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Fiduciary Update | February 2024

Guaranteed Investment Contract Investors Sue for Losses

Former employees of Bed Bath & Beyond (BB&B) lost approximately 10 percent of their guaranteed investment contract (GIC) investments when their 401(k) plan liquidated after the company's bankruptcy. 401(k) plans typically offer at least one capital preservation option in their investment lineups—a GIC, a stable value fund, or a money market option.

BB&B's plan offered participants a GIC that invested in intermediate- to long-term bonds. As interest rates rose in 2022 and 2023, the market value of the underlying bonds in the BB&B GIC fell below the book value. Usually, participants' GIC accounts do not reflect market losses or gains and participants transact at book value (principal plus accrued interest). When there are market losses, the GIC's guaranteed rate of return is adjusted downward over time to make up for the losses.

However, when BB&B declared bankruptcy, the GIC contract automatically terminated, so the investment was liquidated and paid to plan participants at the current market value. Because of the market decline, GIC investors were paid only about 90 percent of their accounts' book value as reported before the plan termination.

Disappointed plan participants sued the plan's fiduciaries and BB&B's Chief Financial Officer. The GIC contract terms around plan termination are common and are not challenged in the lawsuit. What is challenged is the plan fiduciaries' failure to take reasonable steps to mitigate potential GIC losses as BB&B's fortunes dimmed.

According to the complaint, although the bankruptcy filing was made in April 2023, the company's business struggles were publicly apparent as early as 2018 and 2019 when BB&B attempted a turnaround from declining performance. Had the plan fiduciaries been monitoring the potential investment impacts of a bankruptcy, they could have moved out of the GIC and into an investment that would not have been subject to such losses. It is not clear whether the plan fiduciaries would have made such a change. Until 2022, interest rates had been at historic lows for an extended period. If BB&B’s bankruptcy had not coincided with a rapid rise in interest rates, this would not have been such an issue.

This case is a good reminder that the *guarantee* in GICs, which are also sometimes referred to as guaranteed interest agreements or just guaranteed funds, applies only to the interest rate to be credited, not to the principal. It is also a reminder for plan fiduciaries to be aware of the potential consequences of broader corporate events on retirement plan investments. *Harvey v. Bed Bath & Beyond 401(k) Savings Plan Committee* (D. N.J. filed 9-14-23).

Fiduciary Potpourri

The following are real-life illustrations of ERISA’s fiduciary rules.

Not Following a Fiduciary’s Directions Is an Exercise of Discretion, Making the Directed Person a Fiduciary: A plan recordkeeper failed to follow directions in a timely manner to move investments in a 401(k) plan. The plan fiduciaries sued, alleging that the recordkeeper had breached its fiduciary duty to the plan. The recordkeeper denied liability, claiming that it exercised no discretion over plan assets and had no fiduciary liability. The recordkeeper asked for the case to be dismissed, but the judge refused. The judge observed that failing to follow directions of the plan fiduciaries was itself an exercise of discretion over plan assets, which resulted in the recordkeeper being a fiduciary to the plan. The case will move forward. *Martone Construction Management, Inc. v. Thomas A. Barrett, Inc.* (D. Md. 2023).

Retirement Plan’s Terms Cannot Circumvent ERISA’s Fiduciary Requirements: Janus Henderson, the investment firm, sponsors a 401(k) plan for its employees. The plan documents include a requirement that all proprietary Janus Henderson funds be offered for participants to invest their plan accounts. Non-Janus-Henderson funds could also be offered. The plan documents also provide that the plan fiduciary committee has no discretionary authority over the Janus Henderson funds. Rather, they could be removed only through a plan amendment by the plan sponsor.

Fiduciaries of the plan were sued for breaching their duties under ERISA by offering and not monitoring the Janus Henderson funds. Janus Henderson sought to have the case dismissed because they had followed the plan document in offering and not monitoring the Janus Henderson funds. The court refused to dismiss the case, noting that ERISA’s statutory duties to monitor plan investments override the plan document’s mandate to offer—and continue offering—all Janus Henderson funds. *Schissler v. Janus Henderson U.S. (Holdings) Inc.* (D. Co. 2024).

Duty to Monitor Investments in Limited Window of 300+ Funds: Until 2020, the Shell Oil Company 401(k) plan, with more than $10 billion in assets, offered a fund window with more than 300 actively managed mutual funds, in addition to target-date funds, indexed funds, and a separate self-directed brokerage account option. According to the complaint, the fund window included all actively managed funds offered by Fidelity, plus some other individually selected funds. Fidelity was permitted to add any new funds it released without any screening by the plan fiduciaries. The plan fiduciaries kept the investments in the fund window in place without any ongoing monitoring.

