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Fiduciary Update | February 2022

Supreme Court Sides with Plan Participants in Plan Fees Case

The U.S. Supreme Court decided in favor of plan participants in *Hughes v. Northwestern University* (S. Ct. 2021). This much anticipated decision had the potential to curtail the increasing volume of excessive fee cases by changing what must be included in a complaint (the initial filings in a lawsuit) to survive a motion to dismiss. Rather, it left longstanding rules in this area unchanged. The allegations in a complaint cannot be conclusory; they must include facts that plausibly suggest an entitlement to relief.

A few years ago, several separate cases were filed against major colleges and universities, making the now familiar claims that they had overpaid for recordkeeping services and investments and improperly managed their plans. Three of these cases were brought in different federal judicial circuits, and each complaint made essentially the same claims.

As is often the case, motions to dismiss were filed in these cases. A motion to dismiss contends—without delving further into the facts—that the complaint does not include sufficient allegations for the case to proceed. In two of these cases, the motions to dismiss were denied andthe cases proceeded to litigation. In the third, against Northwestern University, the motion to dismisswas granted, and dismissal was upheld by the U.S. Circuit Court of Appeals for the Seventh Circuit. Akey factor relied on by the Seventh Circuit was that, in addition to "expensive" funds, the plan alsooffered lower-cost index funds. The court reasoned that because lower-cost funds were available toplan participants, it did not matter that other funds may have been too expensive. Also, because recordkeeping fees were paid from revenue sharing, participants could select the less expensive index funds to manage the recordkeeping fees they paid.

With the federal judicial circuits split on what must be included in a complaint to survive a motion to dismiss, the Supreme Court accepted the case. In a unanimous decision, the Court reversed the Seventh Circuit's decision, rejecting its reliance on the availability of a diverse menu of investments—including less expensive index funds—as basis for dismissing claims that the plan fiduciaries overpaid for investments and recordkeeping. The Supreme Court also noted that its guidance in *Tibble v. Edison Int'l*, (S. Ct. 2015) was not applied by the lower courts in this case. The *Hughes* decision will make it easier for plan participants to pursue excessive fee claims in jurisdictions that followed the Seventh Circuit's overruled approach.

The Supreme Court reiterated key points in *Tibble v. Edison Int'l* that "a fiduciary normally has a continuing duty of some kind to monitor investments and remove imprudent ones." "Plan fiduciaries are required to conduct their own independent evaluation to determine which investments may be prudently included in the plan's menu of options. If fiduciaries fail to remove an imprudent investment from the plan within a reasonable time, they breach their duty." The case was sent back for the lower court to evaluate the sufficiency of the complaint based on *Tibble's* guidance.

Perhaps in a nod to the challenges plan fiduciaries face, the Court acknowledged that the appropriate fiduciary inquiry will be context specific, and went on to say, "At times, the circumstances facing an ERISA [Employee Retirement Income Security Act] 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."

Cybersecurity: DOL Enforces Subpoena Against Provider

We have previously reported on cybertheft lawsuits filed by participants in two plans administered by Alight Solutions. In one case a participant in the Estee Lauder 401(k) plan lost more than $90,000, and in the other case, a participant in the Abbott Laboratories 401(k) plan lost $137,000. The Department of Labor (DOL) began investigating Alight in 2019 because it had received information that:

- Alight made unauthorized distributions as a result of cybersecurity breaches;
- Alight failed to immediately report the cybersecurity breaches to ERISA plan clients after they

were discovered; and
- Alight repeatedly failed to restore the unauthorized distributions to participants' accounts

As part of its investigation, the DOL issued an administrative subpoena to get records from Alight. Alight refused to provide all requested information, and the DOL filed suit so a court could enforce the subpoena. An enforcement order was issued during the fourth quarter of 2021. *Walsh v. Alight Solutions, LLC* (N.D. IL 2021)

This situation illustrates the attention cybersecurity is receiving at the DOL. It is also reported that the DOL has begun plan audits focusing on cybersecurity practices.

Fee Litigation Continues and Is Impacting the Fiduciary Insurance Market

The flow continues of new cases, decisions, and settlements alleging fiduciary breaches through the overpayment of fees and the retention of underperforming investments in 401(k) and 403(b) plans. These cases are also impacting the fiduciary insurance market. Following is a sampling of this quarter's developments, including a new challenge to the share classes of investments used.

Share Class Challenge—Juniper Networks, Inc., a high tech firm, has been sued in connection with its 401(k) plan. The case includes the now familiar allegations of overpayment for recordkeeping fees and managed account services. However, it also challenges the plan fiduciaries for not using the net least expensive share classes of the mutual funds in the plan, net of revenue sharing.

