparators that allow a court to conclude that a claim is plausible. However, when the funds being compared are different share classes of the same fund, there is a fair comparison that can support a plausible claim.

The court was quick to point out that a variety of not-yet-known factors could "exonerate" the plan fiduciaries. This could include such things as revenue sharing that benefits the plan or limited eligibility for the less expensive share class. The case was sent back to the district court for further proceedings. *Forman v. TriHealth, Inc.* (6th Cir. 2022).

New Cybertheft Lawsuit Filed: $750,000 Missing … and Not Restored

Through a series of well-orchestrated steps, cyberthieves managed another theft of plan assets from a plan administered by Alight. A participant's entire account balance of $751,431 was stolen, and Alight has not restored her account.

Paula Disberry worked as an executive for Colgate-Palmolive from 1993 to 2004 at various locations around the world and participated in Colgate-Palmolive's 401(k) plan. From time to time she checked her account online and intended to leave it in place until she reached age 65. When she tried to check her account online in August 2020, she was unable to access her account because she had the incorrect username and password. She contacted the Colgate-Palmolive benefits department. In September 2020, when she was 52, she was informed that her entire account balance had been distributed to an individual with an address and bank account in Las Vegas, Nevada. Investigation of the theft revealed that:

- The thieves first contacted Alight by phone in late January 2020, posing as Ms. Disberry and asking to update login information. In response Alight sent a temporary PIN by mail to her address in South Africa. The PIN was intercepted by the thieves. Ms. Disberry was not sent an email or contacted by telephone to let her know the PIN was being sent.
- In February, the thieves used the temporary PIN to set a permanent one, accessed the account, and changed the email and phone number on the account. They also changed the user ID and password on the account. Again, the plan participant was not alerted that these

changes were being made.
- In early March, the thieves went online and added direct deposit information for a bank branch in Las Vegas.
- In mid-March, the thieves went online and requested a distribution of the entire account by direct deposit to the bank account added the prior week. They also changed the mailing address from the South Africa address to a Las Vegas address.
- Three days later, the thieves called Alight indicating that a complete distribution had been requested online by direct deposit and were told that distributions were required to be made by check. The payment was processed on March 20.
- After Ms. Disberry submitted a claim for benefits, the plan administrator denied her claim saying that it had reasonable procedures in place for plan distribution, which had been followed and the plan distribution was made "in accordance with all Plan terms and requirements."

A lawsuit seeking recovery of the stolen funds followed. *Disberry v. Employee Relations Committee of the Colgate-Palmolive Company* (SD New York filed 7-7-22). The above is drawn from the complaint that initiated the case.

This case is a good reminder to plan fiduciaries to have qualified personnel review the Department of Labor's cybersecurity best practices and their recordkeeper's cybersecurity program to be sure the recordkeeper's program at least meets the DOL's recommendations. Not conducting that review could subject plan fiduciaries to allegations that they have not prudently evaluated their recordkeeper.

Poor Supplemental Life Insurance Administration: Employer May Have to Pay

Two recent appeals court decisions address situations in which supplemental life insurance was enrolled in and premiums were paid; however, required evidence of insurability was not submitted.

In *Skelton v. Radisson Hotel Bloomington* (8th Cir. 2022), an employee was automatically enrolled in $100,000 of life insurance. A few months later, her husband regained custody of his son, the employee's stepson. The insurance program included a provision that coverages could be changed without evidence of insurability if the employee experienced a life event change. The employee called the benefits department and was told that regaining custody of a child was a life event. She applied for the maximum supplemental life insurance coverage available—$238,000—and began paying for that coverage through payroll deductions.

The insurance company sent her a notice on letterhead with both the insurance company's and the employer's logos that proof of insurability was required. It said the evidence of insurability should be returned to the insurance company. There is a dispute whether evidence of insurability was received, but the employee did not receive notification that the form had or had not been submitted. Upon the employee's death, the insurance company paid $100,000 in life insurance benefits to the surviving husband and refused to pay the supplemental life insurance benefit.

A suit was filed against both the employer and the insurance company. The employer settled for $175,000, and the district court found the insurance company liable for the balance of $63,000. The insurance company appealed, alleging that it was not a fiduciary. The court of appeals disagreed, finding that the insurance company had sufficient involvement in the plan to be a fiduciary. The insurer breached its duties of both prudence and loyalty by failing to maintain an effective enrollment system.

In *Gimeno v. NCHMD, Inc*. (8^{th} Cir. 2022), an employee elected supplemental life insurance coverage of $350,000 in addition to $150,000 in employer-paid coverage. To receive the supplemental coverage, the employee was required to submit evidence of insurability. However, he was not provided the form, and human resources staff at the employer did not follow up with him, so it was not submitted. Even so, premiums were collected for the supplemental coverage for three years until the employee's death.

The insurance company refused to pay the supplemental insurance amount because it had not received evidence of insurability. A lawsuit was then filed against the employer for the $350,000 the designated beneficiary would have received if the supplemental insurance program had been properly administered. The district court denied the claim, believing that ERISA would not permit the employee to recover this amount from the employer.

The court of appeals disagreed, noting that the Supreme Court decision in *CIGNA Corp. v. Amra* (2011) expanded the relief that courts can award. In this situation the relief would be to assess an equitable surcharge against the employer to provide the benefit that would have been awarded if the employer had not breached its fiduciary responsibilities. The case was sent back to the district court for further proceedings.

These cases are a good reminder to employers (and insurers) to monitor the administration of supplemental life insurance programs.