The plan's fiduciaries were sued for failing to monitor the more than 300 actively managed funds in the fund window and failing to eliminate any that were not prudent. Seeking an early judgment, the plan fiduciaries argued that they met ERISA's prudence requirements by coming to a reasoned decision that they were not required to monitor each of the funds. This decision was supported by advice from both internal and external counsel. The magistrate judge was unpersuaded, and the case will likely proceed. *Harmon v. Shell Oil Company* (S.D. Tx. 2023).

It is generally agreed that fiduciaries are not obligated to review the investments in a self-directed brokerage account option, or similar plan arrangement like a fund window, but only if the available investments are not too limited. For instance, is it not uncommon for a self-directed brokerage window to permit investment in all mutual funds, all mutual funds and exchange-traded funds, or all investments available through the self-directed brokerage provider.

In 2022, there were approximately 6,650 actively managed mutual funds in the U.S. Fiduciaries are not required to monitor more than 6,000 mutual funds if their self-directed brokerage account option includes all mutual funds. However, an issue arises when the available investments in the window are significantly limited. In that situation, plan fiduciaries may be responsible for ongoing monitoring of the investments—the core issue of this case involving 300+ investments.

Long-Term Incentive Plan Not Covered by ERISA—Usually: An employee was fired before she could accrue enough service to receive the maximum benefit under her employer's long-term incentive program (LTIP). She sued, alleging a violation of the ERISA prohibition of plan sponsors from taking action to prevent plan participants from receiving benefits. The judge concluded that the LTIP was not covered by ERISA, so the case was dismissed. However, he observed that a bonus-type program, like the LTIP, would be covered by ERISA if payments under the program are systematically delayed to the termination of covered employment or beyond, or if payments are designed to provide retirement income. *Faris v. Southern Ute Indian Tribe* (D. Co. 2023).

Fiduciary Duty to Pay Only Reasonable Fees Includes Recordkeeper's Indirect Fees from Managed Account Providers: In a groundbreaking decision, a Federal Court of Appeals has held that plan fiduciaries must evaluate the reasonableness of all fees received by their plan recordkeepers in connection with services to a plan, not just the fees paid directly to the recordkeeper. AT&T amended its 401(k) plan service agreement with Fidelity to add managed account services, which resulted in Fidelity receiving indirect compensation from the managed account provider, Financial Engines.

Under ERISA, it is a prohibited transaction to use plan assets to pay more than reasonable fees for services. Plan participants sued AT&T, alleging that the plan's fiduciaries did not evaluate the reasonableness of the fees received by Fidelity after adding the managed account service. The district court sided with the plan fiduciaries.

However, the 9th Circuit Court of Appeals reversed this decision, holding that all compensation received by the plan recordkeeper must be evaluated by plan fiduciaries. *Bugielski v. AT&T Services, Inc.* (9th Cir. 2023). This decision is at odds with decisions from the 3rd and 7th Circuit Courts of Appeals, setting up a likely appearance of the issue before the U.S. Supreme Court.

Flow of 401(k) and 403(b) Fee Cases Continues

The flow of cases alleging fiduciary breaches through the overpayment of fees and the retention of underperforming investments in 401(k) and 403(b) plans continues. Here are a few updates from the last quarter:

- Several cases were dismissed because they did not include sufficient allegations of fiduciary breaches. Others survived motions to dismiss and will proceed.
- One case involving a $1 billion plan was settled for $1.45 million. After attorney’s fees, the average participant will receive approximately $100.
- Another case involving a plan with approximately $1.3 billion in assets was settled for $6.75 million. After attorney’s fees, the average participant will receive approximately $265.

The low amounts awarded to plan participants in these settlements are the norm for litigation of this type. In contrast, the plaintiffs’ lawyers usually receive roughly one-third of the settlement amount.

DOL Focusing on Cybersecurity in Plan Audits

Recent plan audits by the U.S. Department of Labor (DOL) include several information requests focused on cybersecurity. One recent request includes the following among a long list of additional items:

- Third-party audits of information technology systems, such as SOC 1 or SOC 2 reports
- The plan’s cybersecurity program, policy statements, and procedures
- Efforts to consider, address, develop, implement, or negotiate cybersecurity problems, procedures, or protections
- The plan’s cybersecurity breach response plan
- Cybersecurity awareness training
- Cybersecurity events, cybersecurity breaches, unauthorized access, or suspicious activity, and potential losses of plan assets because of these cybersecurity events

The above request may be part of an audit project to assess the current state of affairs in this area among plan sponsors. Regardless, plan fiduciaries should take reasonable steps to assess their vendors’ cybersecurity programs and document their assessments. The DOL’s “Cybersecurity Program Best Practices” document is a good starting point.

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