In the Juniper Networks case, the plaintiffs are alleging that plan fiduciaries failed to use the net cheapest share classes. That is, there were share classes available that would be less expensive after offsetting revenue sharing, which could be allocated to plan participants or used to pay plan expenses. *Reichert v. Juniper Networks, Inc.* (N.D. CA 2021)

Other Cases:

- BlackRock Institutional Trust Company—Settlement—Familiar allegations against financial products providers, alleging the use of the firm's own investments in the plan and payment of excessive fees. Settled for $9.65 million, of which $2.8 million will be paid to plaintiff's counsel. BlackRock denies any liability. *Baird v. BlackRock Institutional Trust Company, N.A.* (N.D. CA 2021)
- T. Rowe Price Group—Settlement—Familiar allegations against financial products providers, alleging the use of the firm's own investments in the plan and payment of excessive fees. In the settlement, T. Rowe Price agreed to offer a self-directed brokerage window and pay a total amount of $13.6 million, $6.6 million of which was paid as a partial settlement in 2019. Up to $3.5 million may be paid to plaintiff's counsel. T. Rowe Price denies any liability. As of December 31, 2020, the T. Rowe Price plan has assets of $3.9 billion. *Feinberg v. T. Rowe Price Group, Inc.* (D. MD 2022)
- University of Pennsylvania—Settlement—Familiar allegations against 403(b) plans, alleging the payment of excessive fees and multiple providers, among other things. Settled for $13 million,

of which $4.3 million will be paid in attorney's fees. The University of Pennsylvania denies any liability. On average, 2,097 participants will receive $375 each. Approximately 2,000 participants will receive more than $1,000. *Sweda v. The University of Pennsylvania* (E.D. PA 2021)

Fiduciary Insurance Impacts—The high volume of fee cases, many of which have been settled, has reportedly resulted in increased premiums for fiduciary coverage, and that coverage is now frequently coming with higher retentions (deductibles), in the millions of dollars. It is increasingly common for the renewal and underwriting of this coverage to include a questionnaire asking about a plan's inclusion of indexed funds and efforts to control costs.

Intel Wins Target Date Fund Case on Motion to Dismiss

As previously reported, Intel's 401(k) plan used a custom target date fund solution that included a significant amount of hedge fund investments. Plan fiduciaries were challenged for using hedge funds because their performance and high fees were a significant drag on performance as compared to the performance of target date funds that did not use hedge funds. The district court had previously dismissed the claim because the complaint did not include enough detailed factual support. The plaintiffs were allowed to file an amended complaint, but it also fell short. Finally dismissing the case, the judge pointed out:

- A complaint cannot simply make a bare allegation that costs are too high or returns are too low;
- An allegation that a fund is mismanaged must be fact-specific because there is no one-size-fits-all approach to investing;
- Without presenting a meaningful benchmark, the court cannot evaluate if an alleged violation of the duty of prudence is plausible; and
- ERISA fiduciaries are not required to adopt a riskier strategy simply because that strategy may increase returns. (In this case, the challenged hedge funds dampened risks and returns.)

The judge had previously noted the following:

- The ERISA prudence standard focuses on a fiduciary's conduct in arriving at an investment decision, not on its results, and asks if a fiduciary employed the appropriate methods to investigate and determine the merits of a particular investment.
- On its own, the failure to select the investment with the lowest fees is not sufficient to plausibly state a claim for breach of the duty of prudence.

Anderson v. Intel Corporation Investment Policy Committee (N.D. CA 2021, 2022).

Annual Plan Financial Statement Audit Changes

Changes are coming to the annual plan financial statement audit that is required for all plans with more than 100 participants. This is the audit performed by a qualified accountant and filed with the plan's annual Form 5500. The American Institute of Certified Public Accountants (AICPA) adopted a

new auditing standard for retirement and other employee benefit plans known as SAS No. 136. It applies to plan years ending after December 15, 2021.

- The limited-scope audit, which is utilized by many retirement plans, is being replaced by ERISA 103(a)(3)(c). The basic idea of a limited-scope audit that relies on data from a “qualified institution” is still available. However, the plan sponsor will be required to certify that the trustee or custodian is a qualified institution. It is anticipated that plan recordkeepers will provide support for this certification.
- The roles and responsibilities of each party (e.g., plan sponsor, auditor) will be clarified and documented as part of the audit process.
- Auditors may be more likely to find and disclose errors and other reportable findings.

Plan sponsors should expect the retirement plan audit processes to be different, with additional data and representations required by plan auditors and more detailed reporting back from auditors.

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